IFRS 9 – *Financial Instruments* (March 2016)

Financial Instruments—Determining hedge effectiveness for net investment hedges
The Interpretations Committee received a request to clarify how an entity should determine hedge effectiveness when accounting for net investment hedges in accordance with IFRS 9 *Financial Instruments*. Specifically, the submitter asked whether, when accounting for net investment hedges, an entity should apply the 'lower of' test required for cash flow hedges in determining the effective portion of the gains or losses arising from the hedging instrument. The Interpretations Committee observed that: a. paragraph 6.5.13 of IFRS 9 states that 'hedges of a net investment in a foreign operation … shall be accounted for similarly to cash flow hedges …'. Paragraph 6.5.13 (a), which focusses on net investment hedges, also references paragraph 6.5.11, which deals with the accounting for cash flow hedges; this includes the 'lower of' test. This indicates that, when accounting for net investment hedges, an entity should apply the 'lower of' test in determining the effective portion of the gains or losses arising from the hedging instrument. b. in determining the effective portion of the gains or losses arising from the hedging instrument when accounting for net investment hedges, the application of the 'lower of' test avoids the recycling of exchange differences arising from the hedged item that have been recognised in other comprehensive income before the disposal of the foreign operation. The Interpretations Committee noted that such an outcome would be consistent with the requirements of IAS 21 *The Effects of Changes in Foreign Exchange Rates*. In addition, the Interpretations Committee noted the following: a. it did not receive evidence of significant diversity among entities applying IAS 39 *Financial Instruments: Recognition and Measurement* in determining the effective portion of the gains or losses arising from the hedging instrument by applying the 'lower of' test when accounting for net investment hedges. **b.** few entities have yet adopted the hedging requirements in IFRS 9; consequently, it is too early to assess whether the issue is widespread. However, the Interpretations Committee expects no significant diversity to arise when IFRS 9 is adopted more widely.

In the light of the existing requirements in IFRS Standards, the Interpretations Committee decided 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.