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## IASB issues amendments to IAS 39 on eligible hedged items

On 31 July 2008, the International Accounting Standards Board (IASB) published amendments to IAS 39 **Financial Instruments: Recognition and Measurement** which provide clarification on two issues in relation to hedge accounting:

- identifying inflation as a hedged risk or portion; and
- hedging with options.

The amendments are effective for annual periods beginning on or after 1 July 2009.

### Purpose of the amendments

In September 2007, the IASB issued an Exposure Draft (ED) **Exposures Qualifying for Hedge Accounting** which aimed to clarify what is a qualifying portion of fair value or cash flows. The ED was intentionally broad and provided a list of those risks and portions that were deemed to be eligible for hedging. Following deliberation of constituents' comments, the IASB determined to finalise the amendments to IAS 39, but to limit those amendments by focussing on only two issues in respect of which diversity in practice is believed to exist, or is likely to occur.

### Identifying inflation as a hedged risk or portion

The amendments make clear that inflation may only be hedged in the instance where changes in inflation are a contractually-specified portion of cash flows of a recognised financial instrument. This may be the case where an entity acquires or issues inflation-linked debt. In such circumstances, the entity has a cash flow exposure to changes in future inflation that may be cash flow hedged. The amendments, therefore, do not permit an entity to designate an inflation component of issued or acquired fixed-rate debt in a fair value hedge as the Board considers that such a component is not separately identifiable and reliably measurable.

The amendments also clarify that a risk-free or benchmark interest rate portion of the fair value of a fixed-rate financial instrument will normally be separately identifiable and reliably measurable and therefore may be hedged.

### Hedging with options

IAS 39 permits an entity to designate purchased (or net purchased) options as a hedging instrument in a hedge of a financial or non-financial item. An entity may designate an option as a hedge of changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a one-sided risk).

The amendments make clear that the intrinsic value, not the time value, of an option reflects a one-sided risk and therefore an option designated in its entirety cannot be perfectly effective. The time value of a purchased option is not a component of the forecast transaction that impacts profit or loss. Therefore, if an entity designates an option in its entirety as a hedge of a one-sided risk arising from a forecast transaction hedge ineffectiveness will arise. Alternatively, an entity may choose to exclude time value as permitted by the Standard in order to improve hedge effectiveness. As a result of this designation, changes in the time value of the option will be recognised immediately in profit or loss.

### Effective date and transitional provisions

The amendments are to be applied retrospectively for annual periods beginning on or after 1 July 2009 in accordance with IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors**. Therefore, if an entity has a hedge accounting relationship which, following the amendments, would be considered non-qualifying, the entity must restate its comparative information, including the opening reserves, in order to reflect that hedge accounting was not applied in the reporting period. In some cases, this may result in the restatement of the cash flow hedge reserve to the retained earnings reserve. It is not permitted to restate the comparatives to reflect an alternative hedge accounting designation as hedge accounting can only ever be applied prospectively when all hedge accounting documentation is complete.

If the amendments are applied for a period beginning before 1 July 2009, that fact must be disclosed.

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