Hong Kong Institute of
Certified Public Accountants
香港會計師公會

HKFRS 9 *Financial Instruments* – Hedge Accounting

HKICPA Standard Setting Department Staff Summary (January 2014)

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The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk.

Introduction

1. The issuance of HKFRS 9 *Financial Instruments* (Hedge Accounting and amendments to HKFRS 9, HKFRS 7 *Financial Instruments: Disclosures* and HKAS 39 *Financial Instruments: Recognition and Measurement*) completes another phase of the project to replace HKAS 39.

2. The date when entities would be required to apply HKFRS 9 was previously stated at 1 January 2015. This mandatory effective date has been removed to provide sufficient time for preparers of financial statements to make the transition to the new requirements, which will now become effective from a later date yet to be announced.

Reasons for issuing amendments to HKFRS 9

3. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing amendments to HKFRS 9 is to maintain international convergence arising from the issuance of amendments to IFRS 9 by the International Accounting Standards Board (IASB).

4. The requirements related to hedge accounting are added to HKFRS 9 in this amendment.

Main features of the amendments

5. The amendments make three important changes to HKFRS 9:

   a) Firstly, a new chapter on hedge accounting has been added, which puts in place a new model that introduces significant improvements principally by aligning the accounting more closely with risk management. There are also improvements to the disclosures about hedge accounting and risk management.

   b) The second amendment allows changes to address the so-called 'own credit' issue that were already included in HKFRS 9 to be applied in isolation without the need to change any other accounting for financial instruments; and

c) The third change is to remove the 1 January 2015 mandatory effective date of HKFRS 9. The standard will now become effective at a later date to be announced later.

Hedge accounting

6. *Qualifying criteria for hedge accounting*

The 80-125% 'bright line' test contained in HKAS 39 is replaced by an objective-based model for testing hedge effectiveness which is performed on a prospective basis (that is retrospective assessment of hedge effectiveness is no longer required). In order to be considered as an effective hedge HKFRS 9 now requires:

- There is an economic relationship between the hedged item and the hedging instrument;
- The effect of credit risk does not dominate the value change in the hedge relationship; and
- A qualitative or a quantitative assessment to support that economic relationship may be needed, depending on the complexity of the hedge.

7. *Hedged items*

A key change brought about by HKFRS 9 is the ability to hedge a risk component of a non-financial item. Unlike HKAS 39, the hedge accounting model in HKFRS 9 allows greater flexibility which aligns the treatment of financial and non-financial items to also allow the hedging of risk components in non-financial items (for example, the oil price component of jet fuel price exposure), provided the component is separately identifiable and reliably measurable.

The amendments to HKFRS 9 also allow hedge accounting for investments in equity instruments for which an entity has elected to present changes in fair value in other comprehensive income.

8. *Accounting for the time value of options*

HKFRS 9 aligns the accounting for the time value with the risk management perspective. For transaction-related hedged items the cumulative change in the fair value of the option's time value should be accumulated in other comprehensive income and should be reclassified in a similar way to that for cash flow hedges.

For time-period related hedged items the nature of the time value of the option used as the hedging instrument is that of a cost for obtaining protection against a risk over a particular period of time. Hence, the cost of obtaining the protection should be allocated as an expense over the relevant period on a systematic and rational basis.

Similar changes have also been made to the accounting for the forward element of forward contracts and the foreign currency basis spread of hedging instruments.

9. *Modifying and discontinuing a hedging relationship*

HKAS 39 treats adjustments to an existing hedging relationship that are not envisaged at the inception of the hedging relationship as a discontinuation of the original hedging relationship and the start of a new one.

However, this treatment is inconsistent with risk management practices (e.g. such adjustments are often required to re-align the hedging relationship with risk management policies in view of changed circumstances).

As a result, the amendments allow certain changes to the hedge relationship after inception as part of a continuing hedging relationship without forcing discontinuation for the entire hedging relationship.

In accordance with HKAS 39, an entity also has a free choice to voluntarily discontinue hedge accounting by simply revoking the designation of the hedging relationship (i.e. irrespective of any reason). Under the amendments, an entity shall not voluntarily discontinue hedge accounting when the risk management objective has not changed for the hedging relationship.

10. *Disclosures*

Consequential amendments have been made to HKFRS 7 which introduce more disclosure requirements than currently required, and which will require all disclosures for hedge accounting to be presented in a single section in the financial statements.

Own credit

11. HKFRS 9 (2010) requires changes in the fair value of an entity's own debt caused by changes in its own credit quality to be recognised in other comprehensive income rather than in profit or loss. However, in order to apply this change entities were required to apply all of the requirements in HKFRS 9 that relate to the classification and measurement of financial instruments. This included changing how financial assets are classified.

The amendments allow an entity to change the treatment of the effects of changes in its own credit in isolation (that is, before applying any of the other classification and measurement requirements in HKFRS 9).

Mandatory effective date of HKFRS 9

12. Because the impairment phase of the project is not yet completed, a mandatory effective date of 1 January 2015 would not allow sufficient time for entities to prepare to apply HKFRS 9. Accordingly, the amendments made to HKFRS 9 in December 2013 remove the mandatory effective date from HKFRS 9. Entities may however still choose to apply HKFRS 9.

Other references on amendments to HKFRS/IFRS 9

1. Deloitte 'IFRS in Focus'

http://www.iasplus.com/en/publications/global/ifrs-in-focus/2013/hedging

2. Ernst & Young 'IFRS Developments'

   http://www.ey.com/Publication/vwLUAssets/EY-IFRS-Developments-Issue-68-IASB-issues-IFRS-9-2013-hedge-accounting-is-now-complete/$File/Devel68_BCM_Hedging_Nov2013.pdf

3. KPMG 'Financial Reporting Update'

   http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/Financial-Reporting-Update/Documents/Financial-Reporting-Update-1312-74.htm

4. PricewaterhouseCoopers 'Straight away'

   https://inform.pwc.com/inform2/show?action=informContent&id=1351203011214867