IFRS Accounting

Staff paper

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IFRS® Interpretations Committee meeting

Date	**November 2025**
Project	**Classification of Gains and Losses on a Derivative Managing a Foreign Currency Exposure (IFRS 18)**
Topic	**Initial consideration**
Contacts	Iliriana Feka (ifeka@ifrs.org) Stefano Tampubolon (stampubolon@ifrs.org)

Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about how an entity applies IFRS 18 *Presentation and Disclosure in Financial Statements* to classify any gain or loss on a derivative financial instrument in its consolidated statement of profit or loss. The derivative is a forward contract that is used to manage the foreign currency risk of a net liability exposure, but is not designated as a hedging instrument in accordance with IFRS 9 *Financial Instruments*.

2. The objective of this paper is:
   (a) to provide the Committee with a summary of the matter;
   (b) to present our research and analysis; and
   (c) to ask the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure of this paper

3. This paper includes:
   (a) summary of the submission;

(b) evidence of 'widespread and material effect';

(c) staff analysis;

(d) whether to add a standard-setting project to the work plan; and

(e) staff recommendation.

4. There are two appendices to this paper:

(a) Appendix A—suggested wording for the tentative agenda decision; and

(b) Appendix B—the submission.

Summary of the submission

5. Appendix B to this paper reproduces the submission, which provides further details about the fact pattern, the question and the views identified by the submitter. We provide a summary of the submission below.

The fact pattern

6. An entity (Parent P) has three subsidiaries—Subsidiary A, Subsidiary B and Treasury Entity that it when preparing its consolidated financial statements (group). Subsidiaries A and B have the same functional currency (LC) and have the following loans denominated in a foreign currency (FC):

(a) Subsidiary A issued a loan to a third party of FC100 (investing asset);

(b) Subsidiary B obtained a loan from another third party of FC120 (financing liability).

7. Applying paragraph 49 of IFRS 18, Parent P assesses that it does not have a specified main business activity of investing in particular types of assets or of providing financing to customers. Consequently, in its consolidated financial statements, Parent P classifies the interest income from the investing asset and the interest expense from the financing liability in the *investing* and *financing* category, respectively.

8. Applying paragraph B65 of IFRS 18, Parent P classifies any foreign exchange differences in the same category as the interest income and interest expense from those financial instruments.

9. To manage the foreign currency risk of the group's net liability exposure, Treasury Entity enters into a forward contract with a *third party* at a notional amount of FC20 to sell local currency and buy foreign currency (external derivative).

10. The fact pattern states that, consistent with the group's risk management policy, the purpose of the external derivative is to manage the foreign currency risk of the net liability exposure, *not* the group of *gross exposures* that make up the net exposure.

11. Parent P does *not* designate the external derivative in a hedging relationship in accordance with IFRS 9.

12. Treasury Entity also enters into intercompany derivatives (internal derivatives) with:

    (a) subsidiary A at a notional amount of FC100, to sell foreign currency and buy local currency; and

    (b) subsidiary B at a notional amount of FC120, to sell local currency and buy foreign currency.

The question

13. The submission asks how Parent P, applying IFRS 18, classifies any gain or loss on the external derivative in its consolidated statement of profit or loss. Specifically, in which category of the statement of profit or loss is Parent P required to classify such gains or losses. The submitter identifies three views:

    (a) **View 1**—in the *financing* category, as the single category affected by the risk managed with the external derivative. Proponents of this view note that the external derivative is used to manage the foreign currency risk of the net liability exposure (surplus financing liability of FC20), not the gross exposures which make up the net amount.

(b) **View 2**—in the *operating* category, because the prohibition described in paragraphs B72–B75 of IFRS 18 for 'grossing up' gains and losses on a derivative applies to the fact pattern in the submission.

(c) **View 3**—either in the *financing* or in the *operating* category. A reasonable reading of the applicable requirements results in Parent P classifying the gains or losses on the derivative in either the financing or the operating category.

14. The submission—reproduced in Appendix B—includes further information about the views and the rationale for those views.

Evidence of 'widespread and material effect'

15. The purpose of any information requests we send to stakeholders is to understand whether a submission meets the criteria in paragraph 5.16(a) of the IFRS Foundation's *Due Process Handbook*. We consider:

(a) the prevalence of the transaction or fact pattern submitted; and

(b) whether there is widespread diversity in the accounting applied to that transaction or fact pattern that has, or is expected to have, a material effect on those affected.

16. We did not send an information request related to the submission—and proceeded to analyse the question submitted—for the following reasons:

(a) most entities are in the process of applying—but have not yet applied—IFRS 18. Accordingly, stakeholders would be unable to comment on the existence of diversity in the application of the applicable requirements.

(b) the submitter notes:

(i) derivatives used to manage foreign currency risk of net exposures are a common feature of groups' treasury risk management strategies and, therefore the question in the submission, which relates to classification of gains and losses on such derivatives, is widespread.

(ii) they are aware of entities concluding the requirements are unclear as those entities work through their IFRS 18 implementation projects.

(c) we have had informal conversations with some stakeholders (including for example, accounting firms) that have confirmed the points in paragraph (b). Those stakeholders have informed us about discussions they have had on the same question as that raised by the submitter and these conversations have confirmed that stakeholders understand the applicable requirements differently.

17. In our view, the evidence gathered indicates the matter could have widespread effect and could have a material effect on those affected because:

(a) the question affects all entities that use derivatives to manage identified risks, such as foreign currency exposure, but do not designate such derivatives as hedging instruments applying IFRS 9.

(b) differences in understanding the applicable requirements could result in diversity in applying those requirements once IFRS 18 becomes effective.

18. We obtained sufficient understanding of the widespread effect of the matter from the evidence referred to in the submission and from discussions with stakeholders and, therefore, did not perform outreach on the submission.

Staff analysis

The applicable requirements in IFRS 18

19. Paragraph 47 of IFRS 18 requires an entity to classify income and expenses in one of five categories in the statement of profit or loss: the operating category, the investing category, the financing category, the income taxes category, or the discontinued operations category.

20. In addition, paragraphs B65–B76 of IFRS 18 set out requirements on how foreign exchange differences, the gain or loss on the net monetary position, and gains and losses on derivatives and designated hedging instruments are classified in these categories. Specifically, IFRS 18 requires:

    (a) in paragraph B70, that an entity classifies gains and losses included in the statement of profit or loss on a financial instrument designated as a hedging instrument applying IFRS 9 in the same category as the income and expenses affected by the risks the financial instrument is used to manage.

    (b) in paragraph B72, that an entity also applies the requirements in paragraph B70 of IFRS 18 to classify gains and losses on a derivative that is not designated as a hedging instrument applying IFRS 9, but is used to manage identified risks. However, if doing so would require the grossing up of gains or losses or involve undue cost or effort, the entity shall instead classify all such gains and losses on the derivative in the operating category.

21. Paragraph B74 of IFRS 18 provides application guidance about situations in which a grossing up of gains and losses on a derivative might arise, stating (emphasis added):

> … The grossing up of gains and losses might arise from situations in which:
>
> (a) an entity uses financial instruments to manage the risks of a group of items with **offsetting risk** positions (see paragraph 6.6.1 of IFRS 9 for the criteria for a group of items to be an eligible hedged item); and
>
> (b) the risks managed affect line items in **more than one category** of the statement of profit or loss.

22. In this context, paragraph B75 of IFRS 18 provides an example in which grossing up of gains or losses on a derivative might arise, hence the prohibition applies (emphasis added):

For example, an entity may use a derivative to manage **both** the net foreign currency risk on revenue (classified in the operating category) and interest expenses (classified in the financing category). In such cases, the foreign exchange differences on the revenue are offset by the foreign exchange differences on the interest expenses and the gains or losses on the derivative. However, the entity classifies the foreign exchange differences on the revenue in a different category from the foreign exchange differences on the interest expenses. **To present the gain or loss on the derivative <u>in each category</u>**, an entity would need to present in each category a **<u>larger gain or loss</u> than occurred on the derivative**. Applying the requirements in paragraphs B70–B73, an entity shall not gross up the gains or losses in this manner and instead shall classify any gain or loss on the derivative in the operating category.

23. Paragraphs BC223–BC235 of the Basis for Conclusions on IFRS 18 set out the IASB's rationale for the requirements in paragraphs B70–B75 of IFRS 18.

Applying the requirements in IFRS 18 to the fact pattern

24. As noted in paragraph B76 of IFRS 18, the requirements in IFRS 18 specify *only* how to classify income and expenses into categories of the statement of profit or loss. They do not prescribe the line items in which to include such income and expenses, nor do they override the requirements in other IFRS Accounting Standards. Accordingly, we only analyse the classification of gains and losses in categories of the statement of profit or loss, not their presentation in line items.

25. Furthermore, we considered application of the requirements in IFRS 18 only to gains and losses on the external derivative, not on the internal derivatives. That is because:

    (a) the submission asks how Parent P classifies in its *consolidated* statement of profit or loss any gains or losses on the *external derivative*.

(b) as the IASB noted in paragraph BC6.144 of the Basis for Conclusions on IFRS 9, for financial reporting purposes, the mitigation or transformation of risk is generally only relevant if it results in a transfer of risk to a party *outside the reporting entity*. Any transfer of risk within the reporting entity does not change the risk exposure from the perspective of that reporting entity as a whole. This is consistent with the principles of consolidated financial statements.

26. Accordingly, in the fact pattern described, the external derivative represents the financial instrument used to manage the identified risk.

27. Based on the application guidance in paragraphs B70–B76 of IFRS 18, an entity first needs to identify the risks that the financial instrument is used to manage. This then enables the entity to determine the categories in profit or loss that are affected by that risk and the resulting classification outcome for gains or losses on that instrument.

The risks the external derivative is used to manage

28. Entities typically enter into derivatives in accordance with their risk management policies. Therefore, an entity is generally expected to identify the risk managed using a derivative based on facts and circumstances and its risk management policy.

29. Paragraphs BC227–BC228 of the Basis for Conclusions on IFRS 18 explain the IASB's rationale for requiring entities to identify the link between the derivative and the risk it uses the derivative to manage. The IASB noted that entities typically enter into derivatives in accordance with approved risk management policies. Accordingly, an entity is typically expected to have the information necessary to determine the link between a derivative and the risk the entity uses the derivative to manage.

30. However, in cases when identifying gains or losses affected by the risks managed using derivatives not designated in a hedging relationship involve undue cost or effort, the IASB decided to require an entity to classify gains and losses in the operating category, rather than in the category affected by the identified risk.

31. Based on the fact pattern in the submission, and from talking with the submitter, we understand that the external derivative is:

    (a) *only* used to manage the foreign currency risk of the *net liability exposure*.

    (b) *not* used to manage the foreign currency risk of the gross exposures—the investing asset and the financing liability.

32. Accordingly, the risk that the external derivative is used to manage is the foreign currency risk of the net liability exposure of FC20, representing the surplus of financing liabilities (FC120) over investing assets (FC100).

33. The fact pattern in the submission describes that the Treasury Entity also entered into internal derivatives with Subsidiary A and Subsidiary B. However, as described in paragraph 25 of this paper, the risks managed with the internal derivatives do not change the risk exposure from the perspective of the reporting entity as a whole (ie the group). Accordingly, we have not considered the risks managed using internal derivatives for purposes of this submission which asks about classification in Parent P's *consolidated* statement of profit or loss.

The categories affected by the risk managed using the external derivative

34. In the fact pattern described in the submission, Parent P classifies foreign exchange differences on financial liabilities in the financing category in its consolidated financial statements. Paragraph B72 of IFRS 18 requires entities to classify gains and losses in the same category as the income and expenses affected by the identified risk. Therefore, as the identified risk managed using the external derivative is the net *liability* exposure, Parent P classifies the gains or losses on the external derivative in the financing category, unless doing so would require grossing up of gains and losses or involve undue cost or effort.

35. As, in the fact pattern described, the link between the external derivative and the risk it uses to manage is identified, the undue cost or effort exemption described in paragraph 30 is not applicable.

Does classification in the financing category require grossing up gains or losses on the external derivative

36. Based on the application guidance in paragraphs B74–B75 of IFRS 18, we note that:

(a) paragraph B74 states that grossing up of gains or losses on derivatives might arise in situations in which an entity uses financial instruments to manage *offsetting risks,* and those risks affect line items in *more than one category*.

(b) paragraph B75 provides an example of such situations, illustrating further how grossing up of derivative gains or losses might otherwise arise and why it is prohibited. Specifically, the example illustrates:

(i) **management of offsetting risks that affect more than one category**. An entity that uses a single derivative to manage *both* the foreign currency risk on revenue (classified in the operating category) and on interest expenses (classified in the financing category). That is, two categories are affected by offsetting risks managed with one derivative.

(ii) **how grossing up might otherwise arise**. Consequently, classification of the single derivative's gains or losses in the two affected categories might involve grossing up. Specifically, as the items subject to risk management affect line items in different categories, the derivative's gains or losses would need to be grossed up into offsetting gross amounts to be presented in each of those categories individually.

(iii) **why grossing up is prohibited**. The resulting outcome is prohibited because, to present the gain or loss on the derivative in each category, the entity would need to present in each category a larger gain or loss than occurred on the derivative.

(iv) **how to avoid grossing up**. The entity is instead required to classify all gains or losses on the derivative in the operating category (the default category under IFRS 18). This is to avoid the grossing up of a single instrument's net gains or losses into offsetting gross amounts and recognising them in different categories.

37. Considering paragraphs B74–B75 of IFRS 18 together, we therefore think it is clear that grossing up of derivative's gains or losses:

(a) does not arise in situations in which an entity manages an identified risk which affects line items in a single category of the statement of profit or loss.

(b) might arise in situations in which an entity manages offsetting risks with a derivative and those risks affect line items in more than one category. That is because, to classify the gain or loss on the derivative in each of the categories affected, the entity would need to gross up, ie present in each category a larger gain or loss than occurred on the derivative. Such an outcome is prohibited by paragraphs B70 and B72 of IFRS 18.

38. Based on the fact pattern in the submission, the external derivative is used to manage only the net liability foreign currency exposure, which affects line items in a single category of the consolidated statement of profit or loss—the financing category. Therefore, classifying any gain or loss on the external derivative in the financing category would not require grossing up such gains or losses. As a result, the prohibition in paragraph B72 of IFRS 18 would not apply in this situation.

39. Based on our analysis in paragraphs 24–38, we agree with the consideration under View 1 in the submission that, in the fact pattern described, classifying gains or losses on the external derivative in the financing category would not require grossing up of its gains or losses. The prohibition in paragraph B72 of IFRS 18 would therefore not apply in such a situation.

40. However, if Parent P's risk management policy was to use the external derivative to manage the foreign currency risk of the gross exposures—the investing asset and the financing liability—such an approach would have affected line items in both the investing and the financing category. Consequently, classification of gains or losses on the external derivative in the two affected categories would have required grossing up of gains or losses. Therefore, the prohibition in paragraph B72 of IFRS 18 would have applied, requiring Parent P to instead classify all such gains or losses in the operating category, rather than in the categories affected by the managed risk.

View 2—classification in operating category as the prohibition for grossing up of gains and losses applies to the fact pattern

41. View 2 in the submission sets out an argument that the fact pattern described is similar to the example in paragraph B75 of IFRS 18 in which the prohibition for grossing up of gains or losses applies. Proponents of View 2 argue that, by analogy, the same prohibition also applies to the fact pattern presented in the submission.

42. We disagree with this analysis. As set out in paragraphs 24–38 of this paper, classification of gains or losses on the external derivative in the category affected by the risk being managed does not require grossing up of gains or losses. Therefore, the prohibition in paragraph B72 of IFRS 18 does not apply in the fact pattern described.

43. The fact pattern in the submission and the example in paragraph B75 of IFRS 18 differ in the identified risk(s) being managed using a derivative. Specifically, in the example in paragraph B75 of IFRS 18, the derivative is used to manage *both* the foreign currency risk on revenue and on interest expenses. In contrast, in the fact pattern in the submission, the derivative is used to manage *only* the foreign currency risk on the net liability exposure, not both the investing asset and the financing liability.

View 3—classification in either the operating or the financing category

44. View 3 in the submission states that a reasonable reading of the relevant requirements in IFRS 18 would result in an accounting policy choice—classifying the gains or losses on the external derivative either in the financing or in the operating category.

45. We disagree with this analysis. The requirements in paragraphs B72–B75 of IFRS 18 are clear—an entity is required to classify gains or losses on a derivative in the same category as the income and expenses affected by the risks the derivative is used to manage, unless this requires grossing up of gains or losses. In that case, any gains or losses on the derivative are instead classified in the operating category. Accordingly, there is no accounting policy choice.

Staff conclusion

46. Based on our analysis in paragraphs 24–45 of this paper, we conclude that, in the fact pattern described in the submission, classifying gains or losses on the external derivative in the financing category would not require grossing up of gains or losses. The prohibition in paragraph B72 of IFRS 18 would therefore not apply in the fact pattern.

Question for the Committee

Question for the Committee
1. Does the Committee agree with our analysis of the application of the requirements in IFRS 18 to the fact pattern as discussed in paragraphs 24–46 of this paper?

Whether to add a standard-setting project to the work plan

47. Paragraph 5.16 of the IFRS Foundation *Due Process Handbook* states that the Committee decides to add a standard-setting project to the work plan only if all of the following criteria are met:

(a) the matter has widespread effect and has, or is expected to have, a material effect on those affected;

(b) it is necessary to add or change requirements in IFRS Accounting Standards to improve financial reporting—that is, the principles and requirements in IFRS Accounting Standards do not provide an adequate basis for an entity to determine the required accounting;

(c) the matter can be resolved efficiently within the confines of the existing Standards and the *Conceptual Framework*; and

(d) the matter is sufficiently narrow in scope that the IASB or the Committee can address it in an efficient manner, but not so narrow that it is not cost-effective for the IASB or the Committee and stakeholders to undertake the due process required to change a Standard.

48. In our view, as set out in paragraph 17 of this paper (considering the evidence summarised in paragraph 16 of this paper), the criterion set out in paragraph 5.16(a) of the *Due Process Handbook* is met for this matter.

49. Based on our analysis set out in paragraphs 24–46 of this paper, we think the principles and requirements in IFRS 18 provide an adequate basis for an entity to determine the classification of gains or losses on a derivative that is used to manage an identified risk, but is not designated as a hedging instrument applying IFRS 9. Accordingly, we conclude that the criterion in sub-paragraph 5.16(b) of the *Due Process Handbook* is not met.

Staff recommendation

50. For the reasons described in paragraphs 47–49, we recommend that the Committee not add a standard-setting project to the work plan. We recommend that the Committee instead publish a tentative agenda decision that explains how an entity applies the requirements in IFRS 18 to the fact pattern described in the submission.

51. Appendix A to this paper sets out the suggested wording of the tentative agenda decision. In our view, the suggested tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Accounting Standards.[1]

Questions for the Committee

Questions for the Committee
2. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan?
3. Does the Committee have any comments on the wording of the tentative agenda decision as suggested in Appendix A to this paper?

[1] Paragraph 8.4 of the *Due Process Handbook* states: 'Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'

Appendix A—suggested wording for the tentative agenda decision

Classification of Gains and Losses on a Derivative Managing a Foreign Currency Exposure (IFRS 18 *Presentation and Disclosure in Financial Statements*)

The Committee received a request about how an entity applies the requirements in paragraphs B70–B76 of IFRS 18 to classify any gain or loss on a derivative financial instrument in its consolidated statement of profit or loss. The derivative is a forward contract that is used to manage the foreign currency risk of a net liability exposure, but is not designated as a hedging instrument in accordance with IFRS 9 *Financial Instruments.*

The request asks how the entity, applying IFRS 18, classifies any gain or loss arising from the derivative in its consolidated statement of profit or loss.

Fact pattern

An entity (Parent P) has three subsidiaries—Subsidiary A, Subsidiary B and Treasury Entity that it consolidates when preparing its consolidated financial statements. Subsidiaries A and B have the same functional currency (LC) and have the following loans denominated in a foreign currency (FC):

a. Subsidiary A issued a loan to a third party of FC100 (investing asset);

b. Subsidiary B obtained a loan from a different third party of FC120 (financing liability).

Applying paragraph 49 of IFRS 18, Parent P assesses that it does not have a specified main business activity of investing in particular types of assets or of providing financing to customers. Consequently, in its consolidated financial statements, Parent P classifies the interest income from the investing asset and the interest expense from the financing liability in the investing and financing categories respectively. Applying paragraph B65 of IFRS 18, Parent P classifies any foreign exchange differences in the same category as the interest income and interest expense from those financial instruments.

To manage the foreign currency risk of the group's net liability exposure, Treasury Entity enters into a forward contract with a third party at a notional amount of FC20 to sell local currency and buy foreign currency (external derivative).

Consistent with the group's risk management policy, the purpose of the external derivative is to manage the foreign currency risk of the net liability exposure, not the group of gross exposures that make up the net exposure.

Parent P does not designate the external derivative in a hedging relationship in accordance with IFRS 9.

Treasury Entity also enters into intercompany derivatives (internal derivatives) with:

a. subsidiary A at a notional amount of FC100, to sell foreign currency and buy local currency; and

b. subsidiary B at a notional amount of FC120, to sell local currency and buy foreign currency.

Applicable requirements

Paragraphs B70–B76 of IFRS 18 provide application guidance an entity applies when classifying gains and losses on derivatives and designated hedging instruments. Paragraph B72 of IFRS 18 requires an entity to classify gains and losses on a derivative that is not designated as a hedging instrument applying IFRS 9, but is used to manage identified risks, in the same category as the income and expenses affected by the risks that the derivative is used to manage. However, if doing so would require the grossing up of gains or losses or involve undue cost or effort, the entity is instead required to classify all gains or losses on the derivative in the operating category.

Paragraph B74 of IFRS 18 states that 'grossing up of gains and losses might arise from situations in which:

(a) an entity uses financial instruments to manage the risks of a group of items with offsetting risk positions; and

(b) the risks managed affect line items in more than one category of the statement of profit or loss'.

Paragraph B75 of IFRS 18 provides an example in which grossing up of gains or losses on a derivative might arise.

Applying the requirements

The Committee considered the application of the requirements only to gains or losses on the external derivative, not on the internal derivatives. That is because:

a. the request asked about the classification of gains and losses on the external derivative in the entity's consolidated statement of profit or loss.

b. as paragraph BC6.144 of the Basis for Conclusions on IFRS 9 explains, for financial reporting purposes, the mitigation or transformation of risk is generally only relevant if it results in a transfer of risk to a party outside the reporting entity. Any transfer of risk within the reporting entity does not change the risk exposure from the perspective of that reporting entity as a whole. This is consistent with the principles of consolidated financial statements.

The Committee observed that, based on the application guidance in paragraphs B70–B76 of IFRS 18, an entity first needs to identify the risk(s) a derivative is used to manage. This then enables the entity to determine the categories in profit or loss that are affected by that risk and the resulting classification of gains or losses on that derivative.

The risks the external derivative is used to manage

The Committee observed that, entities typically enter into derivatives in accordance with their approved risk management policies. Therefore, an entity is generally expected to be able to identify the risk managed using a derivative based on facts and circumstances and its risk management policy.

In the fact pattern described in the request, consistent with the group's risk management policy, the external derivative is used to manage only the foreign currency risk of the net liability exposure—not the gross exposures (the investing asset and the financing liability).

The categories affected by the risk managed using the external derivative

In the fact pattern described in the request, Parent P classifies foreign exchange differences on financial liabilities in the financing category of its consolidated statement of profit or loss.

Because the external derivative is used to manage foreign currency risk of a net *liability* exposure, applying paragraph B72 of IFRS 18, Parent P is required to classify any gain or loss on the external derivative in the financing category of its consolidated statement of profit or loss, unless doing so would require grossing up of gains and losses or involve undue cost or effort.

Applying IFRS 18, in cases when identifying gains or losses affected by the risks managed using derivatives not designated in a hedging relationship involve undue cost or effort, an entity is required to classify gains or losses in the operating category, rather than in the category affected by the identified risk. The Committee observed that, in the fact pattern described in the request, the link between the external derivative and the risk it uses to manage is identified. Consequently, the undue cost or effort exemption is not applicable.

Does classification in the financing category require grossing up gains or losses on the external derivative

Based on the requirements in paragraphs B74–B75 of IFRS 18, the Committee observed that the grossing up of gains and losses on a derivative:

(a) does not arise in situations in which an entity manages an identified risk which affects line items in a single category of the statement of profit or loss.

(b) might arise in situations in which an entity manages offsetting risks using a derivative and those risks affect line items in more than one category. That is because, to classify the gain or loss on the derivative in each of the categories affected, the entity would need to present in each category a larger gain or loss than occurred on the derivative. Such an outcome is prohibited by paragraphs B70 and B72 of IFRS 18.

The Committee observed that, in the fact pattern described in the request, the external derivative is used to manage only the net liability foreign currency exposure, which affects line items in a single category of the consolidated statement of profit or loss—the financing category. Therefore, classifying any gain or loss on the external derivative in the financing category would not require grossing up such gains or losses. As a result, the prohibition in paragraph B72 of IFRS 18 would not apply.

Consequently, the Committee concluded that, in the fact pattern described in the request, the entity is required to classify any gain or loss on the external derivative in the financing category of its consolidated statement of profit or loss.

Conclusion

The Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for the classification of gains or losses on a derivative that is used to manage an identified risk, but is not designated as a hedging instrument applying IFRS 9. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—Submission

Classification in profit or loss of gains and losses on derivatives economically hedging a net exposure

Background

It has come to our attention that there are diverse views on the application of the guidance in paragraph B70 to B76 of IFRS 18 to circumstances in which a derivative financial instrument is used to economically hedge the net exposure to risks classified in different categories of the statement of profit or loss, in particular on whether the prohibition on 'grossing up' expressed in paragraph B74 and illustrated in paragraph B75 should be read more broadly as excluding any approach which reflects an 'economic hedge'. We are seeking clarification by the IFRS Interpretations Committee ('the Committee') of the issue detailed below, which is illustrated by means of a simple example but can arise in a variety of circumstances.

Fact pattern

Parent P (which does not have a specified main business activity of either investing in assets or providing finance to customers) includes each of 'Subsidiary A', 'Subsidiary B' and 'Treasury Entity' in its consolidated financial statements.

Subsidiary A has a foreign currency denominated loan to a third party of FC100 and Subsidiary B has a foreign currency denominated loan from a different third party of FC120. Subsidiary A and B have the same functional currency (LC) and the foreign currency denominated items are in the same foreign currency. In both the subsidiaries' own financial statements and Parent P's consolidated financial statements, interest income and expense on the loan asset and liability are classified in the investing and financing categories respectively. Applying paragraph B65 of IFRS 18, foreign exchange differences on these items are classified in the same categories.

Treasury Entity executes an external forward contract, Sell LC16 and Buy FC20 to hedge the net foreign currency exposure of the asset and liability and immediately Treasury Entity enters into the following intercompany derivatives with the respective subsidiaries:

- Subsidiary A: Sell FC100, Buy LC80 – to hedge economically its foreign currency denominated asset for FX risk; and
- Subsidiary B: Sell LC96, Buy FC 120 – to hedge economically its foreign currency denominated liability for FX risk.

Applying the guidance in paragraph B72 of IFRS 18, Subsidiaries A and B classify (in their own financial statements) gains and losses on their derivatives with Treasury Entity in the investing and financing categories of profit or loss respectively (being the same categories in which foreign currency gains and losses on their external balances are presented in both the subsidiaries' own financial statements and Parent P's consolidated financial statements).

It is clear from the group's risk management policy that the purpose of the external derivative entered into by Treasury Entity is to hedge the group's net exposure to LC:FC foreign currency risks (as distinct from the aggregate of a group of gross exposures). Parent P does not, however, choose to designate a hedging relationship under IFRS 9 *Financial Instruments*.

Question and views

In which category of profit or loss are gains and losses on the external forward contract presented in Parent P's consolidated financial statements?

View 1 – In the financing category (reflecting its use as an economic hedge of the group's net exposure to LC:FC foreign currency risk)

Proponents of this view believe that it is clear, given the group's risk management strategy and the terms of the external derivative entered into, that the group is using its forward contract to economically hedge the net exposure arising from its external, foreign currency assets and liabilities (i.e. the excess of its financing liability over its investing asset).

As a result, proponents would apply the general requirement of paragraphs B70 and B72 of IFRS 18 and classify gains and losses on the derivative in the same category as that excess (i.e. financing). Further, they would not view this approach as resulting in 'grossing up' as the gain or loss presented in the financing category is the total gain or loss on the derivative instrument.

View 2 – In the operating category (applying the prohibition on 'grossing up' in paragraph B74 of IFRS 18)

Proponents of this view believe that the prohibition on 'grossing up' in paragraph B74 of IFRS 18 applies, noting the similarity of the circumstances described above with the example provided in paragraph B75 of IFRS 18 (an entity managing foreign exchange risk on revenue (classified in the operating category) and interest expense (classified in the financing category) with a single derivative).

Proponents further believe that the example in paragraph B75, by omission, rules out the possibility of presenting the full gain or loss on a derivative instrument in the same category as the larger of two offsetting risks (in that example, foreign exchange on the larger financing liability), as after ruling out the 'gross up' of derivative gains and losses in more than one category of profit or loss it simply states that classification in the operating category is required without limiting that statement to the specific example in paragraph B75 where the larger of the two offsetting risk arises in respect of a revenue transaction.

View 3 – Accounting Policy Choice

Under this view, neither the arguments for View 1 nor those for View 2 can be dismissed. As a result, either conclusion can be supported.

Reasons for the Committee to address the issue

Divergent views on this matter exist and we believe these issues should be addressed in a timely manner ahead of the effective date of IFRS 18 because they will have widespread effect due to economic hedges of 'net exposures' being a common feature of group treasury strategies.