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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IFRIC meeting:	**July 2007, London**
Project:	**Review of tentative agenda decision published in May IFRIC Update** **IAS 39 *Financial Instruments: Recognition and Measurement* – Hedging future cash flows with purchased options (Agenda Paper 7C)**

Tentative agenda decision published in May 2007 IFRIC Update

The IFRIC was asked how effectiveness should be assessed when an option, in its entirety, is designated as a hedging instrument to hedge 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 the following questions have to be considered in addressing the issue:

(a) whether a hedged item used for assessing and measuring hedge effectiveness should be the same as that designated at inception of the hedge; and

(b) what items are eligible for designation as hedged items at inception of the hedge.

Regarding question (a), IAS 39 requires the hedged item used for assessing and measuring hedge effectiveness to be the same as that designated at the inception of the hedge (see IAS 39 paragraph 88).

Regarding question (b), IAS 39 does not allow derivatives to be designated as hedged items subject to one exception, namely a purchased option in a fair value hedge (see the answer to Question F.2.1 of the Guidance on Implementing IAS 39). Therefore, the IFRIC noted that a (hypothetical or actual) written option cannot be designated as a hedged item under IAS 39.

Moreover, the IFRIC noted that the approach suggested in the requests would effectively result in considering the time value component of an option (that does not exist in the hedged item) in determining changes in the fair value of the hedged item for assessing and measuring hedge effectiveness.

In view of the above requirements, the IFRIC noted the approach suggested in the requests is not allowed under IAS 39. Therefore, the IFRIC [decided] not to take the issue on to its agenda.