

IFRS Briefing Sheet

IFRIC Draft Interpretation D22 *Hedges of a Net Investment in a Foreign Operation*

July 2007, **Issue 73**

This IFRS Briefing Sheet summarises the International Financial Reporting Interpretations Committee's (IFRIC) Draft Interpretation D22 *Hedges of a Net Investment in a Foreign Operation*, which was published on 19 July 2007.

This draft interpretation proposes guidance on accounting for hedges of foreign currency risk arising from a net investment in a foreign operation.

Background and Issue

An entity with an investment in a foreign operation may be exposed to foreign currency risk due to movements in foreign exchange rates between the functional currency of the foreign operation and the functional currency of its immediate, intermediate or ultimate parent entity. The entity may want to apply hedge accounting to this foreign currency risk exposure or essentially enter into a hedge of its net investment in the foreign operation.

The draft interpretation proposes guidance for entities applying net investment hedging to such foreign currency risk exposure that arises from investments in foreign operations. The draft interpretation proposes guidance

on the nature of such a hedged risk and also where in a group the hedging instrument may be held.

Proposed Consensus

The proposed consensus is that hedge accounting may be applied to net investment hedges of foreign currency risk (the hedged risk). The draft interpretation also clarifies that:

- net investment hedging would only be applied when the net assets of the foreign operation are included in the financial statements
- the hedged risk must be an economic exposure and therefore cannot arise from the foreign exchange difference between the presentation currency of the parent or group and the functional currency of the foreign operation.

The draft interpretation proposes that an entity may designate both derivative and non-derivative instruments as hedging instruments in a net investment hedge in a foreign operation. The draft interpretation also proposes that any entity within a group, except for the foreign operation that itself is being hedged, can hedge its exposure to the net investment foreign exchange risk, providing that the IAS 39 *Financial Instrument: Recognition and Measurement* designation, documentation and hedge effectiveness requirements are met.

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Consequently, the entity hedging the net investment would not need to be a party to the hedging instrument.

In addition, the draft interpretation proposes that hedge effectiveness be measured with reference to the functional currency of the entity hedging the net investment (i.e., the effectiveness of the hedging instrument is based on changes in the fair value or cash flows of the hedging instrument, compared to changes in the net investment).

Effective Date and Transition

The draft interpretation proposes prospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, with an effective date of annual periods beginning on or after three months after a final interpretation is issued. Early adoption is permitted.

Response to the IFRIC

The IFRIC has invited comments on this draft interpretation by 19 October 2007.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

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