
Project	Financial Instruments: Replacement of IAS 39
Topic	Cover note

Introduction

1. The following papers will be discussed at this meeting:
 - (a) Agenda paper 8A: hedge accounting – balance sheet presentation for fair value hedges.
 - (b) Agenda paper 8B: hedge accounting – linked presentation for fair value hedges.
 - (c) Agenda paper 8C: illustrative examples.
 - (d) Agenda paper 8D: hedge accounting – linked presentation, alternative view.
2. These papers address different aspects of balance sheet presentation of fair value hedges. Agenda paper 8A discusses presentation issues relating to *equity volatility* and agenda paper 8B discusses presentation issues relating to *leverage volatility*.
3. Agenda paper 8A also discusses possible alternatives for income statement presentation for fair value hedges.

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.

IASB Staff paper

Equity volatility

4. At a previous meeting the Board tentatively decided to replace the fair value hedge accounting mechanics with those used for cash flow hedge accounting. The Board's tentative approach¹ largely aligns the mechanics used for cash flow hedge accounting and fair value hedge accounting resulting in a single presentation method for hedge accounting.
5. Under the Board's tentative approach, gains and losses on the effective portion of the hedging instrument are recognised in other comprehensive income (OCI).
6. This approach introduces volatility in equity for the portion of the fair value change of a derivative (or other hedging instrument) that is an effective fair value hedge.
7. Agenda paper 8A discusses the feedback received from the outreach activities on the Board's tentative approach and provides alternatives and a recommendation for the Board to consider.
8. *If* the Board agrees with the staff recommendation to address equity volatility by adopting the proposed 'separate balance sheet line item' approach, the Board should consider the second presentation issue – leverage volatility.
9. If the Board disagrees with that staff recommendation, then paper 8B is not relevant.

Leverage volatility

10. An accounting treatment other than cash flow hedge accounting results in the recognition of amounts as assets or liabilities for both the hedged item and the hedging instrument. Recognising these assets or liabilities impact the entity's leverage (that is the ratio of its debt to equity or total assets to equity or liabilities) resulting in more volatility for that measure.

¹ The Board tentatively decided to retain the difference between fair value hedges and cash flow hedges in relation to measuring and recognising hedge ineffectiveness (the 'lower-of' test).

IASB Staff paper

11. Agenda Paper 8B provides the Board with an analysis of the concerns raised about leverage volatility resulting from hedge accounting and discusses the feedback received from the outreach activities. That paper also discusses a possible way to address the leverage volatility issue by using linked presentation and asks the Board whether it wants to require linked presentation in the balance sheet to limit the effect of leverage volatility.