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**International  
Accounting Standards  
Board**

*This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.*

*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.*

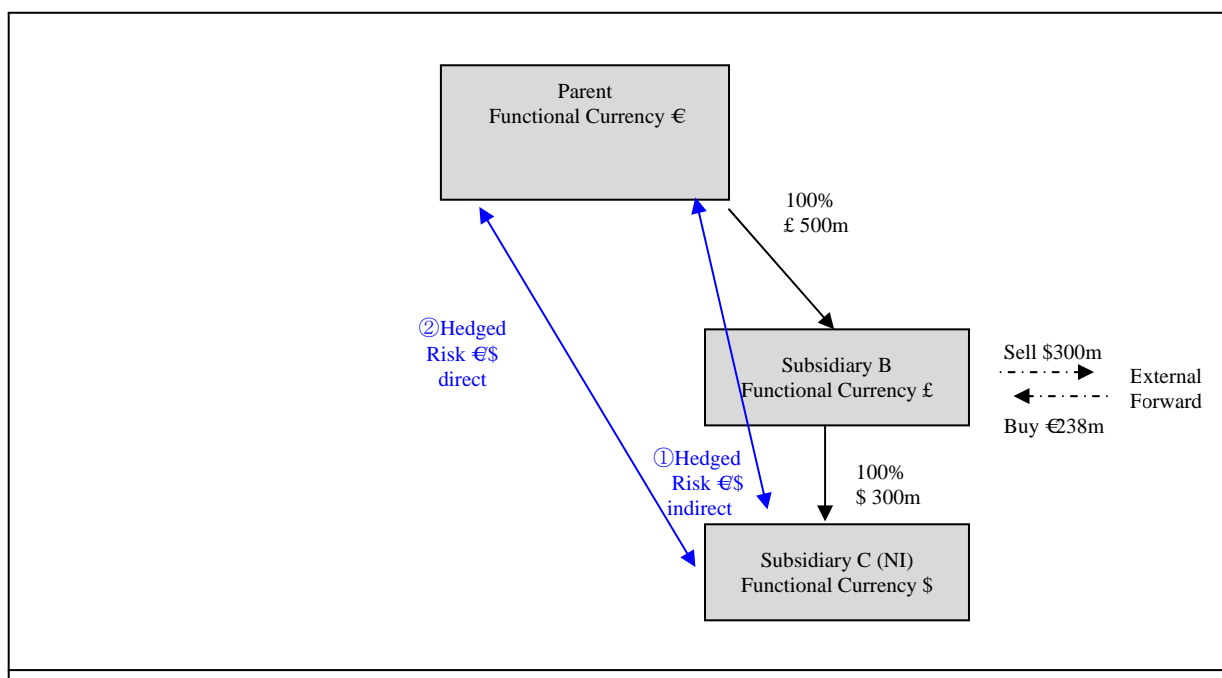
#### **INFORMATION FOR OBSERVERS**

**IFRIC meeting: March 2008, London**

**Project: Situation 2: Hedging instrument held by Subsidiary B —  
Forward (Agenda Paper 2E)**

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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 \$. . On 1 January 2005 Subsidiary B enters into an external forward contract to sell \$300m for €238m in one year's time.. 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 has no assets other than the investment in Subsidiary B. The Parent designates the forward as a hedge of the forward foreign exchange risk associated with the net investment in the first \$300m net assets of Subsidiary C in its consolidated financial statements.



## 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	<b>Spreadsheet No. 2-1 Forward</b> <b>100% effective</b>	<b>N/A (there is no Euro/\$ exposure within these financial statements)</b>

### 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	<b>Spreadsheet No. 2-2 Forward</b> <b>100% effective</b>	<b>N/A (there is no Euro/\$ exposure within these financial statements)</b>

**SITUATION 2 -1 FORWARD (step by step method): designate \$/Euro exposure from Entity C as hedged risk**

Year 0												
	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				300	159	341		500	755			0
	755	0	0	300	159	500		500	755			755
Opening	-755			-300	-159	-500	159	-500	-755		755	-755
FCTR												
Income												
Closing	-755	0	0	-300	-159	-500		-500	-755			-755
Equity												
Forward	0			0	0	0		0	0		0	0
Check	0	0	0	0	0	0		0	0			0

Year 1		average		B accounts			
	1	1		Year 0	Year 1	GBP	EUR
USD	125	121.5				0	0
JPY	0.88	0.84				-17	
EUR	0.58	0.555				-17	-26
GBP							

	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				300	174	341		515	781			0
	755	0	0	300	174	500		515	781			781
Opening	-755			-300	-159	-500	159	-500	-755		755	-755
FCTR(Entity B)-assets*2									-4			-4
FCTR(Entity B)-forward*3												
<b>FCTR (Entity C)</b>					-15			17	4			4
Income						17	-17	0	0			0
Closing	-755	0	0	-300	-174	-483		-498	-755			-755
Forward	0			0	0	-17	0	-17	-26		0	-26
Check	0	0	0	0	0	0		0	0			0

**SITUATION 2 -1 FORWARD (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 value of net assets at forward rates per IE 15 of IFRIC D22	-26 EUR
Hedging instrument	Forward
Change in P/L	17 GBP
<b>Hedge effectiveness</b>	<b>100%</b>

$$*2 \text{ EUR} - 4 = (\text{EUR}755 - \text{EUR}781) - (\text{EUR}0 - \text{EUR}26) - 4$$

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

(B's separate F/S)

Dr) Profit and loss	GBP 17	Cr) Forward	GBP 17
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**being the profit/loss arising from the forward**

(B's consolidated F/S)

Dr) Equity (FCTR-Entity C)	GBP 17	Cr) Profit and loss	GBP 17
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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

(B's consolidated F/S)

Dr) Other assets	GBP 15	Cr) Equity(FCTR-EntityC)	GBP 15
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**being translation of Entity C's GBP financial statements (after elimination) into GBP**

Check: Equity (FCTR) GBP 2

<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	781	781
	<u>781</u>	<u>781</u>
Opening	-755	-755
FCTR(Entity B)-a	-4	-4
FCTR(Entity B)-forward*3		
<b>FCTR (Entity C)</b>	<b>4</b>	<b>4</b>
Income	0	0
Closing	0	0
	<u>-755</u>	<u>-755</u>
Forward	-26	-26
Check	0	0



**SITUATION 2 - 2 FORWARD (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)	USD 300
change in value of net assets at forward rates per IE 15 of IFRIC D22	-26 Euro
Hedging instrument	Forward
Change in P/L	26 Euro
<b>Hedge effectiveness</b>	<b>100%</b>

*1 Change in FCTR arising from Entity B's forward retranslation of income at closing rate (= GBP17/0.58*0.88-EUR26)	0
retranslation of opening of forward at closing rate	0
	0

\*2 EUR-3=EUR515-EUR517

\*3 EUR0=GBP17/0.58\*0.88-EUR26

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

(B's separate F/S)			
Dr) Profit and loss	GBP 17	Cr) Forward	GBP 17
<b>being the profit/loss arising from the forward</b>			
(P's consolidated F/S)			
Dr) Profit and loss	EUR 26	Cr) Forward	EUR 26
<b>being translation of Entity B's GBP profit/ loss into EUR at the average rate</b>			
Dr) Equity (FCTR-Entity B)	EUR 0	Cr) Forward	EUR 0
<b>being retranslation of Entity B's GBP profit/ loss into EUR at the closing rate</b>			
Dr) Equity (FCTR-Entity B)	EUR 0	Cr) Forward	EUR 0
<b>being retranslation of Entity B's opening balance of forward into EUR at the closing rate</b>			
Dr) Other assets	EUR 3	Cr) FCTR-EntityB-assets	EUR 3
<b>being translation of Entity B's assets into Euro at closing rate</b>			
Dr) Equity (FCTR-EntityC)	EUR 26	Cr) Profit and loss	EUR 26
<b>being the hedge accounting entry for the net investment in Entity C</b>			
Dr) Equity (FCTR-Entity C)	EUR 0	Cr) Equity (FCTR-Entity B)	EUR 0
<b>being reclassification entry within Equity (FCTR)for hedging (ie. eliminating FCTR-Entity C)</b>			

The following entries would be recorded for hedged item

(P's consolidated F/S)			
Dr) Other assets	EUR 24	Equity(FCTR-Entity C)	EUR 24
<b>exchange difference arising from translation of Entity C's assets into EUR</b>			

Check: Equity (FCTR) EUR 2

<After hedge entry>

	Before hedge	After hedge	2-1(step)	
	PABC(EUR)	PABC(EUR)	PABC(EUR)	
Investment in A	0	0	0	0
Investment in B	0	0	0	0
Investment in C	0	0	0	0
Other assets	781	781	781	0
	781	781	781	0
Opening	-755	-755	-755	0
FCTR(Entity B)-asse	-3	-3	-4	-1
FCTR(Entity B)-forwa	0	0	0	0
<b>FCTR(Entity C)</b>	-24	26	4	1
Income	26	-26	0	0
Closing		0		
Equity	-755	-755	-755	0
Forward	-26	-26	-26	0
Check	0	0	0	

**SITUATION 2 FORWARD**

Interest rates			
t	€	\$	
0		4.50%	5.50%
1		4.70%	5.70%

<b>Forward</b> matures in one year time, ie. 1/1/02			
Buy	€		237,725,118.48
Sell	\$		300,000,000.00

Fair Value @ 31/12/00	Leg	in GBP	
Buy €		227,488,151.66	150,710,900.47
Sell \$		284,360,189.57	150,710,900.47
<b>TOTAL</b>			0.00

Fair Value @ 31/12/01	Leg		
Buy €		237,725,118.48	156,682,464.45
Sell \$		300,000,000.00	174,000,000.00
<b>TOTAL</b>			-17,317,535.55

NB: all hedges assume that both the spot and forward component are designated

Spot rates				
€	£	Yen	\$	
	0.8	0.53	118	1
	0.88	0.58	125	1

Forward rate (E/\$)	
	1.26

Exchange rates		
Period	0	1
\$/Yen	118	125
\$/GBP	0.53	0.58
\$/€	0.8	0.88
Yen/\$	0.008475	0.008
Yen/GBP	0.004492	0.00464
Yen/€	0.00678	0.00704
GBP/\$	1.886792	1.724138
GBP/Yen	222.6415	215.5172
GBP/€	1.509434	1.517241
€/\$	1.25	1.136364
€/Yen	147.5	142.0455
€/GBP	0.6625	0.659091

**SITUATION 2 FORWARD**

Net assets (\$m)	300,000,000.0000
\$/€ spot rate @ 31/12/00	0.8000
\$/€ spot rate @ 31/12/01	0.8800
€/\$ 1-y forward rate @ 31/12/00 running to 31/12/01	1.2620
€/\$ 1-y forward rate @ 31/12/01	1.1364
Change in hedged item at forward rates*	-26,274,881.5166

\* this calculation involves retranslating the net assets at the forward rate to 31/12/01 @ 31/12/00 and then again at the forward rate to that date at 31/12/01 itself (ie at the spot rate)  
this is consistent with the methodology used in IE 15 of IFRIC D22