In depth

A look at current financial reporting issues

Hedge accounting

Contrasting US GAAP and IFRS

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At a glance

Hedge accounting represents one of the more complex and nuanced topical areas within both US GAAP and IFRS. Both frameworks have updated guidance that attempts to simplify some of the requirements, ease administrative burdens, and allow for more strategies to qualify for hedge accounting. However, complexity still remains. Further, while the objectives of the IASB and FASB were originally similar, each Board ultimately chose a distinct approach. Consequently, significant differences exist between US GAAP and IFRS.

IFRS 9 became effective in 2018 for a calendar year-end entity. However, entitiies can choose to continue to apply all or certain limited parts of IAS 39 in lieu of a full adoption of IFRS 9's hedge accounting guidance.

Under US GAAP, the changes to ASC 815 (in ASU 2017-12, *Targeted Improvements to Accounting for Hedging Activities*) are not required to be adopted until 2019 for calendar year-end public companies, but may be adopted early.

This document highlights some of the significant differences in the hedge accounting guidance between IFRS 9 and amended ASC 815 (after adoption of ASU 2017-12).

The FASB issued updated hedge accounting guidance in ASU 2017-12 in August 2017. The new guidance is intended to simplify certain accounting requirements for hedging activities, resolve practice issues, and better align hedge accounting with an organization's risk management activities.

Early adoption is permitted in any interim period after August 28, 2017 (the date of issuance). For public business entities that do not adopt early, the amendments are effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. For all other entities that do not adopt early, the amendments are effective for fiscal years beginning after December 15, 2019 and interim periods beginning after December 15, 2020.

The IASB's hedge accounting guidance, IFRS 9, *Financial Instruments,* was effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

Similar to the FASB, the goal of the IASB was to simplify hedge accounting, align it more closely with entities' risk management activities, and provide decision-useful information about an entity's risk management strategies.

Under IFRS, entities have an accounting policy choice to apply the IFRS 9 hedge accounting guidance or to continue applying the IAS 39 hedge accounting guidance. This policy choice is applied to all of the entity's hedges, except those in fair value macro hedging relationships. The IASB is planning on proposing a macro hedge accounting model in a separate project, which is still ongoing. In the meantime, if an entity adopts IFRS 9 for hedge accounting, it may apply the "macro hedging" provisions of IAS 39 for a fair value hedge of the interest rate exposure of a portfolio of financial assets and/or financial liabilities (and only for such a hedge) rather than the new IFRS 9 requirements. If an entity chooses not to adopt IFRS 9 for hedge accounting when it adopts the other parts of IFRS 9, it can still choose to adopt IFRS 9's hedging provisions at a later date. However, once an entity has adopted IFRS 9 for hedge accounting, it cannot revert back to IAS 39.

IFRS 9 also addresses the accounting for other financial instruments besides those designated in a hedging relationship. There are a number of differences between US GAAP and IFRS in these areas, including some that may be considered alternatives to hedge accounting, such as the fair value option. Those areas are not addressed by this *In depth*.

Although both IFRS 9 and the amended ASC 815 guidance permit more hedging strategies to qualify for hedge accounting, the frameworks retain complex (though different) requirements for hedge accounting. Both the criteria to qualify for hedge accounting and the accounting for qualifying hedges are different. IFRS 9 has made it easier to qualify for hedge accounting than under IAS 39 by permitting hedging of more components of items, and eliminating the 80-125% effectiveness requirement. US GAAP maintained more stringent qualifying criteria as compared to IFRS 9, including a requirement to perform rigorous assessments of effectiveness in many cases. But the amendments to US GAAP simplified subsequent reporting as compared to the previous ASC 815 guidance and IFRS 9 by eliminating the requirement to separately measure ineffectiveness for cash flow and net investment hedging relationships in earnings in each reporting period.

The Appendix to this *In depth* replaces the content in PwC's *IFRS and US GAAP: similarities and differences* (SD) guide, beginning with section 11.8 to the end of chapter 11. It compares IFRS 9 and amended ASC 815 after adoption of ASU 2017-12.

Comparison of IFRS 9 and ASC 815 hedge accounting models

The Appendix compares the amended ASC 815 hedging model to the IFRS 9 hedging model. It summarizes the differences between IFRS and US GAAP that we generally consider to be the most significant or pervasive, and should be read in combination with the authoritative literature and a thorough analysis of the relevant facts and circumstances. For more detailed guidance on ASC 815, see PwC's *Derivatives and hedging* guide. For more detailed guidance on IFRS 9's hedging provisions, see PwC's In depth: *Achieving hedge accounting in practice under IFRS 9*.

Appendix

11.8 Hedge effectiveness criterion

Both US GAAP and IFRS permit application of hedge accounting to only certain eligible hedging instruments and hedged items and require formal designation and documentation of a hedging relationship at the beginning of the relationship and an assessment of effectiveness. However, the detailed requirements for hedge effectiveness vary between the two frameworks. Unlike US GAAP, there is no high effectiveness criterion to qualify for hedge accounting under IFRS. Instead, IFRS 9 requires an economic relationship between the hedged item and the hedging instrument, which is a less restrictive test.

US GAAP	IFRS
Hedging relationships are required to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk. The term "highly effective" has been interpreted in practice to mean that the change in fair value/cash flows of the designated component of the hedging instrument is within 80 to 125% of the change in fair value/cash flows of the designated proportion of the hedged item attributable to the risk being hedged.	A hedging relationship needs to meet the following effectiveness requirements: 1. There is an economic relationship between the hedged item and the hedging instrument that gives rise to offset. 2. The effect of credit risk does not dominate the value changes that result from that economic relationship. 3. The hedge ratio is the one the entity actually uses under its risk management strategy unless it would create ineffectiveness inconsistent with the purpose of hedge accounting.

11.8.1 Nature and timing of effectiveness assessments

Both US GAAP and IFRS require initial and ongoing assessments of effectiveness. However, the nature and timing of these effectiveness assessments vary between the two frameworks.

US GAAP	IFRS
In certain cases, an initial quantitative assessment is required. In addition, periodic effectiveness assessments need to be performed on both a prospective basis (to reconfirm forward-looking expectations) and a retrospective basis (to determine whether the hedge was highly effective). Effectiveness assessments are required at hedge inception and periodically thereafter, with an assessment required whenever financial statements or earnings are reported, and at least every three months. The initial assessment may be completed by the end of the quarter.	A retrospective effectiveness assessment is not required. However, an entity must make an ongoing assessment of whether the hedge continues to meet the three hedge effectiveness criteria described in SD 11.8. There is no requirement to perform effectiveness assessments every three months. The ongoing effectiveness assessment needs to be performed at each reporting date (which may only be semi-annually or annually) or upon a significant change in circumstances. It is only a forward-looking test.

Additionally, simplified approaches exist for nonpublic nonfinancial institutions. When assessing effectiveness of hedges of forecasted transactions, entities can ignore timing differences between the hedged transactions and the maturity date of the hedging instrument within 31 days or a fiscal month (when that is the only difference between the derivative and the hedged forecasted transactions).	The requirement to maintain the hedge ratio (#3 in SD 11.8) ensures alignment with the economic hedging strategy. The hedge ratio must be rebalanced to maintain the hedge ratio that the entity actually uses to achieve its economic hedging strategy. We expect that rebalancing will rarely occur in practice.

11.8.2 Recognition of ineffectiveness

IFRS requires measurement and recognition of ineffectiveness in a hedging relationship even though the hedge meets the effectiveness criteria. US GAAP no longer has a concept of ineffectiveness that is separately measured and disclosed, although there may still be an income statement impact for certain hedges. Both IFRS and US GAAP permit an entity to exclude certain components from the assessment of effectiveness and separately account for them, which may improve hedge effectiveness, as discussed in 11.8.3.

US GAAP	IFRS
For cash flow and net investment hedges, hedge ineffectiveness is not separately measured and recognized in income each reporting period. If the hedge is highly effective, all changes in the fair value of the derivative hedging instrument will be recorded in other comprehensive income (OCI) (in cumulative translation adjustment (CTA) for net investment hedges), unless different recognition is prescribed/elected for any excluded components. Any difference between the gain or loss on the hedged item and the derivative (except for the excluded component) is recognized when the hedged item affects earnings, at which time the amount deferred in AOCI from the hedging instrument is released to earnings. On the other hand, for fair value hedges, because the change in fair value of the hedged item attributable to the hedged risk and the derivative hedging instrument are both recorded in current earnings, if the hedge is not perfectly effective, there will be an income statement impact. While not identified as ineffectiveness, a reporting entity is required to disclose the change in fair value of the hedged item attributable to the hedged risk and the change in fair value of the derivative.	For cash flow hedges, the effective portion of the change in the fair value of the hedging instrument is recognized in OCI. The amount recognized in OCI should be the lower of (1) the cumulative gain or loss on the hedging instrument from the inception of the hedge, and (2) the cumulative change in the fair value (present value) of the expected cash flows on the hedged item from the inception of the hedge. The remaining ineffective portion of the change in the fair value of the hedging instrument (if any) is recognized in profit or loss. For hedges of a net investment in a foreign operation, the effective portion of the change in the fair value of the hedging instrument is recognized in OCI and the ineffective portion of the hedging relationship is recognized in profit or loss. For fair value hedges, both the effective and ineffective portions of the hedge relationship are recorded in profit or loss. IFRS 7 requires disclosure of ineffectiveness.

11.8.3 Amounts permitted to be excluded from the assessment of effectiveness

Both US GAAP and IFRS permit an entity to exclude certain components of the change in the fair value of a hedging instrument from the assessment of effectiveness. However, the standards diverge in certain respects on what is permitted to be excluded.

<table>
<tr><th>US GAAP</th><th>IFRS</th></tr>
<tr>
<td>An entity may elect to exclude certain components of the change in value of the derivative from the assessment of effectiveness for fair value and cash flow hedges:
● For forwards and future contracts when the spot method is used, an entity can exclude forward points (the difference between the spot price and the forward price).
● For currency swaps, an entity may exclude the portion of the change in fair value attributable to a cross-currency basis spread.
● For options (including eligible collars), the assessment can be based on changes in the intrinsic value of the option or the minimum value (intrinsic value plus the impact of discounting). An entity can also exclude the following portions of the change in time value from the assessment of effectiveness:
○ the portion attributable to the passage of time,
○ the portion attributable to changes in volatility, or
○ the portion attributable to changes in interest rates.

For derivatives designated as net investment hedges, an entity is only permitted to use either (1) the spot method in which the entire difference between the spot price and the forward or futures price is excluded or (2) the full fair value method. Further, an entity is not permitted to exclude only part of the spot-forward difference when using the spot method.

US GAAP prohibits the exclusion of any other components of the hedging instrument.</td>
<td>IFRS 9 only permits three components to be excluded from the effectiveness assessment:
1. the forward element of a forward contract,
2. the foreign currency basis spread, and
3. the time value of an option.

IFRS 9 does not prescribe a specific methodology for calculating the value of the excluded components. However, a discounted calculation (such as discounted spot or discounted intrinsic value) is generally required since IFRS requires an entity to consider the time value of money when measuring hedge effectiveness.

Additionally, entities can elect to exclude only the foreign currency basis spread component of the spot-forward difference for forward contracts, which is not permitted under US GAAP.</td>
</tr>
</table>

11.8.3.1 Accounting for amounts excluded from the assessment of effectiveness

US GAAP and IFRS diverge regarding how to account for a component excluded from the assessment of effectiveness.

US GAAP	IFRS
For cash flow, fair value, and net investment hedges, an entity may choose between two methods to account for an excluded component: 1. *Amortization approach* The initial value of the excluded component is recognized in earnings using a systematic and rational method over the life of the hedging instrument, with any difference between the change in fair value of the excluded component and the amount in earnings recognized in OCI (CTA for net investment hedges). 2. *Mark-to-market approach* The changes in fair value of the excluded component are recognized in current earnings. Unlike IFRS, US GAAP does not have a specific concept of aligned time value (i.e. time value that only relates to the hedged item) or aligned forward element. When using the spot method, discounting of the spot rate is not required (and in the case of a net investment hedge, discounting is not permitted).	IFRS 9 has specific guidance by type of derivative. *Options* For cash flow, fair value, and net investment hedges, if an entity elects to designate only the intrinsic value of the option as the hedging instrument, it must account for the changes in the "aligned time value" (i.e., when the critical terms of the option and hedged item are aligned) in OCI and hold those changes in a hedging reserve in equity. Recognition of the aligned time value in profit or loss will depend on whether the hedge is transaction-related (and recorded in profit or loss at the same time as the hedged item) or time–period-related (and recorded in profit or loss using a systematic and rational basis over the period of the hedge). *Forwards points and currency basis spread* An entity may recognize changes in value due to changes in forward points or foreign currency basis spread in profit or loss immediately or defer them using the recognition guidance for options. *Aligned portion* Recognition of the excluded component applies to the aligned portion, i.e., the portion for which the critical terms such as notional, price, term and underlying of the derivative and the hedged item are aligned. This is called the "aligned time value" or "aligned forward element." IFRS 9 specifies a particular calculation methodology that can be complex to apply when the actual time value or foward element is lower than the aligned time value or forward element at inception of the hedge.

	When the change in spot rate is the designated hedged risk, entities still need to consider the time value of money and, when appropriate, measure the hedged item using the discounted spot rate. However, for a net investment hedge, we believe that an entity can choose not to impute a time period into the hedging relationship and designate the hedged risk without discounting.

11.9 Eligible hedged items

Several differences exist between the two framework as it relates to the eligibility of the hedged item.

11.9.1 Eligible hedged items - Components of nonfinancial items

Under both US GAAP and IFRS, an entity is permitted to hedge a component of a nonfinancial item. However, IFRS 9 permits more nonfinancial components to qualify as hedged items.

US GAAP	IFRS
US GAAP permits cash flow hedges of the variability in cash flows attributable to changes in contractually specified components of forecasted purchases or sales of nonfinancial items, subject to specific criteria. A contractually specified component is an index or price explicitly stated in the contract or governing agreements to purchase or sell the nonfinancial item that is not solely linked to the entity's own operations.	IFRS 9 permits entities to hedge risk components for nonfinancial items, provided such components are separately identifiable and reliably measurable. They do not have to be contractually specified, as under US GAAP. In assessing whether a risk component of a nonfinancial item is eligible for designation as a hedged risk, an entity should take into consideration factors such as: ● Whether the risk component is contractually specified (the contract entails a formula based pricing structure such as "commodity X plus a margin") ● If not, the particular market structure to which the risk relates and in which the hedging activity takes place

11.9.2 Eligible hedged items - Hedges of groups of items

Both US GAAP and IFRS permit an entity to hedge groups of items, but IFRS permits more groups of items to qualify as the hedged item. In particular, IFRS 9 permits hedging groups of offsetting exposures, while US GAAP specifically prohibits it.

US GAAP	IFRS
If an entity wishes to designate a group of individual items as the hedged item in a hedging relationship, the individual items or transactions must share the same risk exposure for which they are designated as being hedged. A quantitative evaluation, known as the "similar assets/liabilities test," of whether a portfolio of assets or liabilities share the same risk exposure is generally required.	IFRS 9 allows hedges of: ● groups of similar items without a requirement that the fair value change of each individual item be proportional to the overall group (e.g., hedging a portfolio of S&P 500 shares with a S&P 500 futures contract), and ● groups of offsetting exposures (e.g., exposures resulting from forecasted sale and purchase transactions). IFRS 9 stipulates additional qualifying criteria. These include: ● The group consists of items that are eligible as hedged items on an individual basis ● The hedged items are managed together on a group basis for risk management purposes ● A cash flow hedge in which the variability in cash flows is not expected to be approximately proportional to the overall group is a hedge of foreign currency risk, and the hedge designation specifies the reporting period when the forecasted transactions are expected to affect profit or loss and their nature and volume. See SD 11.12 on presentation of gains and losses on hedging instruments for a discussion of grouping items with offsetting disclosures.

11.9.3 Eligible hedged items - Hedging pools of prepayable financial assets

Both US GAAP and IFRS permit an entity to hedge layers of items, provided that certain criteria are met. However, US GAAP and IFRS differ in the application of the guidance to interest rate fair value hedges of layers of prepayable financial assets not expected to be prepaid during the hedge period.

US GAAP	IFRS
A "last-of-layer approach" permits the designation of a portion of a closed pool of prepayable assets, beneficial interests secured by prepayable assets, or a combination that is not expected to be prepaid during the hedge period as the hedged item in a fair value hedge of the	IFRS 9 allows a layer of a group to be designated as the hedged item. A layer component can be specified from a defined, but open, population or from a defined nominal amount. If a layer component is designated in a fair value hedge, an entity must specify it from a

benchmark interest rate. When an entity executes a partial-term hedge of the benchmark interest rate, the entity is able to ignore the impact of prepayment and credit risk by assuming that prepayments and defaults relate to the portion of the portfolio that is not part of the designated hedged item (the "last of layer"). For this strategy, a similar assets test may be performed qualitatively and only at inception.	defined nominal amount. A layer of a contract that includes a prepayment option that is affected by changes in the hedged risk is only eligible as a hedged item in a fair value hedge if the layer includes the effect of the prepayment option when determining the change in fair value of the hedged item. In other words, the prepayment option cannot be ignored. In this situation, if an entity hedges with a hedging instrument that does not have option features that mirror the layer's prepayment option, hedge ineffectiveness would arise. For macro hedges of interest rate risk, IFRS 9 permits an entity to elect to apply the requirements in IAS 39 for fair value portfolio hedges instead of applying IFRS 9 in full. Under IAS 39's portfolio hedge model, it may apply fair value hedge accounting in a portfolio of dissimilar items (i.e., macro hedging) whereby the hedged portion may be designated as an amount of currency of a prepayable item, rather than individual assets or liabilities. Further, under this approach in IAS 39, an entity is able to incorporate changes in prepayment risk by using a simplified method set out in the guidance, rather than specifically calculating the fair value of the prepayment option on a prepayable item by item basis. Expected rather than contractual repricing dates may be used. In such a strategy, the change in fair value of the hedged item is presented as a separate line item in the balance sheet and is not allocated to individual assets or liabilities.

11.9.4 Eligible hedged items - Aggregated exposures

IFRS permits an entity to combine a derivative and nonderivative exposure together and to designate them together as the hedged item in a hedging relationship. This is not permitted under US GAAP.

US GAAP	IFRS
US GAAP does not permit hedge accounting for hedged items that are remeasured for changes in fair value through earnings (or a forecasted acquisition of an asset or incurrence of a liability that subsequently will be similarly remeasured at fair value). Therefore, items meeting the definition of a derivative are not permitted to be the hedged item in a hedging relationship either by themselves or when combined with other nonderivatives.	Aggregated exposures can be designated as hedged items. An aggregated exposure is a combination of (1) an exposure that qualifies as a hedged item and (2) a derivative. This includes a forecasted transaction of an aggregated exposure (i.e., uncommitted but anticipated future transactions that would give rise to an exposure and a derivative) as long as the aggregated exposure is highly probable and, once it has occurred, would be eligible as a hedged item. For example, an entity could hedge the forecasted issuance of variable-rate debt even if the currency of issuance is not yet known. If the debt is not issued in the entity's functional currency, but the entity plans to enter into a cross-currency swap to convert the exposure back into its functional currency, it can designate as the hedged item highly probable variable interest payments arising from either (1) debt denominated in the functional currency or (2) a combination of foreign currency debt and a cross-currency swap that will swap the foreign currency debt to functional currency debt.

11.9.5 Eligible hedged items - Partial term hedging

Both US GAAP and IFRS permit partial-term hedging of a financial instrument. However, US GAAP is more prescriptive about the timing of the assumed beginning and maturity of the hedged item.

US GAAP	IFRS
US GAAP allows a partial-term fair value hedge of interest rate risk in which the hedged item is designated as selected consecutive contractual interest payments. For example, entities can hedge the interest rate payments in the first two years, the last two years, or in years two through four in debt with a five-year term. Or, for hedges of a single financial instrument, an entity could simultaneously enter into a hedge of year 1 with a swap in one hedging relationship and years 3 and 4 with another swap in a different hedging relationship.	IFRS similarly permits designation of a derivative as hedging a financial instrument (the hedged item) for only a portion of its cash flows or fair value, if effectiveness can be measured and the other hedge accounting criteria are met. Under IFRS 9, partial-term hedging of forecasted transactions of nonfinancial items, such as purchases and sales, is not permitted. However, the terms of the hedged item and hedging instrument do not need to match exactly to achieve hedge accounting. If the mismatch is not so long as to invalidate the economic relationship,

Partial-term hedging is achieved by assuming that (1) the term begins when the first hedged cash flow begins to accrue, and (2) the maturity of the hedged item is the same date as the last hedged cash flow. To achieve #2, the payments made at the contractual maturity of the hedged item are assumed to be made at the conclusion of the hedged term. In a cash flow hedge of interest rate risk, the hedged forecasted transactions are future interest payments. An entity may choose to hedge only certain selected interest payments to be paid under the terms of a debt agreement.	an entity can designate the hedge for the full period. However, the difference in terms will result in ineffectiveness. Ineffectiveness arises regardless of whether the designated hedged risk is the forward or the spot foreign currency rate because the requirement in IFRS 9 to consider the time value of money is applicable in both circumstances.

11.9.6 Eligible hedged items - Variable-rate financial assets and liabilities

Both US GAAP and IFRS permit designation of the contractually specified interest rate as the hedged risk in a cash flow hedge of interest rate risk of a variable-rate financial instrument. Under IFRS 9, the interest rate does not need to be contractually specified; it only needs to be separately identifiable and reliably measurable. However, IFRS 9 does not permit the designated interest rate component to exceed the contractual cash flows.

US GAAP	IFRS
US GAAP allows hedging the interest rate risk associated with the contractually specified index rate of an existing or forecasted issuance/purchase of a variable rate financial instrument. The rate does not need to be a benchmark interest rate. If an entity desires to hedge interest payments from a forecasted issuance/purchase and does not know whether it will be variable rate or fixed rate, the entity must designate a rate that would qualify both as a contractually specified rate and a benchmark interest rate.	IFRS similarly allows a portion of specific interest payments to qualify as a hedged risk, provided it is separately identifiable and reliably measurable. It does not have to be contractually specified. However, under IFRS 9, a designated portion of the cash flows cannot be greater than the cash flows of the whole financial asset or financial liability. Consequently, an entity that issues a debt instrument whose effective interest rate at designation is below the designated interest rate component can not designate a component of the liability equal to the benchmark interest rate. For example, if an entity issues debt that pays a rate of LIBOR minus 1%, it cannot designate the hedged item as only the LIBOR component of the cash flows. However, IFRS permits the entity to designate as a hedged item the change in cash flows of the entire liability (LIBOR minus 1%) that is attributable to changes in LIBOR. In practice, this may have a similar result, unless the debt contains a floor or contractually permits other variability besides the referenced interest rate.

11.9.7 Eligible hedged items - Fixed-rate financial assets and liabilities

Both US GAAP and IFRS permit the designation of the entire contractual cash flows or a component of the contractual cash flows in a fair value hedge of interest rate risk of a fixed-rate financial instrument. US GAAP also permits a hedge of the benchmark component for fair value hedges of other risks, regardless of whether the coupon or yield is more or less than the benchmark rate.

US GAAP	IFRS
The interest rate risk that can be hedged in a fixed-rate financial asset or liability is explicitly limited to benchmark interest rates. In each financial market, generally only the most widely used and quoted rates are considered benchmark interest rates. In the United States, the benchmark rates currently allowed to be hedged under US GAAP are: ● the interest rates on direct Treasury obligations of the US government, ● the London Interbank Offered Rate (LIBOR) swap rate, ● the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate or OIS), and ● the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate. In calculating the change in value of the hedged item for interest rate changes, an entity can use either the full contractual coupon cash flows or the benchmark rate component as determined at hedge inception. A hedge of the benchmark component of coupons is permitted for all fair value hedges, regardless of whether the coupon or yield is more or less than the benchmark rate. In other words sub-benchmark hedging is allowed. Under US GAAP, an entity should consider the effect of a prepayment option that is exercisable during the hedged term when hedging interest rate risk of a prepayable item. In evaluating the impact to the prepayment option, an entity is explicitly permitted to consider either (1) all factors that would cause a borrower to prepay, or	Similar to US GAAP, IFRS 9 permits an entity to hedge the full contractual coupon or just the interest rate component of the contractual coupon. IFRS allows a portion of a specific risk in a fixed-rate financial asset or liability to be designated as a hedged item, provided it is separately identifiable and reliably measurable. In certain circumstances, an inflation risk component could be considered separately identifiable and reliably measurable even if not contractually specified. Unlike US GAAP, IFRS 9 does not contain a list of acceptable benchmark rates. Additionally, IFRS 9 does not permit use of a designated component of the cash flows that exceeds the total fair value or cash flows of a hedged item. For a fixed rate sub-LIBOR debt, an entity would designate changes in fair value of all the cash flows attributable to changes in LIBOR. If a fixed-rate financial instrument is hedged after its origination/issuance and interest rates have risen, the entity can designate a risk component equal to a benchmark rate that is higher than the contractual rate paid on the item as long as LIBOR is less than the effective interest rate based on the hedged item's fair value at designation. In that case, the cash flows used for the hedged item would consist of the contractual interest and and the difference between the hedged item's fair value at designation and the amount repayable at maturity (discount). While IFRS 9 allows an entity to designate the interest rate component as the hedged risk, it does not specifically provide the approach laid out under US GAAP when considering the impact of a prepayment option. However, in practice, changes in fair value attributable to the referenced interest rate may be designated as the

(2) only how changes in the benchmark interest rate affect prepayments.	hedged risk, which has the same effect.

11.9.8 Eligible hedged items - Hedging more than one risk

IFRS provides greater flexibility than US GAAP with respect to utilizing a single hedging instrument to hedge more than one risk in two or more hedged items. This allows entities to adopt new and sometimes more complex strategies to achieve hedge accounting while managing certain risks under IFRS.

US GAAP	IFRS
US GAAP does not allow a single hedging instrument to hedge more than one risk in two or more hedged items and does not permit creation of a hypothetical component in a hedging relationship of more than one risk with a single hedging instrument. An exception is a basis swap designated as a cash flow hedge of both a floating rate asset and a floating rate liability.	IFRS 9 permits designation of a single hedging instrument to hedge more than one risk in two or more hedged items. A single hedging instrument may be designated as a hedge of more than one type of risk, provided that there is a specific designation of the hedging instrument and of the different risk positions as hedged items. Those hedged items can be in different hedging relationships. In the application of this guidance, a single derivative may be separated by inserting an additional (hypothetical) leg if each portion of the contract is designated as a hedging instrument in a qualifying and effective hedge relationship. For example, an entity whose functional currency is the Japanese yen (JPY) that has a fixed-rate loan receivable denominated in British pounds (GBP) and a variable-rate liability denominated in US dollars (USD) with the same principal amount can enter into a single foreign currency forward contract to hedge the FX exposure on the principal payments of the liability and the note receivable. This would be achieved by splitting a GBP / USD forward into two forwards by imputing two JPY legs into the contract.

11.9.9 Eligible hedged items - Business combinations

IFRS permits hedging foreign currency risk in a business combination, but US GAAP does not.

US GAAP	IFRS
US GAAP specifically prohibits a firm commitment to enter into a business combination, or acquire or dispose of a	An entity is permitted to hedge foreign exchange risk in a firm commitment to acquire a business or a forecasted business

subsidiary, minority interest, or equity method investee from qualifying as a hedged item for hedge accounting purposes (even if it is with respect to foreign currency risk). Additionally, US GAAP does not permit cash flow hedges of forecasted transactions involving business combinations.	combination if the transaction is highly probable.

11.10 Eligible hedging instruments

Several differences exist between the two framework as it relates to the eligibility of the hedging instruments.

11.10.1 Eligible hedging instruments - nonderivatives

Both US GAAP and IFRS permit nonderivatives to be designated as hedging instruments in certain cases. IFRS generally permits nonderivatives to be designated as hedging instruments in more instances than US GAAP. Nonderivative financial instruments are most commonly used as hedges in hedge relationships involving foreign currency risk. In this way, US GAAP and IFRS are similar. As a result, there is not a substantive difference in practice in most cases.

US GAAP	IFRS
Generally, a nonderivative may not be used as a hedging instrument. However, certain nonderivative financial instruments that may give rise to a foreign currency transaction gain or loss may be designated in a hedge of foreign currency risk in fair value hedges of firm commitments and net investment hedges.	Nonderivative financial instruments classified at fair value through profit or loss are permitted to be used as hedging instruments for all types of risks (except for hedges of financial liabilities when changes in fair value as a result of credit risk are presented in OCI). The foreign currency component of nonderivative financial instruments can be designated as a hedge of FX risk (except for equity instruments for which changes in fair value are recorded in OCI).

11.10.2 Foreign currency risk - location of hedging instrument

IFRS permits a parent company to hedge exposures of an indirect subsidiary regardless of the functional currency of intervening entities within the organizational structure. The rules under US GAAP for hedges of foreign exchange risk for forecasted transactions (cash flow hedges) or net investments in foreign operations are prescriptive regarding the functional currency and structure of the entities involved.

US GAAP	IFRS
Either the operating unit that has the foreign currency exposure or another member of the consolidated group that has the same functional currency as that operating unit must be a party to the hedging instrument. However, for another member of the consolidated group to enter into the hedging instrument, there cannot be an intervening entity with a different functional currency. Instead, entities may designate intercompany derivatives between the subsidiary with the exposure and the entity that is a party to an offsetting external derivative if certain criteria are met.	IFRS does not require the entity with the hedging instrument to have the same functional currency as the entity with the hedged item or the operating unit exposed to the risk being hedged within the consolidated group to be a party to the hedging instrument. For example, IFRS allows a parent company with a functional currency different from that of a subsidiary to achieve cash flow hedge accounting for the subsidiary's transactional foreign currency exposure (i.e., an exposure in a currency other than the subsidiary's functional currency). The same flexibility regarding location of the hedging instrument applies to net investment hedges.

11.11 Cash flow hedging and basis adjustments

For hedges of a forecasted purchase of a nonfinancial item, US GAAP and IFRS differ with regards to the accounting (at the time of acquisition of the nonfinancial item) for the fair value changes of the hedging instrument that were deferred in AOCI. This results in different amounts in AOCI and different carrying amounts of the nonfinancial items between US GAAP and IFRS. However, the ultimate effect on earnings is the same.

US GAAP	IFRS
US GAAP prohibits adjusting the basis of the hedged item in a cash flow hedge, and requires the fair value changes deferred in AOCI to be released out of AOCI into earnings when the hedged forecasted transaction impacts earnings.	IFRS 9 requires mandatory basis adjustment of the nonfinancial hedged item once it is recognized. Accordingly, fair value changes in the hedging instrument that are deferred in AOCI (referred to as the "cash flow hedge reserve") are included in the value of the hedged item on its initial recognition. The basis adjustment does not flow back through OCI. It is a direct transfer from equity to the hedged item. Similar accounting is required if a hedged forecasted transaction for a nonfinancial asset or a nonfinancial liability becomes a firm commitment for which fair value hedge accounting is applied.

11.12 Presentation of hedging instrument gains or losses

US GAAP is more prescriptive regarding the presentation of gains and losses from hedges than IFRS.

US GAAP	IFRS
For fair value hedges, the entire change in the fair value of the hedging instrument is presented in the same income statement line item as the earnings effect of the hedged item. For cash flow hedges, the entire change in fair value of the hedging instrument (except for excluded components) should be recorded in other comprehensive income (OCI) and reclassified to earnings in the same income statement line item used to present the earnings effect of the hedged item when the hedged item impacts earnings. Splitting gains and losses into more than one income statement line item is generally not appropriate. However, if the hedging instrument offsets changes in fair value or cash flows that are reported in more than one income statement line item, the changes in fair value of the hedging instrument is split among the line items that include the earnings effect of the hedged item. For cash flow and fair value hedges, amounts excluded from the assessment of effectiveness are presented in the same income statement line item that is used for the hedged item. For net investment hedges, the entire change in fair value of the hedging instrument included in the hedge effectiveness assessment is recorded in CTA and reclassified to earnings in the same income statement line item used to present the earnings effect of the hedged item (when the subsidiary is sold or substantially liquidated). US GAAP is silent on the income statement geography for excluded components for net investment hedges.	IFRS 9 generally has no requirements regarding the income statement presentation of gains and losses from a hedging instrument. However, in practice, we believe most entities present gains and losses from a hedging instrument in the same income statement line item as the hedged transaction. We believe ineffectiveness should be presented in a manner consistent with the entity's policy for trading derivatives. This might mean that the results of hedge ineffectiveness are included in the same line item as the impact of the related hedged item or in "other operating income and expense" or a separate line item if the amount is significant. For cash flow hedges of a group of items with no offsetting risk position, the presentation of gains and losses should be apportioned to the line items affected by the hedged items on a systematic and rational basis. The net gains or losses arising from a single hedging instrument should not be presented as gross amounts in different line items. For a hedge of a group of items with offsetting risk positions whose hedged risk affects different line items in the statement of profit or loss and OCI, any hedging gains or losses in that statement must be presented in a separate line from those affected by the hedged items. Consequently, the amount in the line item that relates to the hedged item itself (e.g., revenue or cost of sales) remains unaffected. In practice, this makes hedges of a group of items less attractive, and we expect many entities to designate just a part of one of the gross positions (rather than the net position).

11.13 Voluntary dedesignation of a hedging relationship

Under both US GAAP and IFRS, an entity is required to discontinue a hedging relationship if the respective qualifying criteria are no longer met. However, voluntary dedesignation is not allowed under IFRS 9. In practice, this may have a limited impact because IFRS requires discontinuance of the hedging relationship when the risk management objective is no longer met. This likely includes most instances when an entity might choose to voluntarily dedesignate a hedging relationship.

US GAAP	IFRS
An entity is permitted to dedesignate a hedging relationship voluntarily at any time.	Under IFRS 9, an entity cannot voluntarily dedesignate a hedging relationship that: ● still meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity still pursues that risk management objective), and ● continues to meet all other qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

11.14 Novations, rollovers, and replacements

Both US GAAP and IFRS permit continuance of a designated hedging relationship when a contract is modified in certain circumstances. However, the circumstances under which the hedge relationship can continue after a modification differ under the two frameworks.

US GAAP	IFRS
A change in the counterparty to a derivative that has been designated as the hedging instrument does not, in and of itself, require dedesignation of that hedging relationship, provided that all other hedge accounting criteria continue to be met. However, US GAAP requires an entity to dedesignate a hedging relationship upon expiration of the derivative or a change to the critical terms of the derivative or hedging relationship.	IFRS explicitly permits the continuation of hedge accounting when the counterparty to a derivative changes through novation to a clearing counterparty (such as a central clearing party) as a consequence of laws or regulations. However, in practice, there may be other scenarios when a novation, in and of itself, would not require a dedesignation of the hedging relationship. IFRS permits the continuation of hedge accounting upon the replacement or rollover of a hedging instrument into another hedging instrument if it is part of the entity's documented hedging strategy.

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