IFRS 9 – *Financial Instruments* (January 2016)

***Financial Instruments*—Transition issues relating to hedging**

The Interpretations Committee received a request for guidance in respect of two issues pertaining to hedge designation and hedge accounting in situations in which an entity makes the transition from IAS 39 *Financial Instruments: Recognition and Measurement* to IFRS 9 *Financial Instruments*.

More specifically, the Interpretations Committee has been asked to consider:

a. whether an entity can treat a hedging relationship as a continuing hedging relationship on transition from IAS 39 to IFRS 9 if the entity changes the hedged item in a hedging relationship from an entire non financial item (as permitted by IAS 39) to a component of the non-financial item (as permitted by IFRS 9) in order to align the hedge with the entity's risk management objective (Issue 1); and
b. whether an entity can continue with its original hedge designation of the entire non-financial item on transition to IFRS 9 when the entity's risk management objective is to hedge only a component of the non-financial item (Issue 2).

In relation to Issue 1, the Interpretations Committee noted that when an entity changes the hedged item in a hedging relationship from an entire non-financial item to a component of the non-financial item upon transition to IFRS 9, it is required to do so on a prospective basis as described in paragraph 7.2.22 of IFRS 9. The Interpretations Committee also noted that changing the hedged item while continuing the original hedge relationship would be equivalent to the retrospective application of the hedge accounting requirements in IFRS 9, which is prohibited except in the limited circumstances described in paragraph 7.2.26 of IFRS 9. The Interpretations Committee observed that in the example presented in Issue 1, the exceptions in paragraph 7.2.26 do not apply and therefore the original hedge relationship could not be treated as a continuing hedge relationship on transition to IFRS 9.

In relation to Issue 2, the Interpretations Committee observed that:

a. paragraphs BC6.97, BC6.98 and BC6.100 of IFRS 9 support the use of hedge designations that are not exact copies of actual risk management ('proxy hedging') as long as they reflect risk management in that they relate to the same type of risk that is being managed and the same type of instruments that are being used for that purpose; and
b. the use of proxy hedging in cases in which it reflects the entity's risk management (that is, where it relates to the same type of risk that is being managed and the same type of instruments that are being used for that purpose) did not appear to be restricted to instances in which IFRS 9 had prohibited an entity from designating hedged items in accordance with its actual risk management.

As a result, the Interpretations Committee noted that hedge designations of an entire non-financial item could continue on transition to IFRS 9 as long as they meet the qualifying criteria in IFRS 9.

In the light of existing IFRS requirements, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee decided not to add this issue to its agenda.