Irish Association of Corporate Treasurers

February 2011

MEMBERS' UPDATE
Accounting

Hedge accounting: practical implications of the IASB's proposals

The International Accounting Standards Board (IASB) has issued an exposure draft that proposes to overhaul the current requirements for hedge accounting under IFRS. The proposals address general hedging of financial and non-financial items and relaxes many of the onerous requirements of the existing rules that prohibited economically sensible risk management practices from achieving hedge accounting. The key provisions include

- The replacement of quantitative calculations (the 80% to 125% test) with a requirement for the hedge to be designated so as to be "neutral and unbiased", in a way that minimises expected ineffectiveness. This could be demonstrated qualitatively or quantitatively. For example, in a simple hedge where all the critical terms match, a qualitative test might be sufficient. On the other hand, in highly complex hedging strategies, some type of quantitative analysis would need to be performed.
- Although the 80-125% 'bright line' rule would be removed, hedge ineffectiveness must still be measured and reported in the profit or loss.
- Many of the restrictions that today prevent some economically rational hedging strategies from qualifying for hedge accounting would be removed. For example, components can be designated for non-financial hedged items provided the component is separately identifiable and measurable. This is good news for entities that hedge non-financial items for a commodity price risk that is only a component of the overall price risk of the item, as it is likely to result in more hedges of such items qualifying for hedge accounting.
- Similarly, gap hedging of net positions would be permitted if it is consistent with an entity's risk management strategy.
- The rules on using purchased options and non-derivative financial instruments as hedging instruments are revised. For example, the proposal views a purchased option as similar to an insurance contract such that the initial time value (that is, the premium generally paid) will be recognised in profit or loss – either over the period of the hedge if the hedge is time related, or when the item impacts profit or loss.

A final IFRS is expected by the end of Q3 2011. It is expected that the IFRS will not become mandatory until about three years after it is issued.

PwC have recorded a 60 minute webcast (http://www.pwc.com/en_GX/gx/audit-services/iasb-proposals-webcast.jhtml) on the practical impact of the exposure draft. The webcast highlights both the positive aspects of the exposure draft as well as those areas where it might not address current problems or have unintended consequences.

Further details are available at http://www.pwc.com/ie/en/banking/market-risk.jhtml

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This members' update is for general information only and should not be regarded as a substitute for tax, legal or other professional advice. Such advice should be taken before acting on or taking steps in relation to matters referred to in this document.

For further information please contact:

Ronan Doyle

Partner

PricewaterhouseCoopers

+ 353 1 792 6559

ronan.doyle@ie.pwc.com

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