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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **January 2009, London**

Project: **IFRIC Interpretation 16 *Hedges of a Net Investment in a Foreign Operation***

Subject: **Amendment to the restriction on the entity that can hold hedging instruments (Agenda paper 18)**

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1. The IFRIC received a question about the restriction in IFRIC 16 that the hedging instrument cannot be held by the foreign operation whose net investment is being hedged. IFRIC 16 Paragraph 14 is set out in the Appendix to this paper. The submitter provided its analysis and a detailed example (both are available from staff on request).

2. In the particular fact pattern in the submission, due to legal restrictions in the jurisdiction, only a licensed foreign exchange dealer is permitted to hold the hedging instrument. Within the group, only the foreign operation being hedged is a licensed dealer in the particular foreign currency market. Similar restrictions may exist in other jurisdictions.

3. The restriction was included in draft Interpretation D22 and attracted little comment from respondents. The IFRIC concluded, as part of its redeliberations, that the restriction was appropriate because the instrument would be part of the net investment being hedged and therefore hedge accounting was not necessary. Its conclusion is explained in paragraph BC24 included in the Appendix. The IFRIC was not aware of the particular situation described in the submission.

4. The staff has analysed the submitter's fact pattern in the same way as the situations previously considered by the IFRIC (this analysis is also available from staff on request) and concluded that the submission is correct. That is, although the total amounts of foreign exchange differences are indeed the same with and without hedge accounting, the split between the amounts included in profit or loss and foreign currency translation reserve (FCTR) is different. Without hedge accounting, the foreign exchange difference arising from the hedging instrument would be included in profit or loss while the difference arising from the net investment would be included in FCTR.

5. Therefore, the staff agree with the submission and recommend that the restriction be removed. The example has been reviewed in detail by an IFRIC member and discussed with the two IFRIC liaison Board members who are FI Board advisors. They all agree with the staff conclusion.

Question for the Board

6. **Does the Board agree with the staff's recommendation that the restriction be removed?**

7. IFRIC 16 is effective for annual periods beginning on or after 1 October 2008 with prospective application. Because hedge accounting designations cannot be retrospective, the staff believes that the amendment should be done urgently. If the Board agrees at this meeting, the staff will provide a ballot draft immediately after the meeting. Given that the matter is urgent and the proposed amendment is very short and correction in nature, we recommend an exposure period of 30 days,

as permitted by the due process handbook paragraph 98 (included in the Appendix). Like all draft Interpretations, the exposure Draft would be with the exposure draft published only on the website. Staff will present an analysis of the comment letters at the IFRIC meeting in March to obtain input from the IFRIC. We propose to finalise the amendment at the IASB meeting in March and make it effective immediately.

Question for the Board

8. **Does the Board agree with the staff's recommendation in paragraph 7?**

APPENDIX

IFRIC 16 paragraph 14

"A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the group **(except the foreign operation that itself is being hedged)**, as long as the designation, documentation and effectiveness requirements of IAS 39 paragraph 88 that relate to a net investment hedge are satisfied. … "

IFRIC 16 paragraph BC 24

"The IFRIC concluded that the foreign operation being hedged could not hold the hedging instrument because that instrument would be part of, and denominated in the same currency as, the net investment it was intended to hedge. In this circumstance, hedge accounting is unnecessary. The foreign exchange differences between the parent's functional currency and both the hedging instrument and the functional currency of the net investment **will automatically be included in the group's foreign currency translation reserve** as part of the consolidation process. The balance of the discussion in this Basis for Conclusions does not repeat this restriction."

Due process handbook for the IASB paragraph 98

"The IASB normally allows a period of 120 days for comment on its consultation documents. **For exposure drafts, if the matter is exceptionally urgent, the document is short, and the IASB believes that there is likely to be a broad consensus on the topic, the IASB may consider a comment period of no less than 30 days.** For major projects, the IASB will normally allow a period of more than 120 days for comments. The comment period on draft IFRIC Interpretations is usually 60 days, but may be less in urgent cases."