



**IFRS AT A GLANCE**  
**IFRIC 16 *Hedges of a Net Investment in a Foreign Operation***



## IFRIC 16 Hedges of a Net Investment in a Foreign Operation

### SCOPE

The issues addressed in IFRIC 16 are:

- ▶ The nature of the hedged risk and the amount of the hedged item for which a hedging relationship may be designated:
  - Whether the parent entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the parent entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the parent entity's consolidated financial statements and the functional currency of the foreign operation
  - If the parent entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate parent entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate parent entity.
- ▶ Where in a group the hedging instrument can be held:
  - Whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity in the group, regardless of its functional currency, can hold the hedging instrument
  - Whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.
- ▶ What amounts should be reclassified from equity to profit or loss as reclassification adjustments on disposal of the foreign operation:
  - When a foreign operation that was hedged is disposed of, what amounts from the parent entity's foreign currency translation reserve in respect of the hedging instrument and in respect of that foreign operation should be reclassified from equity to profit or loss in the parent entity's consolidated financial statements
  - Whether the method of consolidation affects the determination of the amounts to be reclassified from equity to profit or loss.

### DEFINITIONS

- ▶ IFRIC 16 applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to apply for hedge accounting in accordance with IAS 39 Financial Instruments: Recognition and Measurement
- ▶ IFRIC 16 applies only to hedges of net investments in foreign operations; it should not be applied by analogy to other types of hedge accounting.



# IFRIC 16 Hedges of a Net Investment in a Foreign Operation

## CONSENSUS

### NATURE OF THE HEDGED RISK AND AMOUNT OF THE HEDGED ITEM FOR WHICH A HEDGING RELATIONSHIP MAY BE DEMONSTRATED

- ▶ 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
- ▶ In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the parent entity
- ▶ The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any parent entity (the immediate, intermediate or ultimate parent entity) of that foreign operation
- ▶ 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. Therefore, if the same net assets of a foreign operation are hedged by more than one parent entity within the group for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate parent.

### WHERE THE HEDGING INSTRUMENT CAN BE HELD

- ▶ A derivative or a non-derivative instrument 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 as long as the designation, documentation and effectiveness requirements of IAS 39 paragraph 88 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the group should be clearly documented because of the possibility of different designations at different levels of the group.

### DISPOSAL OF A HEDGED FOREIGN OPERATION










- ▶ 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 IAS 39 requires to be identified
- ▶ 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 IAS 21 The Effects of Changes in Foreign Exchange Rates is the amount included in that parent's foreign currency translation reserve in respect of that foreign operation.

# Contact

For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below.

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