Project: **Financial Instruments (Replacement of IAS 39)—Hedge Accounting**

Topic: **Hedge accounting disclosures—Effects of hedge accounting on the balance sheet**

Purpose of this paper

1. This paper provides the Board with a summary of possible hedge accounting disclosures that provide information on the effect of hedge accounting on an entity's balance sheet.
2. The proposals in this paper help achieve the objective identified in agenda paper 20. That objective is to help users of financial statements to understand the effect that hedge accounting had on the entity's balance sheet, income statement and statement of comprehensive income.
3. The appendix to this paper provides an illustrative example of the proposed disclosure requirements. The staff is not proposing a specific format for the table. The table is just an example of what it could look like.

How does hedge accounting affect the balance sheet?

4. At the July 2010 IASB meeting, the Board decided that fair value hedges are accounted for differently from cash flow hedges[1] .

[1] Agenda paper 8A of the July 2010 meeting.

Fair value hedges

5. The Board tentatively decided to present the cumulative gain or loss on the hedged item attributable to the hedged risk as a separate line item in the balance sheet. That line item is presented within assets (or liabilities) for those periods for which the hedged item is an asset (or liability). In contrast, IAS 39 requires the gain or loss on the hedged item attributable to the hedged risk to be applied as a (direct) adjustment to the carrying amount of the hedged item (ie an integral part of that balance sheet line item).

6. This means that fair value hedges relate to hedging instruments in the balance sheet, and result in a separate line item that reflects an adjustment to the hedged item.

Cash flow hedges

7. The Board did not propose any changes to the mechanics of cash flow hedges in IAS 39. Consequently, the balance sheet reflects the fair value of the hedging instrument. Gains or losses on the hedged item are not recognised in the balance sheet.

How should the information be disclosed?

8. The staff recommend that disclosures that provide information on the effects of hedge accounting on the balance sheet should be done in a tabular format that separates the information by risk category and by type of hedge (ie cash flow hedges or fair value hedges).

Tabular format

9. Information about the *effects* that hedge accounting had on the balance sheet is most effectively presented in a tabular format. This allows users of financial statements to quickly identify the relevant numbers and their effects on the

balance sheet. Requiring a table format also increases comparability of the format for this information between entities.

10. To put the effects of hedge accounting in perspective, all related narrative disclosures for a particular risk will be provided as part of disclosures that facilitate understanding the risk management strategy for that risk (see agenda paper 20C).

By type of hedge

11. As described above, the Board has tentatively decided that fair value hedges are accounted for differently from cash flow hedges. Consequently, to provide information that identifies the effects of hedge accounting on the balance sheet, that information needs to be provided in the context of the type of hedge applied (ie cash flow hedge or fair value hedge).

12. During the staff's outreach activities, users indicated that they do not analyse an entity's hedging activities by type of hedge (cash flow hedge or fair value hedge)[2]. They indicated that it is more important to understand the risks that the entity manages and the results after applying the risk management techniques.

13. However, to effectively provide information on the effects of hedge accounting on the primary financial statements, that information should reflect the accounting applied (ie fair value hedge accounting or cash flow hedge accounting). By preparing the required table by risk category and by type of hedge, there should be sufficient links between the accounting information and the risk management information (see agenda paper 20C).

14. This also highlights the differences in the accounting treatment for each type of hedge and how it affects the primary financial statements.

[2] See agenda paper 13 of the March 2010 IASB meeting.

What information should be disclosed?

Separate information about hedging instruments and hedged items

15. In an ideal scenario, it would be useful to see how hedge accounting affected the balance sheet in one table in the notes to the financial statements. However, amounts in the balance sheet related to hedging instruments and hedged items are accounted for differently. A method for providing disclosures that are operationally practical and useful should consider the interaction between hedging instruments and hedged items.

16. Problems with a single table for information on hedging instruments and hedged items include:

    (a) *Ongoing vs. discontinued hedges*—For example, the separate line item in the balance sheet that an entity recognises for changes in the value of a *hedged item* (using fair value hedge accounting) will consist of amounts that relate to ongoing hedges, and, in some situations, discontinued hedges. By comparison, financial assets and financial liabilities can only be designated as *hedging instruments* for ongoing hedges. It would not be possible to provide a disclosure in a single table that compares the balance of the hedging instrument with the hedged item balances related to the hedging instrument for that particular risk without adding complexity to such a table.

    (b) *Operational issue*—Amounts recognised in OCI for cash flow hedges and in the separate line item for fair value hedges are not necessarily captured in accounting systems on a basis that reflects how they relate to a specific hedging instrument. It is not possible to provide a disclosure in a single table that compares the balance of the hedging instrument with the balances related to the hedging instrument for the particular risk without enduring costs to change the accounting system.

17. Consequently, disclosures regarding amounts in the balance sheet that relate to the hedging instrument should be separate from a disclosure regarding amounts in the balance sheet that relate to the hedged item.

Information to be disclosed

18. Based on the accounting requirements, a disclosure requirement that explains the effects of cash flow hedges and fair value hedges on the balance sheet could require disclosure of:

    Information related to the hedging instrument—cash flow hedges and fair value hedges

    (a) the carrying amounts of the hedging instrument, separating assets from liabilities;

    (b) the notional amount of the hedging instrument;

    Information related to the hedged items—cash flow hedges

    (c) the balance in accumulated other comprehensive income (OCI) related to the hedged item;

    (d) the balance of any discontinued hedged item;

    Information related to the hedged item—fair value hedges

    (e) the carrying amount of the accumulated gain or loss on the hedged item (the separate line item recognised in the balance sheet) attributable to the hedged risk, separating assets from liabilities.

19. The information above would be provided in a table format and by risk category. As mentioned in agenda paper 20, the level of aggregation or disaggregation will not be specified. However, the entity will have to consider the level of aggregation for fair value disclosures so that users can easily relate the hedging instruments measured at fair value to the fair value disclosure requirements currently required in IFRS 7 *Financial Instruments: Disclosures*.

20. The information will also have to be provided with sufficient information to make it possible to identify the line items to which they relate.

Why provide a disclosure about the notional amount of the hedging instrument?

21. The carrying amount of the hedging instrument does not necessarily give an indication of the size of the exposure that the entity is hedging with that particular instrument. For example, the fair value of an interest rate swap could be £250,000 whereas the notional amount could be £10,000,000. Consequently, disclosing the notional amount together with the carrying amount of the hedging instrument provides useful information about the size of the exposure. As mentioned before, the risk management disclosures will provide more context for the risk management strategy (see agenda paper 20C).

Additional disclosures regarding discontinued hedged relationships

22. When a hedging relationship is discontinued, it may happen that there is an amount that remains in AOCI or in the separate line item recognised in the balance sheet (see paragraph 18(d)). Users of financial statements need to understand how any balances still remaining in the balance sheet will affect profit or loss in future periods. Consequently, an entity should disclose the period over which the entity expects the remaining balances to affect profit or loss.

Appendix—illustrative example of proposed disclosure requirements for the effects of hedge accounting on the balance sheet

Balances related to hedging instruments

	Notional amount of the hedging instrument	Carrying amount of the hedging instrument	
		Assets	Liabilities
Cash flow hedges			
Commodity price risk			
- Forward sales contracts	xx	xx	xx
Fair value hedges			
Interest rate risk			
- Interest rate swaps	xx	xx	xx
Foreign exchange risk			
- Loan	xx	xx	xx

Balances related to the hedged item

	Separate line item recognised in the balance sheet for the gain or loss on the hedged item[3]		Accumulated OCI related to the risk being hedged
	Asset	Liabilities	
Cash flow hedges			
Commodity price risk			
- Forecast sales	n/a	n/a	xx
- Discontinued hedges (forecasted sales)	n/a	n/a	xx
Fair value hedges			
Interest rate risk		xx	n/a

[3] The Board tentatively decided to present the cumulative gain or loss on the hedged item attributable to the hedged risk as a separate line item in the balance sheet. That line item is presented within assets (or liabilities) for those periods for which the hedged item is an asset (or liability).

- Hedge adjustment loan payable - Discontinued hedges (hedge adjustment—loan payable)		xx	n/a
Foreign exchange risk - Firm commitment	xx	xx	n/a