



# Financial Instruments: Update of IPSAS 28-30

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## **IFRS 9: *Financial Instruments***

# **Phase III: Hedge Accounting**

# IFRS 9: Hedge Accounting – Hedging Basics under IAS 39

- What is hedge accounting?
  - Hedged item
  - Hedged risk
  - Hedging instrument
- Types of hedges
  - Fair value hedge
  - Cash flow hedge
  - Net investment hedge

# IFRS 9: Hedge Accounting – New General Hedge Accounting Model

- IAS 39 hedge accounting model
  - Too stringent - complex and difficult to apply
  - Not reflective of risk management practices
- Hedge Accounting under IFRS 9
  - Widens the range of situations for applying hedge accounting
  - Replaces onerous rules with principle based guidance

Overall: The new model is more practical, flexible, and principle based, and better reflects the risk management practices

# IFRS 9: Hedge Accounting – Major Changes

- Eligibility of Hedging Instruments
  - More inclusive, not limited to derivative instruments

**Example:** To hedge the fair value of a large inventory of crude oil, you invest into a fund with a portfolio of commodity- linked instruments.

- Previously under IAS 39, cannot apply hedge accounting (derivatives only as hedging instruments in a fair value hedge)
- Now under IFRS 9, can apply hedge accounting (designation of non-derivative instruments measured at FVTPL allowed)

# IFRS 9: Hedge Accounting – Major Changes

- Eligibility of Hedged Items

- Allows a risk component of a non- financial item if separately identifiable and measureable

**Example:** Airline faces price risk in jet fuel. Price of jet fuel changes due to inflation, changing crude oil prices, foreign currency risk and other factors. Airline decides to hedge only the crude oil price component by purchasing forward contracts on crude oil.

- Previously under IAS 39, cannot apply hedge accounting (IAS 39 allows hedging non-financial items only in entirety)
- Now under IFRS 9, can apply hedge accounting (designation of a separate risk component of a non-financial item as a hedged item allowed)

- Expands range of eligible hedged items (net positions, synthetic positions)

# IFRS 9: Hedge Accounting – Major Changes

- Hedge Effectiveness Testing

*IAS 39:*

- Prescriptive effectiveness test
  - Effectiveness can be reliably measured
  - Effective only if the test result fall in the range of 80% -125%
- Testing required both prospectively and retrospectively

*IFRS 9:*

- Principle-based criteria with no specific numerical thresholds
  - Economic relationship exists
  - Credit risk does not dominate value changes
  - Designated ratio consistent with risk management strategy
- Tests to only be performed prospectively

Overall: Less onerous, and allow use of information produced for internal risk management.

# IFRS 9: Hedge Accounting – Major Changes

- Rebalancing
  - Allows modifications without terminating the hedge
- Accounting for options, forwards, and foreign currency derivatives
  - Reduces profit or loss volatility when compared with IAS 39
- Discontinuing hedge accounting
  - Does not allow terminating a hedging relationship voluntarily



# IFRS 9: Hedge Accounting – Key Elements that Remained the Same

- Types of Hedges
- Optional Application
- Terminology
- Requirement for hedge documentation
- Hedge ineffectiveness recognition in P&L

# Questions?