

30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

**International
Accounting Standards
Board**

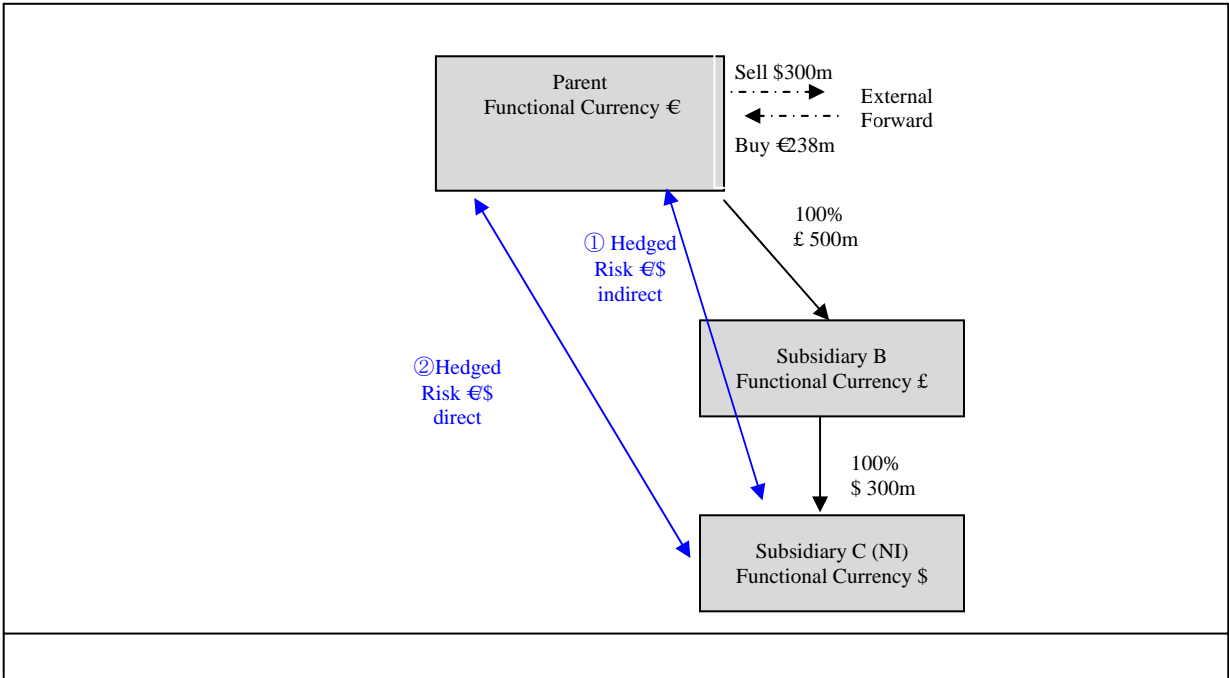
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Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: March 2008, London
**Project: Situation 3A: Hedging instrument held by Parent —
Forward (Agenda Paper 2G)**

- 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 \$. 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. On 1 January 2005 the Parent enters into an external forward contract to sell \$300m for €238m in one year's time.. The Parent's only asset is 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	Spreadsheet No. 3A-1 Forward 100% effective	N/A (Euro/\$ risk not present)

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	Spreadsheet No. 3A-2 Debt 100% effective	N/A (Euro/\$ risk not present)

SITUATION 3A -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	USD	755											0
Investment in B	JPY												0
Investment in C	EUR						159	-159					-755
Other assets	GBP	0			300	159	341		500	755			0
		<u>755</u>	<u>0</u>	<u>0</u>	<u>300</u>	<u>159</u>	<u>500</u>		<u>500</u>	<u>755</u>			<u>755</u>
Opening		-755			-300	-159	-500	159	-500	-755			
FCTR													
Income													
Closing		-755	0	0	-300	-159	-500		-500	-755		755	-755
Equity		<u>-755</u>	<u>0</u>	<u>0</u>	<u>-300</u>	<u>-159</u>	<u>-500</u>		<u>-500</u>	<u>-755</u>			<u>-755</u>
Forward		0			0	0	0		0	0			0
Check		0	0	0	0	0	0		0	0			0

Year 1		average		P accounts		EUR
USD	1	1		Forward	Year 0	0
JPY	125	121.5		Forward	Year 1	-26
EUR	0.88	0.84		P/L		-26
GBP	0.58	0.555				

Year 1		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	USD	755												0
Investment in B	JPY													0
Investment in C	EUR						159	-159						0
Other assets	GBP	0			300	174	341			515	781			781
		<u>755</u>	<u>0</u>	<u>0</u>	<u>300</u>	<u>174</u>	<u>500</u>			<u>515</u>	<u>781</u>			<u>781</u>
Opening		-755			-300	-159	-500	159		-500	-755		755	-755
FCTR (Entity B)*2											-4			-4
FCTR (Entity C)*3						-15				-15	-23			-23
Income		26												26
Closing		<u>-729</u>	<u>0</u>	<u>0</u>	<u>-300</u>	<u>-174</u>	<u>-500</u>			<u>-515</u>	<u>-781</u>			<u>-755</u>
Forward		-26			0	0	0	0		0	0			-26
Check		0	0	0	0	0	0		0	0				0

SITUATION 3A -1 FORWARD (step by step method): designate \$/Euro exposure from Entity C as hedged risk

Hedged item (net assets in amounts)	USD 300m
change in value of net assets at forward rates (as per IE 15 of D22)	-26 Euro
Hedging instrument	Forward to sell \$300m and buy EUR
Change in P/L from forward	26 Euro
	26
Hedge effectiveness	100%

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*2 EUR-4=EUR755-EUR781-(-EUR23)

*3 GBP-15=GBP159-\$300*0.58 EUR-23=GBP-15/0.58*0.88
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The following entries would be recorded for hedging instrument (Forward)			
(P's separate F/S)			
Dr) Profit and loss	EUR 26	Cr) Forward	GBP 26
being the profit/loss arising from the forward			
(P's consolidated F/S)			
Dr) Equity (FCTR-Entity C)	EUR 26	Cr) Profit and loss	EUR 26
being the hedge accounting entry for the net investment in Entity C			

The following entries would be recorded for hedged item			
(P's consolidated F/S)			
Dr) Other assets	EUR 23	Cr) FCTR(EntityC)	EUR 23
retranslation of exchange difference arising from Entity C			

Check:	Equity (FCTR)	EUR	4
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<After hedge entry>

	Before hedge PABC(EUR)	After hedge ABC(EUR)
Investment in A	0	0
Investment in B	0	0
Investment in C	0	0
Other assets	781	781
	781	781
Opening	-755	-755
FCTR (Entity B)	-4	-4
FCTR (Entity C)	-23	26
Income	26	-26
Closing	0	0
	-755	-755
Forward	-26	-26
Check	0	0

SITUATION 3A - 2 FORWARD (direct method): designate \$/Euro exposure from Entity C as hedged risk on P's consolidated F/

Hedged item (net assets in amounts) USD 300m	
change in value of net assets at forward rates (as per IE 15 of D22)	-26 Euro
Hedging instrument	Forward to sell \$300m and buy EUR
Change in P/L from forward	26 Euro
	26
Hedge effectiveness	100%

*2 EUR-3=EUR515-EUR517

*3 EUR-24=EUR240-EUR300*0.88

The following entries would be recorded for hedging instrument (USD forward)			
(P's separate F/S)			
Dr) Profit and loss	EUR 26	Cr) Forward	GBP 26
being the profit/loss arising from the forward			
(P's consolidated F/S)			
Dr) Equity (FCTR-Entity C)	EUR 26	Cr) Profit and loss	EUR 26
being the hedge accounting entry for the net investment in Entity C			

The following entries would be recorded for hedged item			
(P's consolidated F/S)			
Dr) Other assets	EUR 24	Cr) FCTR(Entity C)	EUR 24
retranslation of exchange difference arising from Entity C			

Check: Equity (FCTR) EUR 2

SITUATION 3A FORWARD

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

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

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

Forward rate (E/\$)	Forward rate (E/\$)
0 -> 1	1 -> 2
1.26	1.15

Fair Value @ 31/12/00	Leg	in EUR	
Buy €		227,488,151.66	227,488,151.66
Sell \$		284,360,189.57	227,488,151.66
TOTAL			0.00

Exchange rates		
Period	0	1
\$/Yen	118	125
\$/GBP	0.53	0.58
\$/€	0.8	0.88
Yen/\$	0.008474576	0.008
Yen/GBP	0.004491525	0.00464
Yen/€	0.006779661	0.00704
GBP/\$	1.886792453	1.724137931
GBP/Yen	222.6415094	215.5172414
GBP/€	1.509433962	1.517241379
€/€	1.25	1.136363636
€/Yen	147.5	142.0454545
€/GBP	0.6625	0.659090909

Fair Value @ 31/12/01	Leg		
Buy €		237,725,118.48	237,725,118.48
Sell \$		300,000,000.00	264,000,000.00
TOTAL			-26,274,881.52

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

SITUATION 3A 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	1.1472
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