



<b>To:</b>	<b>AASB members</b>	<b>Date:</b>	28 June 2011
<b>From:</b>	<b>Natalie Batsakis</b>	<b>Agenda Item:</b>	16.3
<b>Subject:</b>	<b>Update on Hedge Accounting</b>	<b>File:</b>	

### Action

1. To provide AASB members with an update of the IASB's tentative decisions resulting from redeliberations of some of the proposals in ED/2010/13 *Hedge Accounting*.

### Background

2. The IASB issued Exposure Draft ED/2010/13 *Hedge Accounting* requesting feedback by 9 March 2011. IASB staff have been providing IASB members with agenda papers covering various issues since the IASB's April 2011 meeting. AASB staff are keeping a running catalogue of tentative decisions (provided in the Appendix to this Memorandum), and therefore issues that have been verbally summarised at past meetings are consolidated in this update.
3. In summarising each of the issues discussed by the IASB, staff have provided a summary of constituent feedback received by the IASB, IASB staff recommendations (from IASB Staff agenda papers), a summary of comments made by the AASB in its submission to ED/2010/13 and points made by IASB members during the meeting.
4. The intention of the IASB remains to issue finalised requirements for hedge accounting (excluding macro hedging) in Q3 of 2011.
5. As with previous meetings, AASB staff will provide an update on the outcomes of any further IASB deliberations held subsequent to Board paper mail-out, but prior to the AASB July 2011 meeting.



**April IASB meeting – 13-16 April 2011**

1	Designation of equity investments at fair value through other comprehensive income (FVTOCI) as hedged items (IASB Agenda Item 8)
ED Proposals	Constituent feedback and IASB staff recommendations
<p>Hedge accounting shall not be applied to investments in equity instruments at FVTOCI.</p>	<p>Constituents raised concerns that limiting the eligibility of hedged risks to those only affecting profit or loss is inconsistent with the objective to align hedge accounting with risk management activities. Many noted price risk and foreign currency risk on equity investments at FVTOCI are managed in the same way as risks on instruments measured at FVTPL.</p> <p>Additionally, some constituents suggested that, for equity investments at FVTOCI, hedge ineffectiveness could be presented in OCI – since both profit or loss and OCI are elements of one overall performance statement.</p> <p>Based on feedback, IASB staff recommended allowing equity investments at FVTOCI to be designated as eligible hedged items, with all ineffectiveness being presented in OCI, and noted the following:</p> <p><i>Advantages</i></p> <ul style="list-style-type: none"> <li>• Allows entities to better reflect their risk management activities hence is more consistent with the overall objective of hedge accounting;</li> <li>• Allows entities to better reflect the nature of the equity investment that is in line with their business model (when not hedging the entire holding period).</li> <li>• Presenting ineffectiveness in OCI is consistent with the IASB’s move towards one single performance statement</li> </ul> <p><i>Disadvantages</i></p> <ul style="list-style-type: none"> <li>• Makes the option to classify equity investments at FVTOCI more attractive (and hence increases its use);</li> <li>• Changes the current hedge accounting principle that hedge ineffectiveness should be presented in profit or loss.</li> </ul>
	<p><b>AASB feedback</b></p> <p>The AASB expressed concern that disallowing equity investments at FVTOCI as eligible hedged items was inconsistent with the proposed objective to align hedge accounting with an entity’s risk management objective. Additionally, it felt that the IASB is taking a view on the nature of items presented in profit or loss, rather than in OCI, without identifying an underlying principle/rationale. If the IASB were to develop a clear basis for presenting items in equity versus OCI versus profit or loss, fair value hedging could be markedly simplified by presenting ineffectiveness in OCI without recycling.</p>

	Voting	
	For	Against
<b>IASB redeliberation and tentative decisions</b>		
<p>Initially some members noted that if users were being true to the intended use of the FVTOCI classification (investments held for strategic purposes as outlined in paragraph BC5.25(c) of IFRS 9 Financial Instruments), there should not be a need to hedge those types of equity investments. If the staff recommendation were to go ahead, those members wanted to redeliberate the definition of non-trading equity investments and the types of investments that are able to be measured at FVTOCI at a future meeting to try to narrow the classification scope exception.</p> <p>Another significant concern was expressed with the recommendation to recognise ineffectiveness in OCI because it would hide a legitimate failing where users of the financial statements would not see it. Therefore, even though recognising ineffectiveness for equity investments at FVTOCI in profit or loss would undo the “recycling” requirement in IFRS 9, it would be clearer for users. Additionally, some members felt the recognition of dividends in profit or loss and ineffectiveness in OCI to be an inconsistent outcome.</p> <p>Those IASB members that supported the staff recommendation gave the following reasons:</p> <ul style="list-style-type: none"> <li>- Focussing on profit or loss is out-dated – should be looking at the one overall performance statement (profit or loss or OCI)</li> <li>- The IASB should be neutral and true to the principles it created – aligning accounting with risk management activities;</li> <li>- They did not consider the disadvantage that it ‘makes the option to classify at FVTOCI more attractive’ to be legitimate.</li> </ul> <p>The IASB tentatively decided to allow equity instruments at FVTOCI to be designated as eligible hedged items, with any ineffectiveness presented in OCI. This would not be extended to other items measured through OCI.</p>	8	7

2 Hedging risk components in sub-LIBOR instruments (IASB Agenda Item 9)			
ED Proposals	Constituent feedback and IASB staff recommendations		
Does not allow the designation of a risk component whose cash flows are bigger than the total cash flows of the hedged item.	<p>Whilst the feedback was generally supportive of the proposals, some constituents wanted clarification on whether there is a full LIBOR component of an interest bearing financial asset or financial liability if the interest rate of the instrument is lower than LIBOR? If so, should that LIBOR-component be eligible for designation as a hedged item? In addition, would the existence of a floor of the interest-bearing financial asset or financial liability affect whether it is possible to designate a hedged item on a full LIBOR risk components basis?</p> <p>IASB staff recommended retaining the current restriction in the ED (as applied to hedged items with an interest rate floor). The pros and cons of this recommendation were outlined as follows:</p> <p><i>Pros</i></p> <ul style="list-style-type: none"> <li>- This alternative avoids counterintuitive outcomes such as ‘negative interest’, deferral of hedge ineffectiveness, and ultimately (in substance) ‘synthetic accounting’ for the combined position of the variable rate asset and the LIBOR interest rate swap;</li> <li>- It highlights the fact that the margin becomes variable within a particular range and therefore captures hedge ineffectiveness that should be recognised in profit or loss.</li> </ul> <p><i>Cons</i></p> <ul style="list-style-type: none"> <li>- The Board will not be addressing the concerns of some of its respondents;</li> <li>- The designation of hedging relationships involving sub-LIBOR instruments may involve increased complexity because entities would not have ‘fully matched’ hedging relationship.</li> </ul>		
	<b>AASB feedback</b>		
	No specific comment.		
		Voting	
<b>IASB redeliberation and tentative decisions</b>		For	Against
<p>The IASB members noted the proposal in the ED (which is consistent with IAS 39 requirements) is to ensure that the portion being designated as a hedged item is not larger than the whole asset or liability because it generates counterintuitive results.</p> <p>The IASB tentatively decided to retain its proposal in ED/2010/13 that a portion of the hedged item cannot be greater than the total cash flows of the hedged item and to clarify in paragraphs B25 and B26 of the Application Guidance that it is possible to designate all of the cash flows of the entire financial asset or financial liability as the hedged item with regard to a benchmark interest rate. Hedge ineffectiveness will arise, but it is not prohibited.</p>		15	-

3 Eligibility of cash instruments as hedging instruments (IASB Agenda Item 10)		
ED Proposals	Constituent feedback and IASB staff recommendations	
Only cash instruments at FVTPL can hedge risks other than foreign currency risk.	<p>Some constituents requested that the IASB extend the eligibility of cash instruments to allow for the designation of those not at FVTPL as hedging instruments against risks other than foreign exchange risk. IASB staff noted that allowing instruments at amortised cost to be designated as eligible hedging instruments would require a change to the measurement basis of the instrument and this would result in additional issues and complexity.</p> <p>An additional issue for consideration was regarding cash instruments and the fair value option (FVO) – and whether cash instruments designated at FVTPL under the FVO should be eligible as hedging instruments. The main issue that staff considered was that the FVO eliminates an accounting mismatch – so if applying hedge accounting undermined the original rationale for that initial designation, then it would not be appropriate to allow those instruments to be designated in a hedging relationship (for example – cash flow hedge where gains or losses on the hedge instrument are recognised in OCI). However, due to the nature of the option – being a once-off irrevocable election on day 1 – the mismatch may not exist at a later date. Therefore, the entity should be able to designate that instrument as an eligible hedging instrument. The only exception should be that financial liabilities designated at FVTPL where part of the fair value change is recognised in OCI cannot be designated as eligible hedging instruments.</p>	
	<b>AASB feedback</b>	
	<p>The AASB supported that proposal that a non-derivative financial asset and a non-derivative financial liability measured at FVTPL should be eligible hedging instruments. However, the AASB believes that the IASB did not properly justify why an equity investment at FVTOCI cannot be designated as an eligible hedging instrument if it used to hedge risks in accordance with an entity’s risk management strategy.</p>	
		Voting
IASB redeliberation and tentative decisions	For	Against
<p>IASB members noted that this issue mainly arises in jurisdictions that do not have access to a derivatives market and therefore, use cash instruments in their hedging strategies. However, during IASB outreach, IASB staff determined that most of the cash instruments were at fair value and therefore, it would not be necessary to further consider the eligibility of cash instruments at amortised cost as hedging instruments – IASB members agreed.</p> <p>The IASB tentatively decided to retain its proposals in the ED that only cash instruments at FVTPL can hedge risks other than foreign currency risk. Additionally, IASB members agreed with the staff analysis and recommendation regarding the interaction between cash instruments and the FVO. Since the mismatch may not exist at a later date, but the instrument would still classified and measured at FVTPL, it would not be appropriate to prohibit designation of the financial instrument as a hedging instrument in a hedging relationship. However, the IASB will clarify that financial liabilities designated at FVTPL, where part of the change in fair value is recognised in OCI, will not be eligible for designation as hedging instruments.</p>	15	-

<b>4</b>	<b>Treatment of forward points (difference between spot rate and forward rate) in foreign currency derivatives (IASB Agenda Item 11)</b>	
<b>ED Proposals</b>	<b>Constituent feedback and IASB staff recommendations</b>	
<p>Entities can designate the spot element of a forward contract and leave the change in the forward points undesignated - therefore the gain or loss from the changes in the forward points is presented in profit or loss (like a trading gain or loss).</p>	<p>Constituents raised the use of funding swaps in managing FX risk. This issue arises where financial institutions have more funding in their local currency than they can invest in financial assets in domestic currency and so they go offshore to do so. They enter into FX derivatives to hedge against FX risk and lock in a net interest margin. The transaction is normally undertaken by:</p> <ol style="list-style-type: none"> <li>(1) Swapping local funds into foreign currency at the spot rate;</li> <li>(2) Investing in FX denominated financial assets;</li> <li>(3) Entering into FX derivatives to convert foreign funds back to local currency at a forward rate.</li> </ol> <p>The forward points (difference between the forward and spot rates) cannot be designate in a hedging relationship. Constituents view the forward points as part of interest revenue in the context of the funding swap and would therefore like to see the proposals for the treatment of the time value of options to be extended to the treatment of forward points.</p>	
	<b>AASB feedback</b>	
	<p>The AASB noted that it was not appropriate to treat the time value of an option as a cost of hedging in isolation of other instruments – there are other types of instruments that have a time value component – for example, forward foreign exchange contracts. The recognition and measurement requirements for a time value component should be applied consistently across all types of instruments.</p>	
		<b>Voting</b>
<b>IASB redeliberation and tentative decisions</b>		<b>For</b>
		<b>Against</b>
<p>No decisions were made in respect of this agenda item. IASB members will consider possible alternatives for the treatment of forward points at a future meeting.</p>		n/a
		n/a

**Additional IASB meeting – 27 April 2011**

<b>5 Accounting for the time value of options – ‘zero-cost collars’ (IASB Agenda Item 2)</b>		
<b>ED Proposals</b>	<b>Constituent feedback and IASB staff recommendations</b>	
The treatment for the time value of options would not apply to zero-cost collars because they have no net time value at inception.	Feedback received is that the treatment for the time value of options should be extended to zero-cost collars – to avoid structuring opportunities to achieve the desired accounting outcome. In addition, constituents noted that whilst the time value of the collar is zero at its expiry, it fluctuates during the life of the hedge. Therefore, the time value of zero-cost collars should be aligned with the treatment for the time value of options.	
	IASB staff agreed with comment letter feedback and recommended aligning the treatment for time value of options and zero-cost collars.	
	<b>AASB feedback</b>	
	The treatment proposed in respect of the time value associated with zero-cost collars was not appropriate because it may encourage entities to undertake particular types of transactions – that is, replace zero-cost collars by collars with a nominal cost so that the proposed accounting treatment for options can be applied.	
		<b>Voting</b>
<b>IASB redeliberation and tentative decisions</b>		<b>For</b>
		<b>Against</b>
IASB members acknowledge that the discussion was not to discuss the suitability/appropriateness of the proposed treatment for the time value of options in the ED.		11
The IASB supported the arguments put forward by staff and tentatively decided to align the treatment of the time value of options and zero cost collars. IASB staff will ask the IASB to consider at a future meeting whether the treatment of the time value of options proposed in ED/2010/13 is appropriate.		1 <sup>1</sup>

<sup>1</sup> One Board member abstained from voting.

**6 | Accounting for fair value hedges (IASB Agenda Item 3)**

ED Proposals	Constituent feedback and IASB staff recommendations
<p><i>The use of OCI</i> – the ED proposes that the gain or loss on the hedged item and hedging instrument be separately presented in OCI and that any ineffectiveness be recognised in profit or loss.</p> <p><i>Statement of financial position presentation</i> – the ED proposed that the gain or loss on the hedged item be presented as a separate line item in the statement of financial position.</p> <p><i>Linked presentation</i> – the ED does not allow linked presentation for fair value hedges.</p>	<p><i>The use of OCI</i></p> <p>Most respondents supported the proposal in the ED. However a number of constituents disagree with the proposals and believe that the gain or loss on the hedging instrument and hedged item should be presented in profit or loss (consistent with the requirements in IAS 39). This was supported by other constituents who commented that the use of OCI should be limited until the IASB completes its financial statement presentation project. However, those constituents supported disclosure of the gain or loss on the hedging instrument and the hedged item in the notes in order to understand the extent of offset between the hedging instrument and the hedged item.</p> <p>In addition, presenting gains/losses on the hedging instrument and hedged item in OCI and then taking any ineffectiveness to profit or loss was akin to the ‘two-step’ approach proposed in the IASB’s Exposure Draft ED/2009/4 <i>Fair Value Option for Financial Liabilities</i>, which the IASB decided to abandon in finalising the requirements in respect of presenting changes in fair value due to credit risk in OCI.</p> <p>Despite the concerns raised, IASB staff recommend that the proposals in the ED should be retained as they provide information about the extent of offset between the hedged item and hedging instrument which is useful information to users. Further, IASB staff do not consider the proposals to be more complex than IAS 39 requirements – an entity would just need to map the gain or loss on the hedging instrument and hedged item to OCI instead of profit or loss.</p> <p><i>Statement of financial position presentation</i></p> <p>The majority of constituents supported the separate presentation of the hedged item and the gain or loss on the hedged item from the fair value hedge as it will increase transparency. However, there are concerns that the additional line items will clutter the statement of financial position. Additionally, the gain or loss on the hedged item does not of itself represent an asset or a liability.</p> <p>Despite the concerns raised, IASB staff recommended that the IASB retain the proposals in the ED as it provides the most useful and transparent information, and the impact of the additional line item on the statement of financial position would be limited.</p> <p><i>Linked presentation</i></p> <p>Most constituents supported the proposals in the ED not to allow linked presentation for fair value hedges because it may confuse users and limit comparability of entities’ financial statements. In addition, a number of constituents felt that linked presentation should not be considered as part of the project on hedge accounting, and that if the IASB wishes to pursue such presentation, it should be included as part of either the financial statement presentation project or the conceptual framework project, or be a totally separate project. However, some constituents believe that linked presentation reflect “...the ‘real’ economic effects of hedges of foreign currency risk of firm commitments”.</p> <p>Based on feedback received (the majority of feedback supports not allowing linked presentation) and the fact that there is not a clear principle for linked presentation, IASB staff recommended that the Board retain the proposals in the ED in respect of linked presentation.</p>



<b>7</b>	<b>Nominal components (IASB Agenda Item 5)</b>		
<b>ED Proposals</b>	<b>Constituent feedback and IASB staff recommendations</b>		
A layer component with a prepayment option whose fair value is affected by changes in the hedged risk cannot be designated as a hedged item.	Some constituents wanted to allow the designation of a layer component when it includes a prepayment option in some circumstances. Staff analysed the issue and recommended retaining the proposals in the ED of not allowing a layer component with a prepayment option to be included as a hedged item.		
	<b>AASB feedback</b>		
	The AASB supported the proposal that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk.		
			<b>Voting</b>
<b>IASB redeliberation and tentative decisions</b>			<b>For</b>
			<b>Against</b>
The IASB agreed with the staff recommendation and tentatively decided to retain the proposals in ED/2010/13.			11
			2

**Additional IASB meeting – 11-12 May 2011**

8 Clarification of “other than accidental offsetting” and the meaning of the ‘unbiased requirement’ (IASB Agenda Item 1)	
ED Proposals	Constituent feedback and IASB staff recommendations
<p>The ED proposed to eliminate the bright line 80%-125% test associated with the qualifying criteria for a hedging relationship and replace the prospective and retrospective hedging requirements with new prospective hedging requirements:</p> <p>(a) must meet the objective of the hedge effectiveness assessment (it ensures that the hedging relationship will produce an ‘unbiased result’ and ‘minimise hedge ineffectiveness’); and</p> <p>(b) must be expected to achieve ‘other than accidental offsetting’.</p>	<p>Constituents expressed overwhelming support with the proposal to eliminate the 80-125% rule and the proposal of a more qualitative approach. However, there was confusion around the intention/meaning of the umbrella terms used in the proposals without detail in the body of the standard – there was an outcry for detailed criteria and guidance in submissions and heard during outreach session. As an example, constituents expressed uncertainty about whether ‘unbiased result’ meant having to find the perfect instrument that would give 100% offset between hedged item and hedging instrument – a scenario of accounting requirements dictating which instrument should be used.</p> <p>Based on the feedback received, IASB staff recommended that umbrella terms be avoided that the requirements in the finalised standard should clearly articulate what is meant. As such, they came up with recommended wording for the IASB’s consideration – to make aspects that are implicit in the umbrella terms explicit – based on what the concepts were intended to mean in the proposed ED.</p> <p>“<i>Other than accidental offsetting</i>’</p> <p>(a) the notion of an economic relationship between the hedged item and the hedging instrument during the life of the hedging relationship, which gives rise to offset; and</p> <p>(b) the effect of credit risk on the level of offset between gains and losses on the hedging instrument and the hedged item that may reduce or modify the extent of offset.” (IASB meeting 11-12 May 2011, IASB Staff paper, Agenda paper 1A, paragraph 30)</p> <p>[Part (a) above must be able to be demonstrated – for example if the entity has a 1:1 LIBOR swap with the same underlying, then it is easy to demonstrate an economic relationship, but the further the entity moves away from the same underlying and gets into benchmarks/substitutes, the more there is a need to run tests to demonstrate a relationship between the hedging instrument and the hedged item.]</p> <p>‘<i>Unbiased</i>’ – the meaning aims to address two issues</p> <p>(a) “Deliberate mismatch between hedged quantity and designated quantity (the IASB wanted to ensure that entities would not deliberately create a difference between the quantity actually hedged and the quantity designated as the hedged item in order to achieve a particular accounting outcome.</p> <p>(b) Inappropriate hedge ratio (the IASB wanted to ensure that an entity would not inappropriately designate a hedging relationship such that it would give rise to systematic hedge ineffectiveness that could be avoided by a more appropriate designation.” (IASB meeting 11-12 May 2011, IASB Staff paper, Agenda paper 1B, paragraph 42)</p>

	<b>AASB feedback</b>	
	The AASB agreed that there should be hedge effectiveness requirements as part of the qualifying criteria and supported the removal of the ‘bright-line’ effectiveness testing rules under IAS 39. However, the AASB raised concerns with the proposed undefined terms that were introduced and noted that the wording seemed overly complex, which would result in confusion and inconsistent application – for example, ‘unbiased’ and ‘accidental offset’. The AASB suggested that the wording of the requirements be simplified if it is to be retained.	
		<b>Voting</b>
<b>IASB redeliberation and tentative decisions</b>	<b>For</b>	<b>Against</b>
<p>All IASB members agreed with the intended meaning of the terms ‘other than accidental offset’ and ‘unbiased’ as articulated in the papers.</p> <p>In respect of ‘accidental offsetting’, some members felt that the words should focus on ‘offset’ whereby an economic relationship can be demonstrated when the hedging instrument and hedged item will move in tandem in opposite directions.</p> <p>In addition, some members felt that the wording for part (b) of the concept of ‘accidental offsetting’ as articulated by staff may be interpreted to mean that you can never hedge credit risk – however, this paragraph has nothing to do with credit risk as a hedged item or if the hedged item is affected by credit risk – members did not want this confusion to arise.</p> <p>In respect of the meaning of ‘unbiased’, IASB members agreed that the intention is that an entity should not be purposely designating a hedging relationship with ineffectiveness or purposely over- or under-hedging. The intention is that an entity avoids the designation of an inappropriate ratio and appropriately recognises any ineffectiveness that arises.</p> <p>The IASB tentatively decided that the words around the hedge effectiveness requirements need to be articulated more clearly, but that the wording provided in the agenda papers did not give the high qualification that the IASB intended. IASB staff have been instructed to provide revised wording for members to consider at a future meeting.</p>	12	-

**Additional IASB meeting – 31May-2 June 2011**

<b>9 Accounting for the time value of options (IASB Agenda Item 7B)</b>		
<b>ED Proposals</b>	<b>Constituent feedback and IASB staff recommendations</b>	
<p>When an entity designates the intrinsic value of an option as the hedging instrument, the change in fair value of the time value of the option is accumulated in OCI and recognise in profit or loss depending on the type of hedged item:</p> <p>(a) Transaction related – e.g. purchase of PPE – accumulated change in fair value is recorded in OCI and then a basis adjustment to the non-financial asset is made.</p> <p>(b) Time-period related – e.g. future sale of inventory – accumulated change in fair value is recorded in OCI and reclassified to profit or loss on a rational basis over the term of the hedging relationship.</p>	<p>The feedback was generally supportive of the proposed treatment. However, some constituents expressed concerns that the treatment was complicated and there was confusion about the difference between a transaction related hedged item and a time-period related hedged item.</p> <p>Based on the feedback, IASB staff recommended that the proposed treatment for the time value of option be retained and to provide additional guidance to assist preparers in applying the requirements.</p>	
	<b>AASB feedback</b>	
	<p>The AASB noted that all hedging instruments could be seen as providing ‘insurance’ and therefore, the treatment for time value of options should not be isolated and treated differently. Forward foreign contracts also have a time value component, and other instruments have an implied cost – such costs should be treated in the same manner.</p>	
		<b>Voting</b>
<b>IASB redeliberation and tentative decisions</b>	<b>For</b>	<b>Against</b>
<p>Whilst one Board member raised concerns about including the time value of an option as a basis adjustment, all other Board members supported the staff recommendation that treating the time value as a cost of insurance requires the distinction between transaction related and time-period related hedged item, otherwise it would be inconsistent with the treatment of such costs in other IFRSs. In addition, Based on a previous IASB tentative decision, the treatment of time value will also be applied to zero-cost collars.</p> <p>In coming to this conclusion, the Board also considered whether there should be an option to treat the time value either as proposed or in accordance with current IAS 39 requirements – i.e. a trading gain or loss recognised in profit or loss. However, the Board tentatively decided not to allow such an option, because the treatment in IAS 39 is inconsistent with the ‘insurance premium’ view.</p>	13	1

10 Designating combinations of options as the hedging instrument (IASB Agenda Item 7C)		
<b>ED Proposals</b>	<b>Constituent feedback and IASB staff recommendations</b>	
Consistent with current IAS 39 requirements, the ED prohibited the designation of a written option in combination with a purchased option as a hedging instrument where there are two or more separate contracts. However, if it is a single instrument (e.g. a collar) and not a net written option, then it can be designated as a hedging instrument.	<p>Whilst there was support for the retention of IAS 39 requirements, some constituents requested that written options not be excluded from being eligible hedging instruments if combined with other designated hedging instruments and the combination does not result in a net written option – that is, the economic substance is the same as a collar. Those constituents noted that:</p> <ul style="list-style-type: none"> <li>- Individual contracts are widely available on trading exchanges; and</li> <li>- Often it is more cost effective to purchase two instruments rather than a collar.</li> </ul> <p>Based on the feedback received, IASB staff recommended that the proposals be amended to allow the designation of a written option with a purchased option as a hedging instrument, whether it arises from one or several contracts, unless the combination results in a net written option.</p>	
	<b>AASB feedback</b>	
	No specific comment.	
		<b>Voting</b>
<b>IASB redeliberation and tentative decisions</b>	<b>For</b>	<b>Against</b>
Whilst one Board member disagreed with the IASB staff recommendation on the basis that written options do not reduce risk and therefore should not qualify as eligible hedging instruments, the majority of Board members supported the recommendation as long as such a combination would not result in a net written option.	13	1

<b>11   Rebalancing – adjustments to the hedge ratio (IASB Agenda Item 8)</b>		
<b>ED Proposals</b>	<b>Constituent feedback and IASB staff recommendations</b>	
The notion of rebalancing was introduced in the ED to complement the hedge effectiveness assessment requirements and thereby allow changes to the hedge ratio without having to discontinue the hedge.	<p>The feedback was generally supportive as the proposals addressed concerns about the existing IAS 39 requirements that do not allow changes to hedge relationships that were not envisaged at the inception of the hedge.</p> <p>However, there were a number of requests for clarification:</p> <ul style="list-style-type: none"> <li>- When rebalancing was required as opposed to permitted;</li> <li>- The frequency of rebalancing – and noted that it would be onerous if it was to be on an ongoing basis;</li> <li>- Whether rebalancing should only be done for risk management purposes – such that the accounting does not trigger changes to or drive the risk management objective.</li> </ul> <p>Based on the feedback, and the IASB’s previous tentative decision on hedge effectiveness assessment, IASB staff proposed that the hedging relationship be rebalanced for hedge accounting purposes when the entity adjusts the hedge ratio for risk management purposes. This would mean that rebalancing is no longer a response to changes in circumstances that affect the hedge ratio, therefore eliminating the need to proactively rebalance.</p> <p>IASB staff note that there may be instances where the hedge ratio is different for hedge accounting and risk management purposes:</p> <ul style="list-style-type: none"> <li>(i) If the change for risk management purposes results in a ratio that would create ineffectiveness; or</li> <li>(ii) If the hedge ratio is retained for risk management purposes, but in new circumstances that ratio would result in ineffectiveness.</li> </ul>	
	<b>AASB feedback</b>	
	<p>The AASB noted that some may perceive the proposals to be onerous, but on balance supported the proposals in respect of rebalancing. However, the AASB noted that there were areas within the proposals that could be clarified – for example, the difference between rebalancing and an overhaul event; whether a delay in the timing of a hedged item would constitute a rebalancing event and whether old terminology (such as ‘de-designation’) was still relevant.</p>	
		<b>Voting</b>
<b>IASB redeliberation and tentative decisions</b>	<b>For</b>	<b>Against</b>
All IASB members supported the IASB staff recommendation.	14	-

12	<b>(No) voluntary discontinuation – clarification (IASB Agenda Item 9)</b>
<b>ED Proposals</b>	<b>Constituent feedback and IASB staff recommendations</b>
<p>An entity must discontinue hedge accounting prospectively when the hedge relationship ceases to meet the qualifying criteria; and that if the entity still meets the qualifying criteria (and the risk management objective has not changed), then the entity is prohibited from voluntarily discontinuing hedge accounting.</p>	<p>The feedback was mixed. Those that supported the proposed requirements considered it an improvement to financial reporting as it holds entities accountable for their decisions by preventing the creation of hedging activities to achieve particular outcomes at particular points in time.</p> <p>Those that disagreed with the proposals did so on the basis that if hedge accounting is voluntary, then discontinuing hedge accounting should also be voluntary. IASB staff noted that there are other instances in IFRS 9 of irrevocable options, such as the fair value option and the FVTOCI presentation exception for equity investments not held for trading purposes. Therefore, that would not be a sound conceptual basis to allow voluntary discontinuation.</p> <p>Others that disagreed with the proposals suggested that discontinuation can be achieved in a number of ways – by closing-out the hedging instrument or entering another opposite instrument, but not designating it in another hedge relationship, to offset the fair value changes of the designated hedging instrument in profit or loss.</p> <p>Additionally, some constituents raised the need to clarify the difference between risk management strategy and risk management objective, and at what level within an organisation risk management policies/procedures should be considered.</p> <p>Based on the feedback, IASB staff recommended to retain the proposed requirements in the ED, but that additional guidance should be added to clarify how risk management strategy differs from risk management objective.</p>
	<p><b>AASB feedback</b></p> <p>The AASB agreed that hedge accounting should be discontinued prospectively when the relationship ceases to meet the qualifying criteria. However, the AASB raised concerns that disallowing an entity to voluntarily discontinue hedge accounting is inconsistent with the objective of hedge accounting. If the entity terminates and pays out the hedging instrument or takes out a new instrument to offset the gains/losses of the designated hedging instrument, then the accounting should reflect this.</p>

	Voting	
	For	Against
<b>IASB redeliberation and tentative decisions</b>		
<p>Some Board members agreed with the view that since hedge accounting is an option in accounting standards, then discontinuing hedge accounting should also be voluntary. In addition, some members noted the range of options available to entities to close out the hedging instrument or offset changes in the fair value of the designated instrument in profit or loss, suggesting therefore, that the proposals are not operational and will cause confusion.</p> <p>The Board also discussed the difference between risk management objective and risk management strategy and agreed with the IASB staff view that risk management strategy is how an entity manages risk at the highest level of the organisation (broad policies), whereas risk management objective is at the level of the hedging relationship – therefore there maybe different risk management objectives required to achieve the entity’s strategy. In addition, risk management objective is likely to be subject to changes on a more frequent basis in order to continue to achieve an entity’s risk management strategy.</p> <p>Whilst one Board member was strongly opposed to not allowing voluntary discontinuation, other supported the proposals in the ED (and therefore the IASB staff recommendation to retain those proposals) as discontinuing hedge accounting when the original risk management objective remains unchanged would be inconsistent with the objective of hedge accounting as proposed in the ED.</p>	13	1

### Attachments

The IASB agenda papers are available on the IASB website. However, please contact Natalie if you would like to receive PDF copies or hard copies of any of the IASB agenda papers.