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IFRS Developments

IASB concludes its re-deliberations on the hedge accounting project

What you need to know

- The IASB has concluded its re-deliberations of the hedge accounting project, which is the third phase of the overall project to replace IAS 39.
- The IASB followed up on its discussion in January on the interaction between macro cash flow hedge accounting and the new hedge accounting model.
- Entities will have an accounting policy choice to apply either the IAS 39 hedge accounting requirements or the new IFRS 9 hedge accounting requirements.
- Entities that apply IFRS 9 for hedge accounting may still apply IAS 39 for macro fair value hedges.
- Entities can continue to apply the hedge accounting requirements of IAS 39 until the IASB completes the project on accounting for macro hedging, which is separate from the IFRS 9 project.
- The new disclosure requirements for hedge accounting will form part of IFRS 7 and will apply to all entities using hedge accounting under IFRSs – even if they continue to apply IAS 39.

Background

On 25 April 2013 the International Accounting Standards Board (IASB, the Board) held its final meeting on the hedge accounting project, which is part of IFRS 9 *Financial Instruments*.

At the meeting the IASB followed up on its discussion in January of the interaction between the new hedge accounting model and macro cash flow hedge accounting (i.e., applying cash flow hedge accounting in the context of open portfolios managed on a net basis as illustrated for interest rate risk in the Implementation Guidance that accompanies IAS 39 *Financial Instruments: Recognition and Measurement*.[1]

Tentative decisions made at the April 2013 meeting

The IASB:

- Tentatively decided to provide entities, until the completion of the IASB's project on accounting for macro hedging, with an accounting policy choice between:
  a. Applying the new hedge model in IFRS 9 (but including the option to use the 'macro fair value hedge' accounting in IAS 39)

  Or

  b. Continuing to apply *all* of the hedge accounting requirements of IAS 39 for all hedging relationships
- Confirmed its previous decision that the new disclosure requirements for hedge accounting will become part of IFRS 7 *Financial Instruments: Disclosures*. Consequently, they apply to all hedge accounting relationships under IFRSs irrespective of the choices listed above.

The IASB also agreed that the due process requirements had been met for this project and that it could finalise the project without re-exposure, and gave the staff permission to prepare a draft for a formal ballot.

[1] IGs F.6.1-F.6.3

The IASB's decision responds to the concerns of some entities about their ability to apply macro cash flow hedge accounting under the hedge accounting model of IFRS 9 or about having to change their macro hedge accounting twice within a relatively short period of time.

Implications

The choice between the two hedge accounting models has the following implications:

Potential benefits of applying IFRS 9

Entities that continue to apply the IAS 39 hedge accounting model in general will not be able to avail themselves of the potential benefits of the IASB's reforms. Examples of such benefits include the new hedge effectiveness assessment, the deferral of costs of hedging in other comprehensive income (OCI), aggregated exposures, groups of items, rebalancing of continuing hedging relationships, partial discontinuation of hedging relationships, the option to elect fair value through profit or loss (FVPL) accounting for financial instruments hedged for credit risk using credit derivatives, risk components of non-financial items and the new option to elect FVPL accounting for own use contracts.

How we see it

The benefits of the new hedge accounting model will vary between entities, but we believe the new model for hedge effectiveness assessment is a significant improvement on the IAS 39 model. Before choosing which standard to apply, entities will need to consider the relative advantages and disadvantages of each in the context of their own business models and existing accounting practices.

There is a risk that the existing accounting practices applied by some entities under IAS 39 may become unacceptable in future in the light of subsequent decisions and interpretations made by the board during the development of IFRS 9.

Interaction with classification and measurement of financial instruments

Entities that choose to apply the IAS 39 hedge accounting model will not be able to apply hedge accounting for investments in equity instruments for which they choose presentation of the fair value changes in OCI[2] once they apply IFRS 9 for classification and measurement[3]. Those hedging relationships would not meet the requirements of a fair value hedge or a cash flow hedge because the hedged risk will never affect profit or loss as the amounts recognised in OCI are not recycled under this presentation option.

[2] See IFRS 9.5.7.5.

[3] The classification and measurement requirements of IFRS 9 as well as all other requirements except for those for the hedge accounting will have mandatory effective dates that do not include an option to continue to apply the respective IAS 39 requirements until the project on accounting for macro hedging is finalised. Therefore, it is most likely that entities will have to apply other requirements of IFRS 9 while they still use IAS 39 for hedge accounting (if entities so choose).

How the new disclosure requirements for hedge accounting will apply

Scope

Entities applying hedge accounting under IFRSs will be required to provide the new disclosures for hedge accounting irrespective of whether they apply IAS 39 or IFRS 9. The reason is that the disclosure requirements in relation to financial instruments are in a separate standard (IFRS 7) instead of in the standards that govern the recognition, measurement and presentation for these instruments (IAS 32 *Financial Instruments: Presentation*, IAS 39 and IFRS 9). Consequently, the new hedge accounting related disclosure requirements will form part of IFRS 7.

Effective date

We believe that the consequential amendments to IFRS 7 for hedge accounting disclosures will have the same mandatory effective date as the new IFRS 9 hedge accounting requirements. This is currently set for annual periods beginning on or after 1 January 2015. This means that all entities would have to provide the new disclosures from that date even if they continue to apply IAS 39.

Implications for entities using the EU 'carve-out'

Entities that apply IFRS 9 for hedge accounting will still have the scope exception available that allows IAS 39 to be applied instead of IFRS 9 for macro fair value hedges. For entities in the EU that means that this scope-out re-directs them to the version of IAS 39 endorsed in the EU so that the carve-out would be available to them for *only* this type of hedge (i.e., macro fair value hedges).

Entities in the EU that choose to continue to apply the IAS 39 hedge accounting requirements instead of those in IFRS 9 will use the version of IAS 39 endorsed in the EU. That means the carve-out will be available to them in the same way as it is currently.

Change of accounting policy

Based on the IASB's discussions, we expect the application of IAS 39 for hedge accounting would remain available until the mandatory effective date of the standard that will result from the IASB's project on accounting for macro hedging. At that date, entities will need to apply macro cash flow hedge accounting within the constraints of the IFRS 9 hedge accounting model, or else adopt the new model for accounting for macro hedging. Also at that date, the scope-out for macro fair value hedges will fall away for entities that already use the new hedge accounting model in IFRS 9.

The IASB discussion was based on the premise that providing the accounting policy choice between the two hedge accounting models is, in effect, equivalent to deferring the mandatory effective date for IFRS 9's hedge accounting requirements until the mandatory effective date of the standard on accounting for macro hedging. That would mean an entity that initially chose to continue to apply IAS 39 for hedge accounting could, later on, change its accounting policy and choose to apply the IFRS 9 hedge accounting model before it becomes mandatorily effective.

How we see it

The choice to continue to apply the IAS 39 hedge accounting requirements comes at the price of foregoing the benefits of the new hedge accounting model and with some risks. Consequently, entities will need to carefully consider the implications to be able to make an informed decision.

We understand the IASB aims to issue a final version of the new hedge accounting requirements by the end of June 2013, but given the need to process drafting changes, this could slip into the third quarter.

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