



HK(IFRIC)–Int 16 *Hedges of a Net Investment in a Foreign Operation*

HKICPA Standard Setting Department Staff Summary (August 2008)

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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. HK(IFRIC)–Int 16 *Hedges of a Net Investment in a Foreign Operation* is effective for annual periods beginning on or after 1 October 2008, the same effective date as IFRIC Interpretation 16 *Hedges of a Net Investment in a Foreign Operation*. Earlier application is permitted. If an entity had designated a hedging instrument as a hedge of a net investment but the hedge does not meet the conditions for hedge accounting in this Interpretation, the entity shall apply HKAS 39 *Financial Instruments: Recognition and Measurement* to discontinue that hedge accounting prospectively.

Reasons for issuing HK(IFRIC)–Int 16

2. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing HK(IFRIC)–Int 16 is to maintain international convergence arising from the issuance of IFRIC Interpretation 16 by the International Accounting Standards Board (IASB).

The issues addressed in the Interpretation were first published in a draft Interpretation D22 *Hedges of a Net Investment in a Foreign Operation* in July 2007. Due to the diverged practice as a result of differing views on which risks are eligible for hedge accounting, the International Financial Reporting Interpretations Committee (IFRIC) provides guidance on the following three issues in IFRIC Interpretation 16:

- identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation;
- where, within a group, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting; and
- how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item.



Main features of HK(IFRIC)–Int 16

The nature of the hedged risk and the amount of the hedged item for which a hedging relationship may be designated

3. Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the parent entity's functional currency (that is, the presentation currency does not create an exposure to which an entity may apply hedge accounting).
4. In respect of the amount that may be designated as a hedged item in a hedge of the foreign currency risk arising from a net investment, it is limited to the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the parent entity.
5. For the purpose of identifying the hedged risk, it is irrelevant whether the net investment is held by the parent directly or indirectly (that is, the net investment is held through an intermediate parent does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate parent entity).
6. An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. In preparing its consolidated financial statements, the higher-level parent can choose to reverse the hedge accounting at the lower parent entity level before the higher level parent's hedge accounting is recognised or it can maintain the hedge accounting at the lower parent entity level.

Where in a group the hedging instrument can be held

7. A derivative or a non-derivative instrument (or a combination of both) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the group (except the foreign operation that itself is being hedged).
8. For the purpose of assessing hedge effectiveness, the change in fair value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the parent entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. All changes in fair value of the hedging instrument are taken into account in testing effectiveness, regardless of whether (in the absence of hedge accounting) those changes would be recognised in profit or loss or in other comprehensive income or both.
9. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.



What amounts should be reclassified from equity to profit or loss as reclassification adjustment on disposal of the foreign operation

10. When a foreign operation that was hedged is disposed of, the amount reclassified to profit or loss as a reclassification adjustment from the foreign currency translation reserve in the consolidated financial statements of the parent in respect of the hedging instrument is the amount that represents the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge in accordance with HKAS 39.
11. The amount reclassified to profit or loss from the foreign currency translation reserve in the consolidated financial statements of a parent in respect of the net investment in that foreign operation in accordance with HKAS 21 *The Effects of Changes in Foreign Exchange Rates* paragraph 48 is the amount included in that parent's foreign currency translation reserve in respect of that foreign operation.
12. In the case of a multi-tiered group, whether the ultimate parent used the direct or the step-by-step method of consolidation may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation. In this respect, the difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. The entity should apply this accounting policy consistently for all its net investments.

Other references on IFRIC 16

1. Deloitte IAS Plus on IFRIC issues Interpretation on net investment hedging
<http://www.iasplus.com/iasplus/0807ifric16.pdf>
2. KPMG IFRS Briefing Sheet on IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*
http://www.kpmg.com.hk/en/virtual_library/Audit/IFRS_briefingsheet/IFRSBS0898.pdf

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