IAS 39 Financial Instruments: Recognition and Measurement (September 2007)

Hedging future cash flows with purchased options

The IFRIC received requests relating to a situation in which an entity designates an option, in its entirety, as a hedging instrument to hedge a one-sided variability in future cash flows in a cash flow hedge. All changes in the fair value of the option (including changes in the time value component) are considered in assessing and measuring hedge effectiveness.

The requests suggested the following approach to assessing and measuring hedge effectiveness. An entity could compare all changes in the fair value of the purchased option with changes in the fair value of a hypothetical written option that has the same maturity date and notional amount as the hedged item. The requests noted that such an approach would minimise or eliminate hedge ineffectiveness when the terms of the purchased option and the hypothetical written option perfectly matched. The IFRIC was asked whether IAS 39 allows such an approach.

The IFRIC noted that some respondents to its tentative agenda decision believed that the issue was complex and that there was diversity in practice regarding whether the approach suggested or other similar approaches are allowed under IAS 39.

However, the IFRIC decided not to take the issue on to its agenda because the Board has recently decided to propose an amendment to IAS 39 to clarify what risks and cash
flows can be designated as hedged risks and hedged portions of risks for hedge accounting purposes. The IFRIC noted that the Board's project will specifically address the issue discussed in this agenda decision.