AASB Exposure Draft

Tier 2 Supplement to ED 208
March 2011

Hedge Accounting

(proposed amendments to AASB 7)

Comments to AASB by 2 June 2011

Australian Government

Australian Accounting Standards Board

Invitation to Comment

Comments on this Tier 2 Supplement to AASB Exposure Draft ED 208 *Hedge Accounting (proposed amendments to AASB 7)* are requested by 2 June 2011. Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to those submissions being treated as confidential. The latter will only occur if the public interest warrants such treatment.

Obtaining a Copy of this Tier 2 Supplement to AASB Exposure Draft

This Tier 2 Supplement to ED 208 is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this Supplement are available by contacting:

The Customer Service Officer
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne Victoria
AUSTRALIA

Phone: (03) 9617 7637
Fax: (03) 9617 7608
E-mail: publications@aasb.gov.au
Postal address:
PO Box 204
Collins Street West Victoria 8007

Other Enquiries

Phone: (03) 9617 7600
Fax: (03) 9617 7608
E-mail: standard@aasb.gov.au

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Background

In December 2010, the IASB published ED/2010/13 *Hedge Accounting*. ED/2010/13 contains proposals to change the hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement* (AASB 139) and related disclosures in IFRS 7 *Financial Instruments: Disclosures* (AASB 7) in order to provide more useful hedge accounting information.

Consistent with its policy of adopting International Financial Reporting Standards (IFRSs), in December 2010 the AASB published ED 208 *Hedge Accounting*, which incorporates ED/2010/13. The AASB's response to ED/2010/13 will be available on the AASB website under Work in Progress/Submissions from AASB.

This Exposure Draft sets out the disclosures proposed in ED 208 from which it is proposed entities applying Tier 2 reporting requirements should be exempt. ED/2010/13 has not proposed any amendments to the existing requirements in IFRS 7. Accordingly, this Exposure Draft does not deal with existing disclosure requirements in AASB 7. The proposals in this Exposure Draft should not be seen as any indication of AASB support or otherwise for the IASB's proposed disclosures in ED/2010/13. That will be determined through the ED 208 due process.

AASB Specific Matters for Comment

The AASB's conclusions in relation to proposed Tier 2 disclosure requirements in this Exposure Draft have been reached after applying its usual approach to the analysis of the disclosures – comparison with disclosures set out in the IASB's *IFRS for SMEs* and application of the 'Tier 2 Disclosure Principles'. Those principles and the analysis of the proposed disclosure requirements in this Exposure Draft are available on the AASB website under Work in Progress/Reduced Disclosure Requirements.

A summary of the main differences between ED 208 and Section 12 *Other Financial Instruments Issues* of the *IFRS for SMEs* in terms of the recognition, measurement and presentation requirements are outlined in Appendix A to this Exposure Draft.

The AASB would particularly value comments on the following:

1. whether you agree with the AASB disclosure proposals regarding paragraphs 40-52 of ED 208 in relation to Tier 2 entities as set out in the Analysis of Proposed Disclosures section below;
2. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of these proposals, particularly any issues relating to:
   (a) not-for-profit entities; and
   (b) public sector entities;
3. whether, overall, these proposals would result in financial statements that would be useful to users;
4. whether these proposals are in the best interests of the Australian economy; and
5. unless already provided in response to specific matters for comment 1-4 above, the costs and benefits of the proposals, whether quantitative (financial or non-financial) or qualitative.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue

ANALYSIS OF PROPOSED DISCLOSURES

The purpose of this Tier 2 Supplement to ED 208 *Hedge Accounting (proposed amendments to AASB 7)* is to seek comment on the disclosure requirements that should apply to Tier 2 entities.

Under the proposals in this Exposure Draft, Tier 2 entities would be exempt from making the proposed disclosure requirements in paragraphs 41, 42, 45, 46, 47, 48, 49(b), 50, 51(a)(iii), 51(c)(iii), the words "in a tabular format" in paragraphs 49 and 51, and the words following the text "… reclassification adjustment" in paragraph 51(c)(ii) of ED 208.

Proposed Reduced Disclosure Requirements

The proposed disclosure requirements in ED 208 *Hedge Accounting* (December 2010) are provided below. Entities applying Tier 2 requirements are proposed to be exempted from applying disclosure requirements shown as shaded text.

40 Hedge accounting disclosures shall provide information about:

(a) an entity's risk management strategy and how it is applied to manage risk;

(b) how the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and

(c) the effect that hedge accounting has had on the entity's statement of financial position, statement of comprehensive income and statement of changes in equity.

41 An entity shall present the required disclosures in a single note or separate section in its financial statements. However, an entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

42 When paragraphs 44-52 require the entity to separate by risk category the information disclosed, the entity shall determine each category of risk on the basis of the risk exposures an entity decides to hedge and for which hedge accounting is applied. An entity shall determine risk categories consistently for all hedge accounting disclosures.

43 To meet the objectives in paragraph 40, an entity shall (except as otherwise specified below) determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need any additional information to evaluate the quantitative information disclosed. However, when an entity determines the level of aggregation or disaggregation, it shall consider the level of aggregation or disaggregation it uses for other disclosure requirements in AASB 7 *Financial Instruments: Disclosures*.

The risk management strategy

44 An entity shall explain its risk management strategy for each category of risk exposure that it decides to hedge and for which hedge accounting is applied. This explanation should enable users of financial statements to evaluate (for example):

(a) how each risk arises;

(b) how the entity manages each risk; this includes whether the entity hedges an item in its entirety for all risks or hedges a risk component (or components) of an item; and

(c) the extent of risk exposures that the entity manages.

The amount, timing and uncertainty of future cash flows

45 For each category of risk exposure, an entity shall disclose quantitative information to enable users of its financial statements to evaluate the types of risk exposures being managed in each risk category, the extent to which each type of risk exposure is hedged and the effect of the hedging strategy on each type of risk exposure.

46 An entity shall provide a breakdown that discloses, for each subsequent period that the hedging relationship is expected to affect profit or loss, the following:

(a) the monetary amount or other quantity (e.g. tonnes, cubic metres) to which the entity is exposed for each particular risk (for hedges of groups of items, an entity shall explain the risk exposure in the context of a group or net position);

(b) the amount or quantity of the risk exposure being hedged; and

(c) in quantitative terms, how hedging changes the exposure (i.e. the exposure profile after hedging such as the average rate at which the entity has hedged that exposure).

47 For each category of risk, an entity shall disclose a description of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term.

48 If other sources of hedge ineffectiveness emerge in a hedging relationship, an entity shall disclose those sources and explain the resulting hedge ineffectiveness.

The effects of hedge accounting on the primary financial statements

49 An entity shall disclose, in a tabular format, the following amounts related to items designated as hedging instruments separately by category of risk for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):

(a) the carrying amount of the hedging instruments (financial assets separately from financial liabilities); and
(b) the notional amounts or other quantity (e.g. tonnes or cubic metres) related to the hedging instruments.

50 An entity shall disclose, in a tabular format, the following amounts related to hedged items separately by category of risk for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):

(a) for fair value hedges:
    (i) the carrying amount of the accumulated gains or losses on the hedged item presented in a separate line item in the statement of financial position, separating assets from liabilities; and
    (ii) the balance remaining in the statement of financial position of any hedges for which hedge accounting has been discontinued.
(b) for cash flow hedges and hedges of a net investment in a foreign operation:
    (i) the balance in the cash flow hedge reserve for continuing hedges that will be reclassified when the hedged item affects profit or loss; and
    (ii) the balance remaining in the cash flow hedge reserve from any hedges for which hedge accounting has been discontinued.

51 An entity shall disclose, in a tabular format, the following amounts separately by category of risk for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):

(a) for fair value, cash flow hedges and hedges of a net investment in a foreign operation:
    (i) changes in the value of the hedging instrument recognised in other comprehensive income;
    (ii) hedge ineffectiveness recognised in profit or loss; and
    (iii) a description of the line item(s) in the income statement in which hedge ineffectiveness is included.
(b) for fair value hedges, the change in the value of the hedged item; and
(c) for cash flow hedges and hedges of a net investment in a foreign operation:
    (i) for hedges of net positions, the hedging gains or losses recognised in a separate line item in the income statement (see paragraph 37);
    (ii) the amount reclassified from the cash flow hedge reserve into profit or loss as a reclassification adjustment (see AASB 101) (differentiating between amounts for which hedge accounting had previously been used, but for which the hedged future cash flows are no longer expected to occur, and amounts that have been transferred because the hedged item has affected profit or loss); and
    (iii) a description of the line item in the income statement affected by the reclassification adjustment (see AASB 101).

52 An entity shall provide a reconciliation of accumulated other comprehensive income in accordance with AASB 101, either in the statement of changes in equity or in the notes to the financial statements, that:

(a) allows users of its financial statements to identify the amounts that relate to the disclosures in paragraphs 51(a)(i), (c)(i) and (c)(ii); and
(b) differentiates between amounts associated with the time value of options that hedge transaction related hedged items and amounts associated with the time value of options that hedge time period related hedged items when an entity accounts for the time value of an option in accordance with paragraph 33 (see paragraphs B67-B69).

Appendix A – Differences between ED 208 *Hedge Accounting* and Section 12 *Other Financial Instruments Issues* of the *IFRS for SMEs*

ED 208 deals with the general hedge accounting requirements. Section 12 of the *IFRS for SMEs* deals with financial instruments that are not 'basic financial instruments'.

The disclosures proposed in ED 208 and the disclosure requirements in Section 12 of the *IFRS for SMEs* have been compared in the Analysis of Disclosure Requirements Relating to Tier 2 Supplement to AASB Exposure Draft ED 208 *Hedge Accounting (proposed amendments to AASB 7)*, which is available on the AASB website under Work in Progress/Reduced Disclosure Requirements.

Main Differences in Recognition, Measurement and Presentation Requirements

The proposals in ED 208 differ from the hedge accounting requirements in Section 12 of the *IFRS for SMEs*, such that the proposals:

(a) require the objective of hedge accounting to represent in the financial statements the effect of an entity's risk management activities when it uses financial instruments to manage exposures arising from a particular risk that could affect profit or loss;

(b) permit certain groups of individually eligible items that represent a gross or net position to be designated as eligible hedged items. In addition, the proposal would require the presentation of gains or losses on the hedged net position as a separate line item in the income statement;

(c) require the gains or losses on the hedging instrument and the hedged item, for fair value hedges, to be presented in other comprehensive income, and the ineffective portion of the gains or losses to be transferred to profit or loss. In addition, the proposal would require the presentation of gains or losses on the hedged item, for fair value hedges, as a separate line item in the statement of financial position; and

(d) provide specific accounting treatment for the the time value of an option when an entity separates the intrinsic value of an option and designates as the hedging instrument only the change in the intrinsic value. The specific accounting treatment for the time value of an option would depend on the nature of the hedged item—whether it hedges for protection against a risk over a particular period of time (time period related) or the transaction costs of the hedged item (transaction related).