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**International
Accounting Standards
Board**

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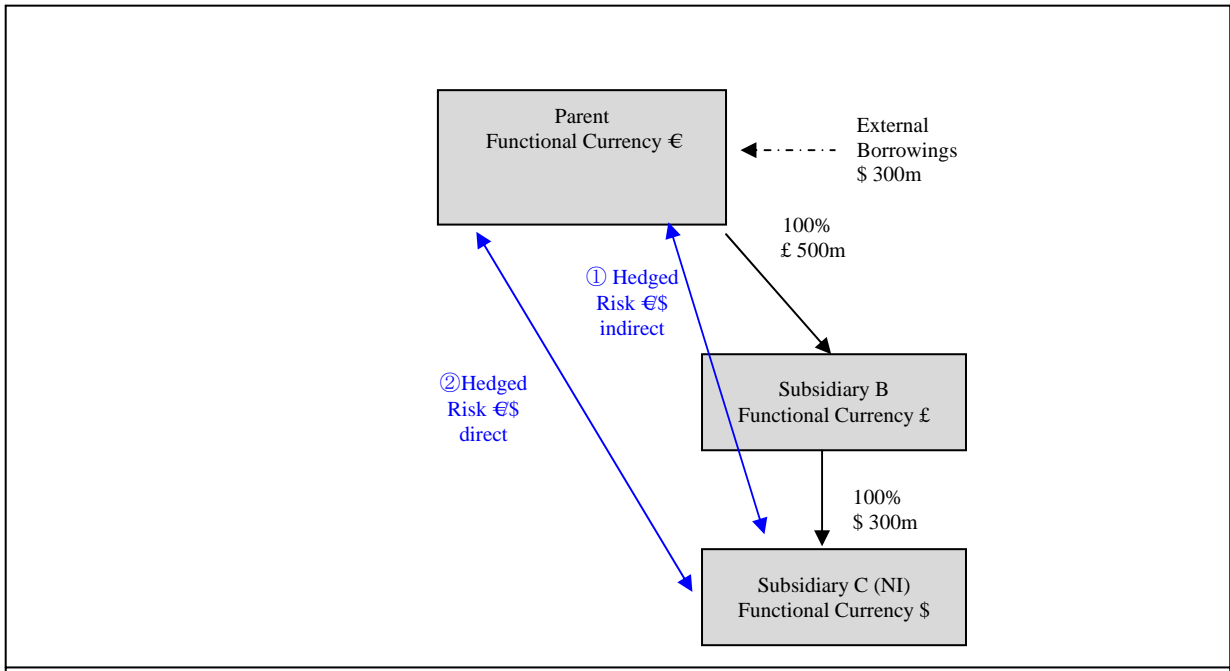
Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: March 2008, London
**Project: Situation 3A: Hedging instrument held by Parent — Debt
(Agenda Paper 2F)**

On 1 January 2005, Parent entity, which presents consolidated financial statements in € holds a 100% investment in Subsidiary B (£500m). Subsidiary B also holds a 100% investment in Subsidiary C (\$300m). Parent entity has a functional currency of € Subsidiary B has a functional currency of Pound Sterling (£) and Subsidiary C has a functional currency of \$. The net assets of Subsidiary B on 1 January 2005 are £500m including an amount in respect of the net assets of Subsidiary C which are equal to \$300m on this date. The Parent borrows \$300m externally on 1 January 2005. The Parent's only assets are the investment in Subsidiary B and the cash raised from the external borrowing which has been deposited in €. The Parent designates the \$300m external borrowing as a hedge of the spot foreign exchange risk associated with the net investment in the first \$300m net assets of Subsidiary C in its consolidated financial statements.

Alternatively, the Parent could have designated the external borrowing as a hedge of the £/\$ spot foreign exchange risk between Subsidiary C and Subsidiary B in its consolidated financial statements. This alternative designation is not illustrated in the related spreadsheet.



Results of hedge effectiveness

Step-by-step method of consolidation

Hedged risk	In which financial statements?	
	In Parent's consolidated F/S	In Sub B's consolidated F/S
① Euro/\$ exposure from a net investment in Subsidiary C between Parent and Subsidiary C	Spreadsheet No. 3A-1 Debt 100% effective	N/A (Euro/\$ risk not present)

Direct method of consolidation

Hedged risk	In which financial statements?	
	In Parent's consolidated F/S	In Sub B's consolidated F/S
② Euro/\$ exposure from a net investment in Subsidiary C between Parent and Subsidiary C	Spreadsheet No. 3A-2 Debt 100% effective	N/A (Euro/\$ risk not present)

SITUATION 3A -1 DEBT (step by step method): designate \$/Euro exposure from Entity C as hedged risk

USD	1
JPY	118
EUR	0.8
GBP	0.53

	P (EUR)	A(JPY)	A(EUR)	C(USD)	C(GBP)	B(GBP)	consol adj	BC(GBP)	BC(EUR)	pre-acq	consol adj	PABC(EUR)
Investment in A												0
Investment in B	755											0
Investment in C						159	-159					0
Other assets*1	240			300	159	341		500	755			995
	995	0	0	300	159	500		500	755			995
Opening												
FCTR	-755			-300	-159	-500	159	-500	-755		755	-755
Income												
Closing												
Equity	-755	0	0	-300	-159	-500		-500	-755			-755
Debt	-240			0	0	0		0	0		0	-240
Check	0	0	0	0	0	0		0	0			0

USD	1	1
JPY	125	121.5
EUR	0.88	0.84
GBP	0.58	0.555

P accounts	EUR
USD 300m borrowings Year 0	240
USD 300m borrowings Year 1	264
P/L	24

	P (EUR)	A(JPY)	A(EUR)	C(USD)	C(GBP)	B(GBP)	consol adj hedge	BC(GBP)	BC(EUR)	pre-acq	consol adj	PABC(EUR)
Investment in A												0
Investment in B	755											0
Investment in C						159	-159					0
Other assets	240			300	174	341		515	781			1021
	995	0	0	300	174	500		515	781			1021
Opening												
FCTR (Entity B)*2	-755			-300	-159	-500	159	-500	-755		755	-755
FCTR (Entity C)*3									-4			-4
Income	24				-15			-15	-23			24
Closing	-731	0	0	-300	-174	-500		-515	-781			-758
Debt	-264			0	0	0	0	0	0		0	-264
Check	0	0	0	0	0	0		0	0			0

SITUATION 3A -1 DEBT (step by step method): designate \$/Euro exposure from Entity C as hedged risk

Hedged risk	USD/EUR exposure from C
Hedged item (in amounts)	USD 300
Change in year 1	-23 Euro
Hedging instrument	USD borrowings
Change in P/L	24 EUR
Hedge effectiveness	100% Considered rounding effect

*1 Assumption: Parent deposited US\$ cash into Euro account on 1 Jan.200€

*2 $EUR-4 = -(GBP15/0.58 * 0.88 - EUR755 - EUR23)$

*3 $GBP-15 = GBP159 - \$300 * 0.58$
 $EUR-23 = GBP-15 / 0.58 * 0.88$

The following entries would be recorded for hedging instrument (USD borrowings)

(P's separate F/S)

Dr) Profit and loss	EUR 24	Cr) Debt	GBP 24
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being the profit/loss arising from the Debt

(P's consolidated F/S)

Dr) Equity (FCTR-Entity C)	EUR 24	Cr) Profit and loss	EUR 24
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being the hedge accounting entry for the net investment in Entity C

The following entries would be recorded for hedged item

(P's consolidated F/S)

Dr) Other assets	EUR 23	Cr) FCTR (Entity C)	EUR 23
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retranslation of exchange difference arising from Entity C

Check: Equity (FCTR) EUR 1

<After hedge entry>

	Before hedge	After hedge
	PABC(EUR)	ABC(EUR)
Investment in A	0	0
Investment in B	0	0
Investment in C	0	0
Other assets	1021	1021
	<u>1021</u>	<u>1021</u>
Opening	-755	-755
FCTR (Entity B)	-4	-4
FCTR (Entity C)	-23	1
Income	24	0
Closing	<u>0</u>	<u>0</u>
	<u>-758</u>	<u>-758</u>
Debt	<u>-264</u>	<u>-264</u>
Check	0	0

SITUATION 3A - 2 DEBT (direct method): designate \$/Euro exposure from Entity C as hedged risk on P's consolidated F/S

Hedged risk	USD/EUR exposure from C
Hedged item (in amounts)	300 USD
Change in year 1	-24 Euro
Hedging instrument	USD borrowings
Change in P/L	24 EUR
Hedge effectiveness	100%

*1 Assumption: Parent deposited US\$ cash into Euro account on 1 Jan. 200€

*2 $EUR-3 = EUR515 - GBP341 / 0.58 * 0.88$

*3 $EUR-24 = EUR240 - EUR300 * 0.88$

The following entries would be recorded for hedging instrument (USD borrowings)			
(P's separate F/S)			
Dr) Profit and loss	EUR 24	Cr) Debt	GBP 24
being the profit/loss arising from the Debt			
(P's consolidated F/S)			
Dr) Equity (FCTR-Entity C)	EUR 24	Cr) Profit and loss	EUR 24
being the hedge accounting entry for the net investment in Entity C			

The following entries would be recorded for hedged item			
(P's consolidated F/S)			
Dr) Other assets	EUR 24	Cr) FCTR(Entity C)	EUR 24
retranslation of exchange difference arising from Entity C			

Check: Equity (FCTR) EUR 0