Project	**Financial Instruments: Hedge Accounting**
Topic	**Disclosures—Statement of Financial Accounting Standards No. 161 *Disclosures about Derivative Instruments and Hedging Activities***

Purpose of this paper

1. Some respondents to the IASB's hedge accounting exposure draft commented that they believed that the IASB should aim to achieve convergence with the disclosure requirements in the FASB's Statement of Financial Accounting Standards No. 161 *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161)[1]. They believed that the tabular disclosures in the exposure draft go some way in achieving convergence with these requirements, but that the IASB should also aim to achieve convergence on other aspects in SFAS 161. It is worth noting that this was only raised by respondents from the United States.
2. This paper provides an analysis of how SFAS 161 is different to the hedge accounting disclosures proposed in the exposure draft and IFRS 7 *Financial Instruments: Disclosures.*
3. This paper does not ask the Board for a decision.

[1] SFAS 161 has been included in topic ASC 815 *Derivatives and Hedging* in the FASB's codification. This paper refers to SFAS 161 for ease of reference.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

Background

4. According to the introduction of SFAS 161, the FASB Statement of Financial Accounting Standards No. 133 *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) does not provide adequate information about how derivative and hedging activities affect an entity's financial position, financial performance and cash flows. SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about:

    (a) how and why an entity uses derivative instruments;

    (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations; and

    (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows.

5. The FASB decided to limit the scope of its disclosure project to **derivative instruments** because of its desire not to delay the improved transparency about the location and amounts of derivative instruments in an entity's financial statements.

A comparison of SFAS 161 and IFRSs (*Hedge Accounting* exposure draft and IFRS 7)

6. The staff have prepared a table illustrating the main differences between SFAS 161, IFRS 7 and the proposed hedge accounting disclosure requirements. This is followed by a short discussion of the main differences.

SFAS 161	IFRS (*Hedge Accounting* exposure draft and IFRS 7)
Scope Generally the disclosure requirements only apply to **derivative instruments**. However, some disclosures also apply to non-derivative instruments that are designated and qualify as hedging instruments.	**Scope** *Exposure draft* The proposed disclosure requirements apply to risk exposures the entity decides to hedge and **for which hedge accounting is applied**. *IFRS 7* The disclosures apply to all **financial instruments** (not only derivative instruments).

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Objectives

Disclose information that enables users of financial statements to understand:

(a) how and why an entity uses derivative instruments;

(b) how derivative instruments and related hedged items are accounted for under SFAS 133 *Accounting for Derivatives and Hedging Activities* and related interpretations; and

(c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows.

(SFAS 133 has been included in topic ASC 815 *Derivatives and Hedging* in the FASB's codification.)

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Objectives

Exposure draft

Disclose information that enables users of financial statements to understand:

(a) an entity's risk management strategy and how it is applied to manage risk;

(b) how the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and

(c) the effect that hedge accounting has had on the entity's statement of financial position, statement of comprehensive income and statement of changes in equity.

IFRS 7

Disclose information that enables users of financial statements to understand:

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from the financial instruments to which the entity is exposed during and at the end of the period, and how the entity manages those risks.

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Disclosures about how the instruments are used	**Disclosures about how the instruments are used**
The entity shall explain the objective for holding (or issuing) derivative instruments (or non-derivative instruments that are designated and qualify as hedging instruments). The disclosure shall distinguish between those instruments used for risk management purposes and those used for other purposes.	*Exposure draft* An entity shall explain its risk management strategy for each category of risk exposure that it decides to hedge and for which hedge accounting is applied. This includes a description of how the entity uses the financial instrument to manage the risk exposure arising from the hedged item. *IFRS 7* IFRS 7 does not have any direct disclosure requirement to provide information on how and why particular financial instruments are used. However, IFRS 7 does require qualitative and quantitative disclosures about the nature and extent of risks arising from financial instruments and how they are managed. As a result, entities would have to discuss their hedging activities and risk management strategies so that users understand the nature and extent of risks arising from financial instruments. However, IFRS 7 does not have requirements as specific as those of SFAS 161 in this regard.

Tabular disclosure for amounts in the balance sheet	**Tabular disclosure for amounts in the balance sheet**
(a) The amount and location of the fair value amounts of derivative instruments reported in the statement of financial position. (b) Information shall be separated by: (i) asset and liability amounts; (ii) those instruments that are designated as hedging instruments and those that are not designated as hedging instruments; and (iii) type of derivative contract.	*Exposure draft* (a) The notional amount and fair value of the hedging instruments. (b) The change in value on the hedged item presented in a separate line item in the balance sheet[2]. (c) The carrying amount of the cash flow hedge reserve. (d) The information shall be separated by[3]: (i) asset and liability amounts; (ii) type of hedge; and (iii) risk category. *IFRS 7* There is no specific requirement for tabular disclosures. IFRS 7 requires disclosures of the carrying values of financial instruments.

[2] At the 27 April IASB meeting, the Board tentatively decided to the change to proposed presentation of fair value hedges. Refer to agenda paper 3 of that meeting.
[3] The Board did not propose a specific level of aggregation or disaggregation for the information to be disclosed (ie by type of contract). Rather, the Board proposed that entities consider the level of aggregation and disaggregation of other disclosures in IFRS 7 for the purpose of determining the appropriate level of aggregation or disaggregation for the tabular disclosures.

Tabular disclosures for amounts in the statement of comprehensive income	**Tabular disclosures for amounts in the statement of comprehensive income**
(a) The location and amount of gains or losses, separated as follows: (i) Derivatives designated as hedging instruments in fair value hedges and the related hedged items. (ii) Gains or losses on derivative instruments designated in cash flow hedges recognised in OCI. (iii) Gains and losses on derivative instruments designated in cash flow hedges, which was reclassified form AOCI. (iv) The amount of ineffectiveness recognised. (v) Derivative instruments not designated or that do not qualify as hedging instruments. (b) The above disclosures shall be separated by type of derivative contract.	*Exposure draft* (a) The location and amount of gains or losses, separated as follows: (i) Change in the value of the hedged item and hedging instrument for fair value hedges. (ii) Changes in the value of the hedging instrument recognised in OCI for cash flow hedges. (iii) Hedge ineffectiveness recognised in profit or loss. (iv) Amount reclassified form AOCI. (b) The above disclosures shall be separated by type of hedge and category of risk. *IFRS 7* There is no specific requirement for tabular disclosures. IFRS 7 requires disclosures of the carrying values of financial instruments and related gains or losses.

Disclosures about derivative instruments that are not designated or do not qualify as hedging instruments	**Disclosures about derivative instruments that are not designated or do not qualify as hedging instruments**
An entity may elect not to separately disclose gains or losses on derivative instruments that are not designated as hedging instruments by type of contract. In that case the following must be disclosed: (a) amount and location of the gains and losses; and (b) a description of the nature of its trading activities and related risks and how the entity manages those risks. These disclosures will be separated by major type of item (for example, foreign exchange, equity, commodity and credit).	*Exposure draft* There is no equivalent disclosure requirement for items that do not qualify for hedge accounting or for which hedge accounting is not applied—it is outside the scope of the exposure draft to address this as it is document about hedge accounting. *IFRS 7.* IFRS 7 focuses on the effects of financial instruments on financial statements, how those instruments expose the entity to risks and how those exposures are managed. IFRS 7 does not require specific disclosures to indicate which derivatives are designated as hedging instruments and which are not—although some entities choose to provide this separation to explain their hedging activities.

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Credit-risk related contingent features

Derivative instruments often contain contingent features that could result in an immediate payment to a counterparty on an agreement that is in a liability position. In that case the following must be disclosed:

(a) The existence and nature of credit-risk related contingent features and the circumstances in which the features could be triggered.

(b) The aggregate fair value of the derivative instruments that contain credit-risk related contingent features.

(c) The aggregate fair value of assets, which are already posted as collateral at the end of the reporting period, and the aggregate fair value of additional assets that would be required to be posted if the credit-risk related contingent feature were triggered.

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Credit-risk related contingent features

Exposure draft

No equivalent disclosure requirement—it is outside of the scope of the exposure draft as it is not specific to hedge accounting.

IFRS 7

There is no specific requirement in IFRS 7. However, IFRS 7 does require an entity to disclose:

(a) qualitative disclosures about exposures to risk and how those exposures are managed; and

(b) quantitative disclosures about risk exposures based on information provided to key management personal

(As part of the application guidance of quantitative liquidity risk disclosures, paragraph B11F(f) of IFRS 7 contains a similar disclosure requirement).

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Staff analysis

Scope of the disclosure requirements

7. SFAS 161, the IASB's exposure draft on hedge accounting and IFRS 7 all have a different focus. This is clear when comparing the scope and the objectives of each. For example:

   (a) **SFAS 161**—focuses on how and why an entity uses **derivatives.** The standard is relevant whether applying hedge accounting or not. (It also applies to non-derivatives designated as hedging instruments).

   (b) **IFRS 7**—focuses on **financial instruments** (not just derivatives) and the risks they expose an entity to and how those risks are managed. it is not limited to when hedge accounting is applied.

   (c) **Hedge accounting exposure draft**—focuses on how and why an entity uses financial instruments (**hedging instruments**) to manage risk exposures (arising from hedged items). These disclosures only apply if an entity hedges a risk exposure **and** elects to apply hedge accounting.

8. The proposed hedge accounting disclosures in the exposure draft will (subject to changes made during redeliberations) ultimately replace the hedge accounting disclosures currently in IFRS 7. If the Board wanted to consider convergence between SFAS 161 and IFRS 7, it would need to:

   (a) consider amending IFRS 7 to include an objective of providing information that enables users of financial statements to understand **how and why** an entity uses a derivative instrument (irrespective of electing to use hedge accounting).

   (b) consider whether it would want to investigate disclosures about how and why **derivatives** are being used or extend this to **financial instruments** more generally.

9. The staff thinks that exploring such disclosure requirements falls outside the scope of the hedge accounting project. That is because this information is focused on **all** derivative instruments (or possibly all financial instruments depending on the scope) an entity holds whether designated as hedging instruments or not. In other words, irrespective of whether an entity elects to apply hedge accountiwhether would be required to disclose how and why it uses its derivative instruments. Consequently, the staff believe that exploring such disclosures would require a holistic consideration of IFRS 7 rather than a specific consideration of hedge accounting[4].

10. Refer to agenda paper 1A for a discussion of the scope of the IASB's proposed hedge accounting disclosures.

How and why the entity uses the instruments

11. Both SFAS 161 and the proposed hedge accounting disclosures require some information to be disclosed about the objectives of holding hedging instruments. However, as mentioned above, the scope of the documents are different. for derivatives SFAS 161 goes beyond just hedging instruments. However, for non derivatives SFAS 161 limits the information to be disclosed to instruments designated as hedging instruments.

12. Consequently, SFAS 161 and the proposed hedge accounting disclosures should provide similar information for the purpose of understanding how an entity manages a particular risk using a particular hedging instrument. However, SFAS 161 has more specific disclosure requirements on the objectives of holding derivative instruments, for which an entity elects **not** to apply hedge accounting. However, IFRS 7 requires qualitative and quantitative disclosures about the nature and risks arising from financial instruments. Consequently, albeit not as specific as SFAS 161, IFRS 7 does

[4] Any extension of the scope of the proposed disclosure requirements would result in a re-exposure of the disclosure requirements in the hedge accounting exposure draft.

provide disclosures about risks and risk management for derivatives (and other instruments) for which hedge accounting is not applied.

13. Refer to agenda paper 1B for a discussion of the IASB's proposed disclosure requirements about the entity's risk management strategy.

Tabular disclosures

14. Both SFAS 161 and the proposed hedge accounting disclosures require some information to be disclosed in tabular format so that users of financial statements can understand how hedge accounting has affected the financial statements.

15. However, SFAS 161 also requires tabular disclosures that distinguish between derivatives designated as hedging instruments and those that are not. The IASB's exposure draft does not require this information.

16. The tabular disclosures of SFAS 161 and the proposed hedge accounting disclosures are similar in that they both require the following information:

    (a) The fair value of the hedging instruments.

    (b) For fair value hedges, the amount of ineffectiveness recognised in profit or loss.

    (c) For cash flow hedges and hedges of net investments in foreign operations:

        (i) the amount recognised in OCI;

        (ii) the amount reclassified from OCI; and

        (iii) the ineffectiveness recognised in profit or loss.

17. However, there are some differences between the tabular disclosures. These differences are as follows:

    (a) The hedge accounting exposure draft requires all the amounts recognised in the balance sheet that relate to hedge accounting to be disclosed. This includes the balance of the cash flow hedge reserve.

These amounts shall be separated by each category of risk being managed. SFAS 161 does not require the same information.

(b) SFAS 161 requires the information to be disclosed by type of derivative contract. in contrast our proposed hedge accounting disclosures do not prescribe the level of aggregation or disaggregation. For the purpose of the hedge accounting disclosures, entities have to apply judgment and consider the level of aggregation or disaggregation used for other disclosures in IFRS 7 (and IFRS 13 *Fair Value Measurement*).

(c) The hedge accounting exposure draft requires entities to disclose the separate line item recognised in profit or loss as a result of a hedge of a net position by risk category. SFAS 161 has no such requirement because that specific accounting treatment is not allowed in US GAAP and thus is not relevant.

(d) SFAS 161 requires that the information about recognised gains and losses be disclosed by type of derivative contract. The IASB's hedge accounting exposure draft requires information about gains and losses to be disclosed by type of risk category.

18. The tabular disclosures in SFAS 161 have a different focus than the proposed tabular disclosures in the exposure draft.

(a) SFAS 161: the tabular disclosures provide information about hedging instruments and hedged items from an accounting perspective. In other words, it focuses on dissecting the information based on the hedging relationships.

(b) The IASB exposure draft: the tabular disclosures provide information about each hedging strategy under each risk category. In other words, it focuses on dissecting the information based on the hedging strategies.

19. Refer to agenda paper 1C for a discussion of the IASB's proposed disclosures about the effects of hedge accounting on the financial statements.

Amount, timing and uncertainty of future cash flows

20. the IASB's exposure draft is focussed on disclosures from a risk perspective. TheRefore the IASB's exposure draft proposes that entities disclose quantitative information so that users of financial statements can evaluate the types of risk exposures being managed in each risk category, the extent to which each type of risk exposure is hedged and the effect of the hedging strategy on each type of risk exposure.

21. SFAS 161 does not contain similar requirements.

22. Refer to agenda paper 1D for a discussion of the IASB's proposed disclosures about amount, timing and uncertainty of future cash flows.

Credit-risk related contingent features

23. SFAS 161 requires disclosures about credit-risk related contingent features. These disclosures provide users of financial statements with information on contingent features that could result in an immediate payment to a counterparty on an agreement that is in a liability position.

24. Because credit-risk related contingent features are not directly linked to hedge accounting, the IASB's hedge accounting exposure draft does not require such information to be disclosed. However, the staff note that paragraph B11F(f) of IFRS 7 requires similar information to be disclosed. That paragraph states that an entity should consider providing disclosure whether the entity as instruments that include accelerated repayment terms (eg on the downgrade of the entity's credit rating). Paragraph B11F(f) is part of the application guidance in IFRS 7 on quantitative liquidity risk disclosures.

25. As mentioned earlier in this paper, the scope of SFAS 161 is different to that of the IASB's exposure draft on hedge accounting and IFRS 7. If the board

wants to address this issue the staff believes that disclosures about credit-risk related contingent features in derivative instruments are something that should be considered more comprehensively in the context of IFRS 7 and not as part of hedge accounting (see agenda paper 1A for a discussion of the scope of the IASB's proposed hedge accounting disclosures).