International Accounting Standards Board®

Press Release

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IFRIC publishes proposed guidance on hedges of a net investment in a foreign operation

The International Financial Reporting Interpretations Committee (IFRIC) has today released for public comment a draft Interpretation, IFRIC D22 *Hedges of a Net Investment in a Foreign Operation.* The proposal is open for public comment until 19 October 2007.

IFRIC D22 clarifies two issues that have arisen on two accounting standards—IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 39 *Financial Instruments: Recognition and Measurement*—about the accounting for hedging foreign currency risk within a company and its foreign operations. The IFRIC proposal clarifies what qualifies as a risk in the hedge of a net investment in a foreign operation and where within a group the instrument that offsets that risk may be held.

In some companies the currency that is used to present financial statements (the presentation currency) differs from the currency that the company or its foreign subsidiaries use daily and in which they generate net cash flows (the operating, or functional, currency). At present, some companies use hedge accounting when 'translating' that functional currency into the presentation currency. The IFRIC takes the view that this mere translation of currency for presentational use does not represent a hedgeable economic risk. Consequently, it proposes not to allow the use of hedge accounting when translating a functional currency into a presentation currency. The IFRIC concluded that the hedged risk is the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any parent entity within the group structure. Clarification was needed on whether a company could account for a hedged foreign currency risk only in the immediate parent entity, only in the main parent entity, or in those or any intermediate parent entity of the foreign subsidiary.

30 Cannon Street, London EC4M 6XH, United Kingdom
Telephone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411 Email: iasb@iasb.org Web: www.iasb.org

IFRIC D22 also considers which individual entity within a group structure can hold a hedging instrument. The IFRIC proposes that the hedging instrument can be held by any subsidiary or parent entity within a group regardless of the entity's functional currency. To assess how effective the hedging instrument is in offsetting the risk from the foreign operation, the company must calculate the change in value of the hedging instrument in the functional currency of the parent hedging its risk and not the functional currency of the subsidiary holding the instrument.

The IFRIC recognises the difficulty that entities would face in preparing adequate documentation from the inception of the hedge relationship. It therefore proposes that, if confirmed, the guidance should be applied prospectively, ie for all future transactions.

IFRIC D22 *Hedges of a Net Investment in a Foreign Operation* is available for eIFRS subscribers from today and will be freely available on the IASB Website from tomorrow.

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Press enquiries:

Mark Byatt, Director of Corporate Communications, IASB
telephone: +44 (0)20 7246 6472, email: mbyatt@iasb.org

Sonja Horn, Communications Adviser, IASB
telephone: +44 (0)20 7246 6463, email: shorn@iasb.org

Technical enquiries:

Robert Garnett, Chairman, IFRIC
telephone: +44 (0)20 7246 6410, email: rgarnett@iasb.org

Tricia O'Malley, IFRIC Co-ordinator
telephone:+44 (0)20 7246 6929, email: tomalley@iasb.org

About the IFRIC

The IFRIC is the interpretative body of the International Accounting Standards Board (IASB). Its objective is to review newly identified issues not specifically addressed in IFRSs or issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop in the absence of authoritative guidance. Any individual or organisation can ask for an issue to be put on the IFRIC's agenda. To be considered, those issues should be widespread and have practical relevance. The IFRIC comprises 12 voting members (all part-time) drawn from a variety of countries and professional backgrounds. They are appointed by the Trustees of the International Accounting Standards Committee Foundation and are selected for their ability to maintain an awareness of current issues as they arise and the technical ability to resolve them. IFRIC interpretations are subject to IASB approval and have the same authority as a standard issued by the IASB.