
Project	Financial Instruments (Replacement of IAS 39) – Hedge Accounting
Topic	Scope of hedge accounting disclosures

Purpose of this paper

1. This paper:
 - (a) provides an overview of the staff's approach regarding the *scope* of hedge accounting disclosures; and
 - (b) asks the Board whether they agree with that approach.
2. This paper does not propose any specific disclosure requirement, and nor does it ask the Board to make any decisions on specific disclosures.
3. This paper is structured as follows:
 - (a) Background;
 - (b) Reporting on the overall risk that the entity is exposed to;
 - (c) Reporting on the exposure attributable to the hedged risk; and
 - (d) Staff recommendation and question to the Board.

Next steps

4. The staff will present a paper on possible hedge accounting disclosure requirements after the general hedge accounting model has been more fully developed.
5. That paper will include, amongst other things:
 - (a) the objective of hedge accounting disclosures;
 - (b) the information needed to understand how hedge accounting affected the statement of financial position;
 - (c) the information needed to understand how hedge accounting affected the income statement and statement of other comprehensive income; and

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- (d) the information needed to understand the entity's hedging strategy, its exposure to risk and how those risks have been managed.

Background

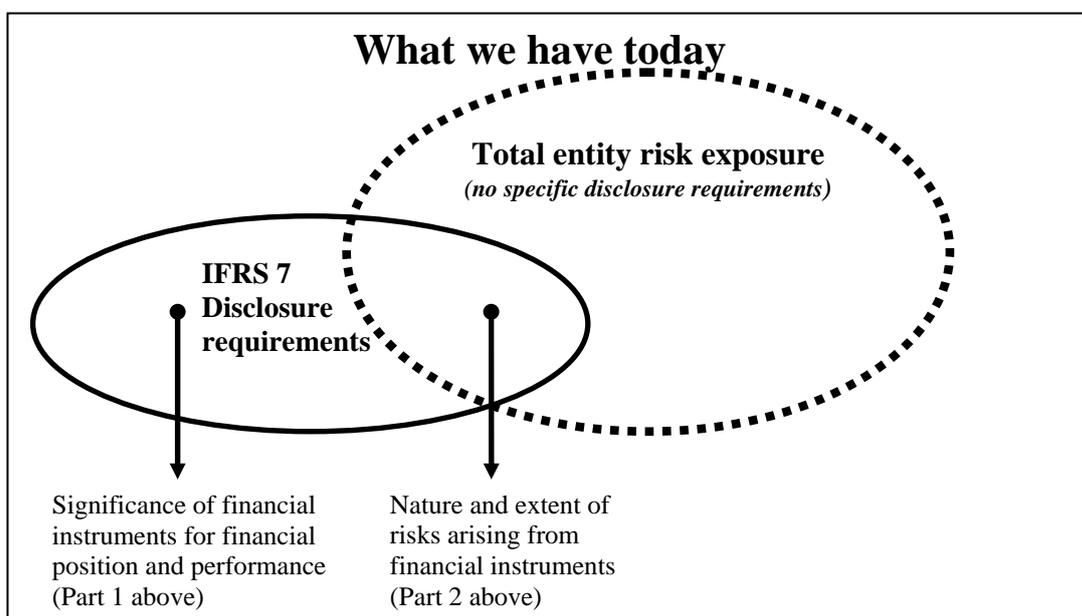
- 6. Entities face many economic risks in carrying out their business and operations. Entities enter into transactions to reduce or mitigate some of these exposures.
- 7. During the staff's outreach activities on hedge accounting, users of financial statements have indicated that it is important for them to have information on the risk that an entity is exposed to and how those risks are being managed.
- 8. To be able to develop disclosures for hedge accounting that portray the risks that the entity is exposed to and how they are being managed, it is important that we determine the parameters (scope) of what exposures it is that we are trying to provide more information on. In other words, we need to determine:
 - (a) whether we want to require information on each and every one of the risks that the entity in its entirety is exposed to, to better understand how hedging activity reduces or mitigates the overall risk of the entity (a 'top-down' approach); or
 - (b) whether we want to require information on the exposure attributable to the hedged risk to give greater insight into the hedged risk ('bottom-up' approach).
- 9. IFRS 7 *Financial Instruments: Disclosures* already address some of these, but not all. Whatever approach the Board decides to follow (based on the above two alternatives) will require the disclosure requirements in IFRS 7 to be expanded.
- 10. The staff have prepared a short summary below of the requirements in IFRS 7 to put this in perspective.

Current disclosure requirements with regard to an entity's exposure to risk

- 11. IFRS 7 disclosure requirements are in two parts:

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- (a) Part 1: requires information to be disclosed that enables users of its financial statements to evaluate the significance of financial instruments for its *financial position and performance*. This part of IFRS 7 disclosures focuses mainly on providing a breakdown of the amounts recognised in the balance sheet and income statement.
 - (b) Part 2: requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risks *arising from financial instruments* to which the entity is exposed at the end of the reporting period.
12. It is important to note that IFRS 7 only requires information to be disclosed with regard to the nature and extent of risks arising from *financial instruments*. That is because the scope of IFRS 7 is all about financial instruments. In other words, IFRS 7 does not require an entity to provide information on the extent to which non-financial instruments expose the entity to risk.
13. The diagram below illustrates what information IFRS 7 provides today.



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Reporting on the entity's overall risk exposure

14. Information on entities' overall risk exposure (the 'top-down' approach) would undoubtedly be useful to users of financial statements. However, providing such information as part of a disclosure package on hedge accounting raises some issues.
15. Reporting an entity's overall risk position is a much broader proposition than focusing on hedge accounting and on the related risks being managed. Consequently, it may not be appropriate (or indeed realistic) to require a 'top-down' approach as part of this project.
16. Because IFRSs do not currently require an entity to provide information on the total exposure that it has, the Board would have to consider the following issues (and this list is not comprehensive) if it pursues a 'top-down' approach:
 - (a) should entities be required to disclose their total risk exposure even if they do not apply hedge accounting?
 - (b) what risk exposures should be included and what risks should be excluded from such a disclosure?
 - (c) to what extent should an entity provide information on risk exposures on forecast transactions?
 - (d) how should entities deal with overlapping risks for a particular item?
17. The Board would also need to consider the time that it would take to develop related guidance, and its effect on the project timeline.

Reporting on the exposure attributable to the hedged risk

18. An alternative ('bottom-up') approach could be to require disclosures around the exposure that an entity has hedged. In other words, this would mean disclosing information about what exposure the entity has to the risk being hedged in its risk management process.

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19. For example, if an entity hedges its price risk on coffee bean purchases, it would provide information on the (material) exposure that the entity has to this specific price risk. Or, if the entity hedges its fixed interest rates, it would provide information on the exposure that the entity has with respect to fixed interest rates.
20. Entities do not (often, cannot) track *all* the exposures that they have. Consequently, the disclosures under this approach would be to provide information on those exposures the entity tracks as part of its risk management. For example, assume that an entity has total coffee bean purchases of £150. Of that amount, £50-worth of purchases are carried out by smaller subsidiaries, and the company does not track those purchases as part of its central treasury function. The entity will therefore provide information on the price risk exposure that the entity has on its £100 of coffee bean purchases from its larger subsidiaries.
21. This approach:
 - (a) expands IFRS 7 disclosures to include the exposure to a specific risk for financial *and* non-financial items when an entity applies hedge accounting; and
 - (b) limits the disclosures on the risk exposure of the entity to only those exposures that are tracked as part of the risk management process.

Staff recommendation and question to the Board

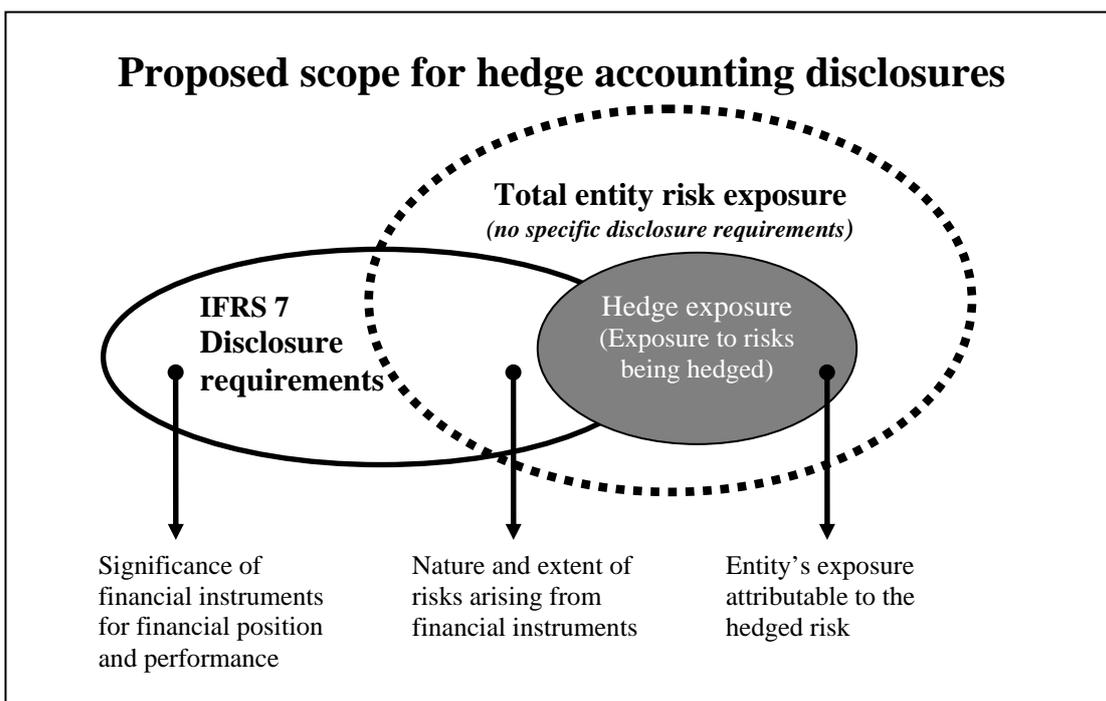
22. The staff recommend that the Board should:
 - (a) expand IFRS 7 disclosures to include the exposure to a specific risk for financial and non-financial items when an entity applies hedge accounting; and
 - (b) limit hedge accounting disclosures about the risk the entity is exposed to, to only those exposures that are tracked as part of the risk management process.

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23. The staff thinks that if the Board wants to develop disclosures about an entity’s total risk exposure, this would be better suited to a different or separate (possibly future) project. For example, the Board’s project on management commentary proposed disclosures along this line. Paragraph 30 of Exposure Draft ED/2009/6 *Management Commentary* states:

Disclosures of an entity’s principal risk exposures, its plans and strategies for bearing or mitigating those risks, and the effectiveness of its risk management strategies, helps users to evaluate the entity’s risks as well as its expected outcomes. It is important that management distinguish the principal risks and uncertainties facing the entity, rather than listing all possible risks and uncertainties.

24. The diagram below illustrates the staff’s proposed scope for hedge accounting disclosures.



Question

Does the Board agree with the staff recommendation in paragraph 22?

If not, why not, and what would the Board propose and why?