IFRS

STAFF PAPER

September 2019

IFRS® Interpretations Committee meeting

Project	**Fair value hedge of foreign currency risk on non-financial assets (IFRS 9)**
Paper topic	Agenda decision to finalise

CONTACT	Gustavo Olinda	golinda@ifrs.org	+44 (0) 20 7246 6481
	Riana Wiesner	rwiesner@ifrs.org	+44 (0) 20 7246 6412

Introduction

1. At its June 2019 meeting, the IFRS Interpretations Committee (Committee) discussed two submissions about fair value hedge accounting applying IFRS 9 *Financial Instruments*. Both submissions asked whether foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset held for consumption that an entity can designate as the hedged item in a fair value hedge accounting relationship.

2. In considering the question in the submissions, the Committee assessed:

   (a) whether an entity can have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss;

   (b) if an entity has exposure to foreign currency risk on a non-financial asset, whether it is a separately identifiable and reliably measurable risk component; and

   (c) whether the designation of foreign currency risk on a non-financial asset held for consumption can be consistent with an entity's risk management activities.

3. The Committee observed that:

   (a) depending on the particular facts and circumstances, it is possible for an entity to have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss. This would be the case when, at a global level, the fair value of a non-financial asset is determined only in one particular currency and that currency is not the entity's functional currency.

   (b) foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset. Whether that is the case will depend on an assessment of the particular facts and circumstances within the context of the particular market structure. Nonetheless, the Committee observed that foreign currency risk is separately identifiable and reliably measurable when the risk being hedged relates to changes in fair value arising from translation into an entity's functional currency of fair value determined in the circumstances described in (a) above.

   (c) applying IFRS 9, an entity can apply hedge accounting only if it is consistent with the entity's risk management objective and strategy for managing its exposure. To the extent that an entity intends to consume a non-financial asset (rather than to sell it), the Committee observed that changes in the fair value of the non-financial asset may be of limited significance to the entity. In such cases, an entity may not be managing or hedging risk exposures on the non-financial asset and, in that case, it cannot apply hedge accounting.

4. Accordingly, the Committee published a tentative agenda decision in which it concluded that the requirements in IFRS 9 provide an adequate basis for an entity to determine whether foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset held for consumption that an entity can designate as the hedged item in a fair value hedge accounting relationship.

5. The objective of this paper is to:

   (a) analyse the comments on the tentative agenda decision; and

(b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision.

Structure of the paper

6. This paper is structured as follows:

   (a) comment letter summary;

   (b) staff analysis; and

   (c) staff recommendation.

7. There are two appendices to this paper:

   (a) Appendix A—Proposed wording of the agenda decision; and

   (b) Appendix B—Comment Letters.

Comment letter summary

8. We received 10 comment letters by the comment letter deadline. All comment letters received, including any late comment letters, are available on our website.[1] This agenda paper includes analysis of only the comment letters received by the comment letter deadline. These are reproduced in Appendix B to this paper.

9. The responses are summarised as follows:

   (a) three respondents agree with the Committee's analysis and conclusions—Mazars, the Institute of Indonesia Chartered Accountants and the Malaysian Accounting Standard Board.

[1] At the date of finalising this agenda paper, there were no late comment letters.

(b) two respondents agree with the Committee's conclusions, but say that elements of the tentative agenda decision may be open to conflicting interpretations and ask for greater clarity—International Air Transport Association's Industry Accounting Working Group (IATA) and easyJet.

(c) two respondents agree with aspects of the Committee's analysis and conclusions, but comment on other aspects—PwC and Deloitte.

(d) two respondents comment on the Committee's analysis and conclusions—Institute of Chartered Accountants of India (ICAI) and the Accounting Standards Committee of Germany (ASCG).

(e) one respondent (Petrobras) disagrees with the Committee's conclusion that the requirements in IFRS 9 provide an adequate basis for an entity to conclude on the matter. It says the Committee should add the matter to its standard-setting agenda.

10. We present below further details about the comments raised by respondents, together with our analysis.

Staff analysis

11. We grouped comments using the structure of the tentative agenda decision, based on whether they relate to:

(a) exposure to foreign currency risk on a non-financial asset held for consumption (paragraphs 12–17);

(b) whether foreign currency is a separately identifiable and reliably measurable risk component (paragraphs 18–25); and

(c) consistency with an entity's risk management activities (paragraphs 26–50).

Exposure to foreign currency risk on a non-financial asset held for consumption

Circumstances in which foreign exchange risk arises

Respondents' comments

12. The ASCG says it is concerned with the Committee's description that foreign exchange risk arises from pricing a non-financial asset 'in one particular currency at a global level'. It says it remains unclear whether fair value hedge accounting applies in the circumstances described in the two examples included in Agenda Paper 4 for the June 2019 Committee meeting (June Agenda Paper)[2]. The examples refer to a 'established market' in the foreign currency, and to a market in which 'purchases and sales of the non-financial asset are routinely denominated' in the foreign currency. Therefore, the ASCG says the tentative agenda decision might inadvertently narrow the fact patterns to which fair value hedge accounting applies.

13. IATA says it is unclear whether the tentative agenda decision applies to non-financial assets priced only in a single currency in the relevant market, or only in a single currency in all markets. It suggests clarifying the wording through an illustrative example.

Staff analysis

14. In considering the matter described in the submissions, the Committee decided to address more generally whether and how the hedge accounting requirements in IFRS 9 apply to foreign currency risk on non-financial assets held for consumption, rather than considering specific fact patterns that are not yet common (including those illustrated in the examples in the June Agenda Paper). In doing so, the Committee specifically described the circumstances in which it concluded that an entity would be exposed to foreign currency risk. The tentative agenda decision applies only when these

[2] Paragraphs 6.5.2(a) describes a fair value hedge as 'a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss'.

circumstances exist (ie it would apply to fact patterns such as those in the examples *if* they represent the circumstances described in the tentative agenda decision).

15. We note that the Committee specifically discussed the circumstances in which foreign exchange risk arises on a non-financial asset held for consumption at the June Committee meeting. The tentative agenda decision reflects the Committee's view that this is the case when the fair value of the non-financial asset is determined only in one currency in all markets for that non-financial asset (ie at a global level). We think no changes are needed to the wording of the tentative agenda decision in this regard.

Implementation Guidance that accompanied IAS 39

Respondent's comments

16. Paragraph F.6.5 of the Implementation Guidance that accompanied IAS 39 *Financial Instruments: Recognition and Measurement* states that an entity cannot apply fair value hedge accounting to hedge foreign currency risk in a ship 'since a ship does not contain any separately measurable foreign currency risk'. PwC suggested that the Committee clarify why that paragraph does not apply to the matter addressed in the tentative agenda decision.

Staff analysis

17. The submissions asked how an entity applies the hedge accounting requirements in IFRS 9, not those in IAS 39. Based on its analysis, the Committee concluded that the requirements in IFRS 9 provide an adequate basis for an entity to conclude on the matter, without the need to refer to the Implementation Guidance that accompanied IAS 39 for further insights. Furthermore, we note that any material included in implementation guidance accompanying IFRS Standards does not override requirements in the Standards.

Whether foreign currency is a separately identifiable and reliably measurable risk component

Foreign currency risk as a 'building block' of fair value

Respondents' comments

18. PwC says, when determining whether a risk component is separately identifiable and reliably measurable, IFRS 9 requires an entity to determine whether the risk component is a 'building block' of the fair value using the relevant market structure. PwC asks why this would be the case in the fact pattern in the submission, because the foreign currency effect arises only from translating a market price determined in a foreign currency to the entity's functional currency.

19. PwC says that different considerations apply to financial assets because those assets generate foreign currency cash flows from payments of dividends, interest, and principal, rather than only from their sale. For those assets, PwC says foreign currency clearly is a separately identifiable and reliably measurable risk component.

20. On the other hand, IATA says both IAS 39 and IFRS 9 state that foreign currency is an eligible risk for hedge accounting purposes. It also says that foreign currency risk is not priced into the asset; rather, it is established when an entity with another functional currency holds the asset.

Staff analysis

21. We think the tentative agenda decision already explains the reasons for the Committee's conclusion that foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset.

22. Paragraph 6.5.2(a) of IFRS 9 describes a fair value hedge as 'a hedge of the exposure to changes in fair value of a recognised asset…that is attributable to a particular risk and could affect profit or loss'. The measure of fair value that could affect profit or loss—and therefore to which an entity is exposed—is the fair value translated into the entity's functional currency (translated fair value).

23. Therefore, the entity considers whether foreign currency risk is separately identifiable and reliably measurable with reference to the effect of changes in exchange rates on the translated fair value, rather than the fair value determined in the foreign currency before translation. The effect of translation is therefore a component of the translated fair value that an entity can separately identify and reliably measure.

24. When an entity hedges changes in fair value, the translated fair value of an asset changes as a result of changes in exchange rates irrespective of whether the asset directly generates foreign currency cash flows. In such circumstances, the changes in fair value of the assets an entity hedges arise from the translation of the asset's fair value—not its cash flows—into an entity's functional currency. This is the case for both financial and non-financial assets.

25. We note however that foreign currency risk is not always an eligible hedged risk. In particular and, as noted in the tentative agenda decision, paragraph 6.3.7(a) of IFRS 9 requires risk components to be separately identifiable and reliably measurable based on an assessment within the context of the particular market structure.

Consistency with an entity's risk management activities

Cash flow hedge is more consistent with risk management activities

Respondents' comments

26. PwC and the ICAI suggest that, when a non-financial asset is held for consumption, cash flow hedge accounting would be more consistent with the entity's risk management strategy than fair value hedge accounting. They say, in the fact pattern submitted, foreign currency risk arises primarily from the forecast sale of the asset after it has been used for a substantial period, and not from cash flows generated by the asset's use in the period before it is sold. Therefore, the entity's risk management strategy is to hedge the foreign currency risk arising from the sale of the non-financial asset, rather than to hedge its current fair value.

27. IATA also says a hedge of foreign currency exposure on the expected value of a non-financial asset at the date of sale would appear to be a cash flow hedge of a highly probable transaction, not a fair value hedge.

Staff analysis

28. The submissions asked whether an entity can designate foreign currency risk on a non-financial item held for consumption as the hedged item in a *fair value* hedge accounting relationship. The submissions did not ask whether an entity can apply cash flow hedge accounting to a highly probable forecast sale of a non-financial asset.

29. The tentative agenda decision sets out the Committee's considerations on whether an entity can apply fair value hedge accounting. These considerations include whether, and in which circumstances, the designation can be consistent with an entity's risk management activities in the context of a fair value hedge. Therefore, we think the tentative agenda decision appropriately responds to the question asked. We recommend no change to the tentative agenda decision in this regard.

Risk management activities in practice

Respondents' comments—risk management and the amount of the hedged item

30. PwC says the wording of the tentative agenda decision does not sufficiently convey the expectation, expressed by some Committee members, that the designation of foreign currency risk on a non-financial asset held for consumption would be consistent with an entity's risk management activities only in very limited circumstances. PwC suggests that the Committee strengthen the wording of the tentative agenda decision in this regard, possibly by drawing on paragraph 46 of the June Agenda Paper.[3]

[3] That paragraph stated: 'We expect that an entity would manage and hedge exposures to changes in fair value of non-financial assets held for consumption only in very limited circumstances. This may be the case, for example, if (a) the non-financial asset is priced, and its fair value determined, only in a foreign currency; (b) the entity has an

31. The tentative agenda decision states that 'to the extent that an entity intends to consume a non-financial asset (rather than to sell it), the Committee observed that changes in the fair value of the non-financial asset may be of limited significance to the entity. In such cases, an entity may not be managing or hedging risk exposures on the non-financial asset and, in that case, it cannot apply hedge accounting.' PwC says it agrees with the Committee's observation, but this statement could affect the amount that would be eligible for hedging—the current fair value or only the residual value of the non-financial asset.

32. PwC says when the entity's strategy is to use the non-financial asset for a period of time to generate largely functional currency cash flows from its use and only then to sell it in the foreign currency, foreign currency risk arises only from the future sale of the asset for its residual value. However, PwC says some hold the view that, if there is any realistic possibility that the entity might sell the asset, then the current fair value may be hedged, even if such sale is unlikely.

33. IATA, on the other hand, says it is concerned that the tentative agenda decision could be read as only permitting an entity to hedge the residual value of the non-financial asset (ie it would not permit an entity to hedge the current fair value). It says such interpretation would appear to be inconsistent with the conclusion that a non-financial asset held for consumption may have a foreign currency risk that could affect profit or loss.

34. IATA says it reads the tentative agenda decision as supporting a hedge of the current fair value. It says:

    (a) an airline may own large commercial aircrafts, which are priced exclusively in one currency (USD).

---

established practice of selling the non-financial asset (eg a PPE asset) part-way through its economic life; (c) the expected residual value of the asset at the date of sale is significant; and (d) the entity manages the foreign currency exposure only on the residual value of the item'.

(b) the ownership of such an aircraft exposes the airline to its fair value whether it intends to consume or sell the aircraft, because fair value affects decisions on whether to refinance, sell, deploy or reinvest in the aircraft.

(c) an airline assesses such decisions throughout the life of the aircraft and foreign currency movements are a determining factor.

35. Therefore, a fair value hedge of foreign currency risk on the full current fair value of an aircraft may be part of an airline's risk management activities.

Respondent's comments—volatility from lease liabilities

36. easyJet says the tentative agenda decision helps address an issue introduced by the application of IFRS 16 *Leases*, whereby the translation of lease liabilities denominated in a foreign currency creates foreign exchange volatility in profit or loss. easyJet says that industries, such as the airline industry, that have large amounts of liabilities denominated in a foreign currency 'have been forced to address this issue by, in many instances, altering their risk management strategy to mitigate potentially large, unpredictable movements in the income statement'. It says 'utilising fair value hedging on the related non-financial asset (right of use asset or other owned PPE Asset) would reduce this accounting risk by matching the foreign exchange impacts of the lease liability to the value of the asset held (which could, in theory, be sold)'.

Respondent's comments—uncertainty about existence of possible risk management policies

37. Deloitte says some references in the tentative agenda decision could be read as introducing uncertainty about the existence of possible risk management policies to manage changes in fair value of a non-financial asset held for consumption.[4] Deloitte

[4] These references are (a) 'to the extent an entity intends to consume a non-financial asset (rather than to sell it), the Committee observed that changes in fair value of the non-financial asset may be of limited significance to the entity' and (b) 'an entity would consider how its hedge accounting designation addresses…[the] expected sale/maturity of the hedged item'.

says, in practice, such risk management strategies may validly exist, although this will depend on the particular facts and circumstances. Deloitte suggests either deleting the references or providing further clarification on the necessary components of a risk management strategy that qualifies for hedge accounting.

Staff analysis

38. At the June meeting, the Committee considered whether an entity can designate foreign currency risk on a non-financial asset held for consumption as the hedged item in a fair value hedge accounting relationship. In this context, the Committee noted that even though an entity might be exposed to foreign exchange risk on a non-financial asset it holds, the entity is unlikely to take active steps to hedge that exposure if it intends to fully consume the asset.

39. The section of the tentative agenda decision quoted in paragraph 31 of this paper therefore captured the notion that an entity is unlikely to be managing or hedging risk exposures on the portion of the value of a non-financial asset that it expects to consume (ie 'the extent' to which it is consumed). In that case, an entity's risk management activities would not be expected to target the full current fair value (and in this case the related foreign currency exposure) of a non-financial asset held for consumption.

40. We acknowledge that entities may monitor changes in fair value of non-financial assets held for consumption, and that such changes may influence business and operating decisions such as those described in paragraph 34(b). However, the fact that an entity makes such decisions based on the fair value of a non-financial asset does not mean the entity's risk management strategy is to *hedge* these exposures.

41. Indeed, a risk management strategy to hedge the current fair value of a non-financial asset held for consumption would be inconsistent with the entity's business model of holding that non-financial asset for consumption (rather than for sale). Therefore, we disagree with IATA that a risk management strategy can be consistent with the designation of the full current fair value of a non-financial asset as the hedged item when the entity intends to consume (or partially consume) that non-financial asset.

42. IFRS 9 permits an entity to apply hedge accounting only for hedged items it *actually* hedges, using hedging instruments that the entity *actually* uses to hedge the hedged item. This is reflected, for example, in the requirement in paragraph 6.4.1(c)(iii) of IFRS 9.[5] IATA mentions reasons why entities in the airline industry may monitor changes in the current fair value of aircraft, but it did not provide further insights on how these entities use hedging instruments to manage that foreign exchange risk exposure on the non-financial assets. For a hedge accounting designation to be consistent with an entity's risk management activities, the entity must actually use hedging instruments for risk management purposes.

43. An entity might have a risk exposure arising from a financial instrument—for example, foreign currency risk arising from a foreign currency borrowing—that it decides not to hedge because the exposure is within the entity's risk tolerance. The fact that the entity's risk management strategy allows the entity to accept such risk exposure is different from the deliberate use of that instrument (eg a foreign currency borrowing) to hedge a fair value risk exposure the entity expects will never affect its profit or loss.

44. Accordingly, risk management activities that involve monitoring changes in fair value of non-financial assets for business and operating purposes would not necessarily involve the 'actual' use of hedging instruments to hedge the risk exposures.

45. Furthermore, IFRS 9 prescribes strict criteria for hedging relationships to qualify for hedge accounting. One such requirement is the existence of an economic relationship between the hedged item and the hedging instrument—this means that the hedging instrument and hedged item have values that generally move in the opposite direction because of the same risk, which is the hedged risk.[6] We note that the fair value of a non-financial asset in the foreign currency can change for reasons that would not result in a

[5] Paragraph 6.4.1(c)(iii) of IFRS 9 requires that the hedge ratio of a hedging relationship is the same as that resulting 'from the quantity of the hedged item that the entity *actually* hedges and the quantity of the hedging instrument that the entity *actually* uses to hedge that quantity of hedged item' (emphasis added).

[6] Paragraph B6.4.4 of IFRS 9

change in the amount of the hedging instrument. Because of this, an economic relationship may not exist between the current fair value of the non-financial asset and the hedging instrument in the functional currency of the reporting entity.

46. For these reasons, we continue to think an entity would actively manage the exposure to changes in fair value of non-financial assets held for consumption only in very limited circumstances. We also consider that, in such circumstances, an entity would use hedging instruments to hedge only those fair value exposures that it expects will affect its profit or loss as opposed to the full current fair value of the asset.

47. Finally, we note that easyJet describes risk management activities aimed at reducing foreign exchange volatility arising from translating a financial liability denominated in a foreign currency. We think that such risk management activities are inconsistent with the designation of foreign exchange risk on a non-financial asset as the hedged item in a fair value hedge relationship. This is because, in the case described by easyJet, the risk exposure (and accounting effect) the entity actually manages would appear to be those arising on a financial liability, thereby indicating that the hedged item is the financial liability rather than the non-financial asset.

48. Comments received indicate that it would be helpful to expand the discussion in the agenda decision regarding an entity's risk management activities. Consequently, based on our analysis we recommend that the Committee clarify that:

    (a) to the extent it intends to consume the non-financial asset, an entity is unlikely to be managing and using hedging instruments to hedge the risk exposures on the non-financial asset;

    (b) the Committee expects that an entity would manage and hedge exposures to changes in fair value of non-financial assets held for consumption only in very limited circumstances, and provide an example of such circumstances; and

    (c) risk management activities that aim only to reduce foreign exchange volatility arising from translating a financial liability denominated in a foreign currency are inconsistent with the designation of foreign exchange risk on a non-financial asset as the hedged item in a fair value hedge accounting relationship.

49. Appendix A to this paper sets out suggested changes to the tentative agenda decision.

50. In addition, we recommend that the Committee retain the references mentioned by Deloitte. We think the changes recommended above would clarify the Committee's views on the circumstances in which the designation of foreign currency risk on a non-financial asset held for consumption can be consistent with an entity's risk management activities.

Other comments

51. The table below summarises other comments received together with our analysis of those comments.

Comments	**Staff analysis and conclusions**
1. *Inconsistency with agenda decision on the application of the highly probable requirement* PwC asks whether the Committee's conclusion is inconsistent with the agenda decision 'Application of the Highly Probable Requirement when a Specific Derivative is Designated as a Hedging Instrument' published in IFRIC Update in March 2019. PwC says, in that agenda decision, the Committee concluded an entity could not apply hedge accounting because of the variability in the hedged item. PwC questions why different principles would apply in the two cases.	*We recommend no change to the tentative agenda decision in this respect.* The agenda decision referred to by PwC addressed a question about cash flow hedge accounting. It was therefore about a different aspect of the hedge accounting requirements in IFRS 9 than this question. The highly probable requirement in IFRS 9 is not applicable in the fact pattern discussed in this paper.

Comments	**Staff analysis and conclusions**
2. *Designation of a 'bottom layer' as the hedged item* PwC says entities considering designating a fair value hedge accounting relationship would need to hedge a fluctuating foreign currency amount. It says one approach being considered is to hedge a 'bottom layer' of risk up to the foreign currency amount the entity judges sufficiently certain to exist at the expected time of sale. Paragraph B6.3.19 of IFRS 9 requires that 'if a layer of a component is designated in a fair value hedge, an entity shall specify it from a defined nominal amount'. PwC questions how this paragraph would apply in the context of a non-financial item because fair value does not seem to be a 'defined nominal amount'.	*We recommend no change to the tentative agenda decision in this respect.* In responding to the question in the submissions, the Committee assessed only whether foreign currency can be a separately identifiable and reliably measurable risk component of a non-financial asset held for consumption. It did not consider how all other requirements in IFRS 9 would apply. Therefore, we think it would be beyond the scope of the agenda decision to specifically address this particular requirement. The tentative agenda decision does, however, note that an entity must apply all other applicable requirements in IFRS 9 in determining whether it can apply fair value hedge accounting in its particular circumstances.
3. *Interaction with commodities held as inventory* PwC says many of the considerations in the tentative agenda decision apply to commodities held as inventory. However, such items differ from items of Property, Plant and Equipment (PPE) because an entity often does	*We recommend no change to the tentative agenda decision in this respect.* One of the submissions included an example of a commodity inventory held for consumption. The considerations included in the tentative agenda decision

Comments	Staff analysis and conclusions
not consume inventory over time, but sells it for its full fair value. PwC suggests that the Committee clarify how this affects the analysis, in line with one of the submissions.	apply to any type of non-financial asset held for consumption, not only to items of PPE. Furthermore, as explained in paragraph 14 of this paper, the Committee decided not to consider specific fact patterns (such as the hedging of foreign currency risk on inventories held for consumption) because we have no evidence that such fact patterns are common.
4. *New information not in IFRS 9* Petrobras says the Committee added information not in IFRS 9 in paragraph 46 of the June Staff Paper (see paragraph 30 of this paper). Petrobras say additional clarifications should be incorporated in the Standard.	*We recommend no change to the tentative agenda decision in this respect.* We disagree with Petrobras. We think the tentative agenda decision adequately explains the Committee's basis for its conclusion based on the requirements in IFRS 9.
5. *Interpretation of 'could affect profit or loss'* The ICAI says fair value hedge accounting appears to be very rare and unusual for fact patterns such as the ones described in the June Staff paper. It says it is concerned that the interpretation of the words 'that could affect profit or loss' in paragraph 6.1.1 of IFRS 9 is	*We recommend no change to the tentative agenda decision in this respect.* As explained in the tentative agenda decision, IFRS 9 does not require changes in fair value to be expected to affect profit or loss; only that they 'could affect profit or loss'. For this reason, we

Comments	Staff analysis and conclusions
too liberal and could have unintended consequences.	continue to agree with the Committee's reading of paragraph 6.1.1 of IFRS 9.

Staff recommendation

53. Based on our analysis, we recommend the agenda decision is finalised as published in *IFRIC Update* in June 2019, with the changes noted in paragraph 48 of this paper. Appendix A to this paper sets out the proposed wording of the final agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision as set out in Appendix A to this paper?

Appendix A—Proposed wording of the agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined, and deleted text is struck through).

Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (*IFRS 9 Financial Instruments*)

The Committee received two requests about fair value hedge accounting applying IFRS 9. Both requests asked whether foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset held for consumption that an entity can designate as the hedged item in a fair value hedge accounting relationship.

Hedge accounting requirements in IFRS 9

The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or, in some cases, other comprehensive income) (paragraph 6.1.1 of IFRS 9).

If all the qualifying criteria specified in IFRS 9 are met, an entity may choose to designate a hedging relationship between a hedging instrument and a hedged item. One type of hedge accounting relationship is a fair value hedge, in which an entity hedges the exposure to changes in fair value of a hedged item that is attributable to a particular risk and could affect profit or loss.

An entity may designate an item in its entirety, or a component of an item, as a hedged item. A risk component may be designated as the hedged item if, based on an assessment within the context of the particular market structure, that risk component is separately identifiable and reliably measurable.

In considering the request, the Committee assessed the following:

Can an entity have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss?

Paragraph 6.5.2(a) of IFRS 9 describes a fair value hedge as 'a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss'.

Therefore, in the context of a fair value hedge, foreign currency risk arises when changes in exchange rates result in changes in the fair value of the underlying item that could affect profit or loss.

Depending on the particular facts and circumstances, a non-financial asset might be priced—and its fair value determined—only in one particular currency at a global level and that currency is not the entity's functional currency. If the fair value of a non-financial asset is determined in a foreign currency, applying IAS 21 *The Effects of Changes in Foreign Exchange Rates* the measure of fair value that could affect profit or loss is the fair value translated into an entity's functional currency (translated fair value). The translated fair value of such a non-financial asset would change as a result of changes in the applicable exchange rate in a given period, even if the fair value (determined in the foreign currency) were to remain constant. The Committee therefore observed that in such circumstances an entity is exposed to foreign currency risk.

IFRS 9 does not require changes in fair value to be expected to affect profit or loss but, rather, that those changes could affect profit or loss. The Committee observed that changes in fair value of a non-financial asset held for consumption could affect profit or loss if, for example, the entity were to sell the asset before the end of the asset's economic life.

Consequently, the Committee concluded that, depending on the particular facts and circumstances, it is possible for an entity to have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss. This would be the case when, at a global level, the fair value of a non-financial asset is determined only in one particular currency and that currency is not the entity's functional currency.

If an entity has exposure to foreign currency risk on a non-financial asset, is it a separately identifiable and reliably measurable risk component?

Paragraph 6.3.7 of IFRS 9 permits an entity to designate a risk component of an item as the hedged item if, 'based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable'.

Paragraph 82 of IAS 39 *Financial Instruments: Recognition and Measurement* permits the designation of non-financial items as hedged items only for foreign currency risks, or in their entirety for all risks, 'because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to specific risks other than foreign currency risks'. Paragraph BC6.176 of IFRS 9 indicates that, in developing the hedge accounting requirements in IFRS 9, the Board did not change its view that there are situations in which foreign currency risk can be separately identified and reliably measured. That paragraph states that the Board 'learned from its outreach activities that there are circumstances in which entities are able to identify and measure many risk components (not only foreign currency risk) of non-financial items with sufficient reliability'.

Consequently, the Committee concluded that foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset. Whether that is the case will depend on an assessment of the particular facts and circumstances within the context of the particular market structure.

The Committee observed that foreign currency risk is separately identifiable and reliably measurable when the risk being hedged relates to changes in fair value arising from translation into an entity's functional currency of fair value that, based on an assessment within the context of the particular market structure, is determined globally only in one particular currency and that currency is not the entity's functional currency. The Committee noted, however, that the fact that market transactions are commonly settled in a particular currency does not necessarily mean that this is the currency in which the non-financial asset is priced—and thus the currency in which its fair value is determined.

Can the designation of foreign currency risk on a non-financial asset held for consumption be consistent with an entity's risk management activities?

Paragraph 6.4.1(b) of IFRS 9 requires that, at the inception of a hedging relationship, 'there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge'. Accordingly, the Committee observed that, applying IFRS 9, an entity can apply hedge accounting only if it is consistent with the entity's risk management objective and strategy for managing its exposure. An entity therefore cannot apply hedge accounting solely on the basis that it identifies items in its statement of financial position that are measured differently but are subject to the same type of risk.

To the extent that an entity intends to consume a non-financial asset (rather than to sell it), the Committee observed that changes in the fair value of the non-financial asset may be of limited significance to the entity. In such cases, an entity ~~may not~~ is unlikely to be managing ~~or hedging~~ and using hedging instruments to hedge risk exposures on the non-financial asset and, in that case, it cannot apply hedge accounting.

The Committee expects that an entity would manage and hedge exposures to changes in fair value of non-financial assets held for consumption only in very limited circumstances. This may be the case, for example, if (a) the entity expects to sell the non-financial asset (eg an item of property, plant and equipment) part-way through its economic life; (b) the expected residual value of the asset at the date of sale is significant; and (c) the entity manages and uses hedging instruments to hedge the foreign currency exposure only on the residual value of the asset.

Furthermore, the Committee observed that risk management activities that aim only to reduce foreign exchange volatility arising from translating a financial liability denominated in a foreign currency applying IAS 21 are inconsistent with the designation of foreign exchange risk on a non-financial asset as the hedged item in a fair value hedge accounting relationship. In such circumstances, the entity is managing the foreign currency risk exposure arising on the financial liability, rather than the risk exposure arising on the non-financial asset.

Other considerations

An entity applies all other applicable requirements in IFRS 9 in determining whether it can apply fair value hedge accounting in its particular circumstances, including requirements related to the designation of hedging instruments and hedge effectiveness. For example, an entity would consider how its hedge accounting designation addresses any differences in the size, depreciation/amortisation pattern and expected sale/maturity of the hedged item and the hedging instrument.

For any risk exposure for which an entity elects to apply hedge accounting, the entity also makes the disclosures required by IFRS 7 *Financial Instruments: Disclosures* related to hedge accounting. The Committee noted, in particular, that paragraphs 22A–22C of IFRS 7 require the disclosure of information about an entity's risk management strategy and how it is applied to manage risk.

The Committee concluded that the requirements in IFRS 9 provide an adequate basis for an entity to determine whether foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset held for consumption that an entity can designate as the hedged item in a fair value hedge accounting relationship. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda

Appendix B—Comment letters

Deloitte.

Deloitte Touche Tohmatsu Limited
Hill House
1 Little New Street
London
EC4A 3TR

Phone: +44 (0)20 7936 3000
Fax: +44 (0)20 7583 0112
www.deloitte.com/about

Direct phone: +44 20 7007 0884
vepoole@deloitte.co.uk

20 August 2019

Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom
E14 4HD

Dear Ms Lloyd

Tentative agenda decision – Fair value hedge of foreign currency risk on non-financial assets (IFRS 9)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the June 2019 IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on fair value hedge accounting for foreign currency risk on non-financial assets.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision. However, we have some concerns with the articulation of the agenda decision in the case where an entity is intending to consume the non-financial item.

We believe there are three main questions to be addressed:

- Can an entity have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss?
- If an entity has exposure to foreign currency risk on a non-financial asset, is it a separately identifiable and reliably measurable risk component?
- Can the designation of foreign currency risk on a non-financial asset held for consumption be consistent with an entity's risk management activities?

The response to the first two questions as articulated in the agenda decision is broadly yes, subject to the specific facts and circumstances. We support this. We also support the need to ask the third question given under IFRS 9 an entity can only apply hedge accounting if it is consistent with the risk management objective and strategy for managing its exposure. Therefore, in order for an eligible fair value hedge to be designated it needs to be consistent with the entity's risk management objective. However, the proposed agenda decision states that "[t]o the extent an entity intends to consume a non-financial asset (rather than to sell it), the Committee observed that changes in fair value of the non-financial asset may be of limited significance to the entity" but does not rule out that such a risk management strategy could be valid. The agenda decision also states that "an entity would consider … [the] expected sale/maturity of the hedged item" in the designation of the non-financial asset. We believe, taken together, these two parts of the agenda decision could be read as introducing an uncertainty about the existence of possible risk management policies to manage changes in fair value of a non-financial asset held for consumption. In practice, it is possible that such a risk management strategy may validly exist and that a hedge is consistent with that strategy, but this will depend on the specific facts and circumstances. Therefore, we would suggest either deleting the two references noted above or providing further clarification on what are the necessary components of a risk management strategy that would qualify.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Ms Sue Lloyd
Chair, IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
London E14 4HD

7 August 2019

Dear Sue

Tentative agenda decision - Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9 Financial Instruments)

We are commenting on the above tentative agenda decision, published in the June 2019 edition of IFRIC Update, on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the rejection. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree with the Committee addressing this issue in an agenda decision. Whilst this kind of hedge is not currently common, we are aware of a number of entities considering using such hedge accounting in particular given their adoption of IFRS 16.

We have a number of comments on the tentative agenda decision. We have set these out below under each of the sub-headings used in the tentative agenda decision.

Can an entity have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss?

We agree an entity can, in limited circumstances, have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss. We also agree that this might arise if the entity were to sell the asset before the end of its useful economic life.

However, in the fact pattern in the agenda submission, the foreign currency risk arises primarily from the forecast sale of the asset for its residual value after it has been used for a substantial period, and not from the cash flows generated by the asset's use in the period before it is sold. It follows that the risk being hedged arises from the residual value at the time of the future sale rather than the current fair value. This raises two key questions that are not fully addressed in the tentative agenda decision: first whether cash flow hedge accounting (rather than fair value hedge accounting) would be more consistent with the entity's risk management strategy; and secondly what amount may be hedged (the current fair value or only the expected residual value at the time of sale). We expand on these below in our comments on risk management activities and on how this hedge might differ from a hedge of an asset not held for consumption such as commodity held as inventory. We suggest the Committee address them in finalising the agenda decision.

pwc

If an entity has such exposure, is it a separately identifiable and reliably measurable risk component?

When determining if a risk component is separately identifiable and reliably measurable, we note that IFRS 9 requires this be "based on an assessment within the particular market structure" (IFRS 9 6.3.7(a)). Furthermore, the examples in IFRS 9 para B6.3.10 demonstrate that IFRS 9 takes a "building block" approach. We therefore think that, in the context of a fair value hedge of a non-financial item, IFRS 9 requires an entity to determine whether the risk component is a 'building block' of the fair value determined using the relevant market structure.

We suggest the Committee explains why this is the case in the fact pattern in the agenda submission, where the foreign currency effect arises only from translating a market determined fair value/price (in say USD) into the entity's functional currency (that is non-USD). In particular we suggest the Committee addresses the alternative view in the agenda submission that, in such a case, USD is not one of the building blocks or components of the USD market price/fair value. We also suggest that the Committee clarify why IG F6.5 – that states that an entity cannot apply fair value hedge accounting to a hedge of the foreign currency risk in a ship "since a ship does not contain any separately measurable foreign currency risk" – does not apply given that we understand certain types of ship are purchased and sold in USD on a global basis.

In particular we are aware that a number of airlines (with a non-USD functional currency) are considering applying hedge accounting in the way set out in the agenda submission. This would be on the grounds that certain types of aircraft are very often traded – and their prices quoted – in USD. However, we understand that the USD might often not be judged to be a separately identifiable and reliably measurable component of the quoted USD price. Rather, the prices of second hand aircraft are mainly influenced by factors such as supply and demand for airline travel in different parts of the world, technology (that influences which routes individual aircraft are permitted to fly on), model type (as illustrated by recent developments affecting the Boeing Max 737), and age and usage of the aircraft (as all other things being equal, the value of an aircraft tends to decrease with age and miles flown since the last D-check). So a separately identifiable USD risk component arises only from translating the USD quoted price into the entity's non-USD functional currency.

A further challenge arises from the fact that the USD price will fluctuate because of a number of factors as noted above (including when the asset will be sold). So the entity would need to hedge the USD risk of a fluctuating USD amount. In this context we note that one approach being considered is to hedge the 'bottom layer' of risk up to the USD amount that the entity judges is sufficiently certain to exist at the expected time of sale. However we note that IFRS 9 para B6.3.19 requires that "If a layer component is designated in a fair value hedge, an entity shall specify it from a defined notional amount." We question how this paragraph applies in this context as the USD price of aircraft would not seem to be a "defined notional amount" - and hence whether it precludes such an approach of hedging a 'bottom layer'. We also note that in the recent agenda decision on load following swaps, the variability in the hedged item was the reason that the Committee concluded hedge accounting could not be applied, even when the amount of the hedging instrument itself incorporates the same variability (that is not the case here). We therefore question if the tentative agenda decision is consistent with that on load following swaps. Whilst the conclusion on load following swaps was in the context of a cash flow hedge rather than a fair value hedge, we question why different principles should apply, in particular given our question above about whether a hedge of a forecast sale of an asset held for consumption might be better accounted for as a cash flow hedge than a fair value hedge. We therefore suggest that the Committee clarify how the requirement of B6.3.19 is met in the fact pattern in the submission.

pwc

We note that this issue has wider implications beyond just aircraft and other PPE held for consumption. In particular, we understand some companies that hold commodities (such as crude oil and certain precious metals) as inventory might also look to apply fair value hedge accounting. Whilst many of the same considerations apply there is one key difference from a hedge of PPE. This is that the hedged item is often not consumed by being used over time and so all of the fair value is realised from its sale in the foreign currency. We suggest the Committee clarify how this affects the analysis, in line with the second agenda submission received by the Committee.

We also note that some have questioned whether different considerations apply for foreign currency financial assets (such as debt and equity investments). We think they do. We note a foreign currency financial assets generates cash in the foreign currency from payments of dividends/interest and principal rather than only from its sale. So if those are in the foreign currency it is clear there is a separately identifiable and reliably measurable risk component (consistent with the guidance in IG F2.19).

Can the designation of foreign currency risk on a non-financial asset held for consumption be consistent with an entity's risk management activities?

We agree with the Committee that an entity can apply hedge accounting only if it is consistent with the entity's risk management objective and strategy for managing its exposure. We further note that in the discussion at the June Committee meeting several Committee members commented that the designation of foreign currency risk on an asset held for consumption would be consistent with an entity's risk management activities only in very limited circumstances. Some members referenced paragraph 46 of the agenda paper that describes when these 'very limited circumstances' might arise[1]. In our view the wording of the tentative agenda decision does not sufficiently convey this and we are aware that some are of the view that fair value hedge accounting can be used if there is any realistic possibility the entity might sell the asset, even if such a sale is unlikely. We therefore suggest the Committee consider strengthening the words in this section, perhaps drawing on paragraph 46 of the agenda paper.

We also agree that to the extent an entity intends to consume a non-financial asset (rather than to sell it), changes in the fair value of that asset may be of limited significance to the entity and it may not be managing or hedging risk exposures on the asset. As noted above, we think this affects the amount that may be hedged – and whether this is the current fair value or only the expected residual value at the time of sale. In particular, where (as in the case in the submission), the entity's strategy is to use the non-financial asset for a period of time to generate largely functional currency cash flows from its use and only then to sell it in the foreign currency, we think the foreign currency risk arises only from the future sale of the asset for its then residual value. However, we are aware that some are of the view that if there is any realistic possibility the entity might sell the asset at the reporting date then the full

---

[1] "We expect that an entity would manage and hedge exposures to changes in fair value of non-financial assets held for consumption only in very limited circumstances. This may be the case, for example, if (a) the non-financial asset is priced, and its fair value determined, only in a foreign currency; (b) the entity has an established practice of selling the non-financial asset (eg a PPE asset) part-way through its economic life; (c) the expected residual value of the asset at the date of sale is significant; and (d) the entity manages the foreign currency exposure only on the residual value of the item."

current fair value may be hedged, even if such a sale is unlikely and the current fair value is substantially higher than the expected residual value at the time of sale. We therefore suggest the Committee consider strengthening the words in this section.

Finally, as noted above, we question whether cash flow hedge accounting might be more consistent with the entity's risk management strategy. Where (as in the case in the submission), the entity's strategy is to use the non-financial asset for a period of time to generate largely functional currency cash flows from its use and only then to sell it in the foreign currency, the entity's risk management strategy is to hedge only the foreign currency risk from the future sale of the asset. We note the distinction is important as it affects both:

- whether the hedge qualifies for hedge accounting. In particular for a cash flow hedge of a forecast sale, that sale must be highly probable; and
- the amount that may be hedged. In a cash flow hedge of a forecast sale it is clear that only the forecast sales proceeds – i.e. the residual value at the time of the sale – can be hedged. Conversely, as noted in the point above, in a fair value hedge this is less clear.

We therefore suggest that if the Committee continues to believe this can be accounted for as a fair value hedge, it is clearer as to why and in what circumstances.

If you have any questions in relation to this letter please do not hesitate to contact Henry Daubeney, PwC Head of Reporting and Chief Accountant (+44 7841569635), or Sandra Thompson (+ 44 7921 106900).

Yours sincerely,

PricewaterhouseCoopers

PricewaterhouseCoopers

Mrs Sue Lloyd

IFRS Interpretations Committee

Columbus Building,
7 Westferry Circus, Canary Wharf

London E14 4HD
United Kingdom

Paris, 1 August 2019

Tentative Agenda Decisions – IFRIC Update November 2018

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee Tentative Agenda Decisions published in the June 2019 IFRIC Update.

We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

We would like to draw your attention to three issues that we think are worth considering:

- The Tentative Agenda Decision on the Lessee's Incremental Borrowing Rate is not conclusive as to whether IBR should reflect the payment profile of the lease. We believe that sufficient guidance exists in the standard and the basis for conclusions for the Committee to reach the conclusion that IBR should be consistent with the payment profile of the lease.
- The assessment of the lease term is the most important area of judgement in applying IFRS 16, and we observe that significant diversity exists in practice on that matter. This is a strong indicator that the standard needs clarifications, and we believe these clarifications cannot be provided through a simple agenda decision considering the interactions of the different paragraphs of the standard and inconsistencies between the standard itself and the corresponding basis for conclusions. That is why we urge

61, rue Henri Regnault - 92075 - Paris la-Défense Cedex
Tel: +33 (0)1 49 97 60 00 - Fax: +33 (0)1 49 97 60 01 - www.mazars.fr

Mazars
Société Anonyme d'Expertise Comptable et de Commissariat aux Comptes à Directoire et Conseil de Surveillance
Capital de 8 320 000 euros
RCS Nanterre 784 824 153 - Siret 784 824 153 00232 - APE 6920Z
Siege social : 61 rue Henri Regnault - 92400 Courbevoie - Tva intracommunautaire : FR 07 784 824 153

the Committee and/or the Board to undertake a narrow-scope standard-setting project on the lease term. In the meantime, we believe the Committee should not issue any agenda decision because its conclusions would preempt the outcome of the debate to be held during the standard-setting process.

- By not considering the question of whether the amount of airline compensation for delays or cancellations recognised as a reduction of revenue should be limited to reducing the transaction price to nil, the Committee fails to address an area of significant diversity in practice. A conclusion on that issue would be of great help.

Should you have any questions regarding our comments on the various tentative agenda decisions, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin

Financial Reporting Advisory

Edouard Fossat

Appendix 1

Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9 Financial Instruments) — Agenda Paper 4

We agree with the Committee's analysis and with its decision not to add this matter to its standard-setting agenda.

Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

ASCG • Zimmerstr. 30 • 10969 Berlin

Sue Lloyd
Chair of the IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH

United Kingdom

IFRS Technical Committee
Phone: +49 (0)30 206412-12
E-Mail: info@drsc.de

Berlin, 19 August 2019

Dear Sue,

IFRS IC's tentative agenda decisions in its June 2019 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decisions taken by the IFRS Interpretations Committee (IFRS IC) and published in the June 2019 *IFRIC Update*.

We agree with most of the tentative agenda decisions. However, we do not agree with the conclusion and/or the reasons behind three of these.

Please find our specific comments in the appendix to this letter. If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

Appendix – Detailed Comments

Tentative decision on IFRS 9 – Fair value hedge of FX risk on non-financial assets

We are not convinced that the IFRS IC's discussion and its findings help appropriately addressing the questions raised.

We have concerns with the IFRS IC's description where the FX volatility arises from in the different fact patterns (PPE, inventory, etc.). As per the tentative agenda decision, the (potentially designated) FX risk arises from pricing a non-financial asset "in one particular currency at a global level". In contrast, as per the Agenda Paper the non-financial assets are "routinely [be] denominated in a particular currency" or "purchased in an established market". As these are different, nonetheless precise, descriptions of FX market circumstances under which assets are to be translated into the functional currency, it remains unclear whether the condition in IFRS 9.6.5.2(a) is considered met under any of these circumstances. Depending on this, the wording might inadvertently narrow the fact patterns to which the IFRS IC's tentative decision would apply.

Tentative decision on IFRS 15 –Compensation for delays or cancellations

We do not fully agree with the tentative decision and conclusion in respect of the submitted fact pattern. Specifically, we would have appreciated a more holistic discussion that included variations of the fact pattern submitted or modified circumstances in order to better distinguish between situations where something is indeed a reduction of the selling price per IFRS 15 or separate obligations provided for under IAS 37. Without this, the tentative decision is not as helpful as it could be, as it does not illustrate potential legal or contractual rights and obligations that could distinguish between (a) compensations "still" being a variable consideration of the very same performance obligation and (b) those being a separate obligation, thus in the scope of IAS 37. Examples are distinguishing primary services vs. collateral services/obligations, low or non-performance vs. (penalty for) harm/damage, legal warranties vs. contractual guarantees, service-type warranties, product liabilities, etc. This said, we suggest the IFRS IC extend its discussion in this regard. This is of particular interest, as an agenda decision by the IFRS IC could affect service contracts in many different industries and not merely affect the airline sector concerned in the specific agenda item request.

Further, we question the appropriateness of not addressing the very important question of how to account for compensations that exceed the transaction price as we do believe this to be important in the fact patterns concerned, which is why it should not be ignored. Therefore, we request the IFRS IC to continue its discussion by considering and answering this follow-up question.

Given the broad relevance and complexity of this issue, we also suggest the IFRS IC re-consider whether clarifying IFRS 15 by way of an agenda decision is appropriate, esp. against the proposals in the revised Due Process Handbook.

Tentative decision on IFRS 16 – Lessee's incremental borrowing rate

We believe that the tentative decision and the explanation should be clarified. As the IFRS IC only states that "IFRS 16 does not **explicitly** require…" to determine the implicit borrowing rate based on a loan with a similar payment profile, it remains unclear whether, or under which circumstances, this is still implicitly required or not.

Since we understand IFRS 16 not to require an entity to revert to a loan with a similar payment profile, and in this respect agree with the tentative decision, we suggest that the word "explicitly" in the agenda's wording be deleted.

MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

20 August 2019

Ms. Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Ms. Lloyd

IFRS Interpretations Committee Tentative Agenda Decisions

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the Tentative Agenda Decisions published in IFRIC Update June 2019.

Our detailed responses are enclosed in the Appendix to this letter.

If you need further clarification, please contact the undersigned by email at beeleng@masb.org.my or at +603 2273 3100.

Thank you.

Yours sincerely,

TAN BEE LENG
Executive Director

Appendix

Compensation for Delays or Cancellations (IFRS 15 *Revenue from Contracts with Customers*) - Agenda Paper 8

We agree with the Interpretations Committee's conclusion that compensation for delays or cancellations, as described in the request, is a variable consideration and an entity applies IFRS 15 paragraphs 50-59 accordingly.

However, we would like to request the Interpretations Committee to clarify whether the amount of compensation recognised as a reduction of revenue is limited to reducing the transaction price to nil. Without such clarification an accounting policy would have to be developed for compensation exceeding the consideration received, either as reduction of revenue or separate expense. In this regard, the clarification would improve financial reporting as entities would be applying the requirement consistently and therefore comparable financial results are provided to users of financial statements.

- **Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9 *Financial Instruments*) - Agenda Paper 4**
- **Lessee's Incremental Borrowing Rate (IFRS 16 *Leases*) - Agenda Paper 2**
- **Lease Term and Useful Life of Leasehold Improvements (IFRS 16 *Leases* and IAS 16 *Property, Plant and Equipment*) - Agenda Paper 3**
- **Presentation of Liabilities or Assets Related to Uncertain Tax Treatments (IAS 1 *Presentation of Financial Statements*) - Agenda Paper 7**
- **Disclosure of Changes in Liabilities Arising from Financing Activities (IAS 7 *Statement of Cash Flows*) - Agenda Paper 5-5A**
- **Subsequent Expenditure on Biological Assets (IAS 41 *Agriculture*) - Agenda Paper 9**

We agree with the Interpretations Committee's reasons set out in the respective Tentative Agenda Decision for not adding these items onto its agenda.

Unit 13A-1, Menara MBMR, No. 1, Jalan Syed Putra, 58000 Kuala Lumpur.
Tel : (603) 2273-3100 Fax : (603) 2273-9400 Email : masb@masb.org.my Website : www.masb.org.my

IKATAN AKUNTAN INDONESIA
(INSTITUTE OF INDONESIA CHARTERED ACCOUNTANTS)

Jakarta, August 20th 2019

Ref.: 1287/DSAK/IAI/VIII/2019

Ms. Sue Lloyd
Chairperson
IFRS Interpretation Committee,
IFRS Foundation,
London, UK

DSAK IAI Comments on the Tentative Agenda Decision Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9).

Dear Ms. Sue Lloyd,

The Indonesian Financial Accounting Standards Board (DSAK IAI), as part of the Institute of Indonesia Chartered Accountants, is the national accounting standard-setter in Indonesia.

On behalf of DSAK IAI, I am writing to comment on the Tentative Agenda Decision Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9).

Our detailed responses to the questions are attached in the Appendix to this letter below.

We hope that our comments could contribute to the IFRIC's future deliberations. Should you have further concerns regarding our comments, please do not hesitate to contact us at dsak@iaiglobal.or.id.

Thank you.

Best Regards,

IKATAN AKUNTAN INDONESIA
(Institute of Indonesia Chartered Accountants)

Djohan Pinnarwan
Chairman
The Indonesian Financial Accounting Standards Board
Institute of Indonesia Chartered Accountants

GRHA AKUNTAN, Jalan Sindanglaya No. 1, Menteng, Jakarta 10310 - INDONESIA
Telp.: (62-21) 3190 4232 Hunting, Fax.: (62-21) 315 2076, E-mail: iai-info@iaiglobal.or.id, Home Page: http://www.iaiglobal.or.id

APPENDIX – Comment Letter of Tentative Agenda Decision - Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9)

DSAK IAI agrees with the IFRIC's Tentative Agenda Decision Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets and not to add it in its standard setting agenda. The objective of hedge accounting is to reflect the entity risk management on particular risk that could affect profit and loss in the financial statement and may be applied if all criteria in IFRS 9 are met.

Foreign exchange risk can be a separately identifiable and reliably measurable risk component of a non-financial asset depend on the assessment of particular facts and certain market structure. However the hedge accounting only can be applied if it is consistent with the entity's risk management objective and strategy of managing exposures. Entity should apply all requirement in IFRS 9 in determining whether it can apply fair value hedge accounting, including requirements related to the designation of hedging instruments and hedge effectiveness assessments. Entity applies IFRS 7 *Financial Instruments: Disclosures* related to the disclosure of hedge accounting.

We view IFRS 9 has provide an adequate basis to the fair value hedge of foreign currency risk on non-financial asset.

--- End of Document ---

Ms Sue Lloyd, August 20, 2019
Chair, IFRS Interpretations committee,
IFRS Foundation,
London, UK

Dear Ms Sue,

Subject: Tentative Agenda Decision (TAD) – Public Comments by August 20, 2019

Thank you for giving us an opportunity to comment on the seven tentative agenda decisions of IFRS Interpretation Committee published in June 2019. We have comments on following TADs:

- Fair Value Hedge of Foreign Currency Risk on Non- Financial Assets (IFRS 9)
- Lease Term and Useful Life of Leasehold Improvements (IFRS 16 and IAS 16)
- Compensation for Delays or Cancellations (IFRS 15)

The comments are given in the Annexure A. We hope you will find the same useful and relevant.

With kind regards,

CA. M.P Vijay Kumar
Chairman
Accounting Standards Board
Institute of Chartered Accountants of India

Annexure A

<u>Comments on TAD- 'Fair Value Hedge of Foreign Currency Risk on Non- Financial Assets (IFRS 9)'</u>

We have reviewed TAD and related IFRS Interpretations Committee (IFRS IC) agenda papers. Our concerns are as follows:

a) Considering fact pattern and examples of non-financial assets, like Property, Plant and Equipment, mentioned in the agenda papers, we believe use of hedge accounting appears to be very rare and unusual in such cases. We were also not sure whether it meets the fundamental objective of hedge accounting that particular risk could affect profit or loss. We are concerned that interpretation of words 'that could affect profit or loss' stated in paragraph 6.1.1 of IFRS 9 appears to be very liberal and may have unintended consequences.

b) Secondly, in view of the fact pattern, whether cash flow hedge accounting would be more consistent with the entity's risk management strategy rather than fair value hedge accounting. For example, where the entity's strategy is to use the non-financial asset for a period of time to generate cash flows from its use and then only to sell it in foreign currency, in such cases, entity's risk management strategy is to hedge the foreign currency risk from the sale of the non-financial asset and application of fair value hedge accounting may not be appropriate and consistent with the entity's risk management strategy.

<u>Comments on TAD- Lease Term and Useful Life of Leasehold Improvements (IFRS 16 and IAS 16)</u>

The Committee has concluded that the principles and requirements in IFRS 16 provide an adequate basis for an entity to determine the enforceable period and lease term of cancellable and renewable leases. The Committee reached the conclusion on the basis of the paragraphs 18, 19, B34, B37, BC 156 of IFRS 16 referred in the TAD.

IFRS 16.B34: *"In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the <u>contract is enforceable</u>. If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty"*

IFRS 16.B37: *"…….The entity considers all relevant facts and circumstances <u>that create an economic incentive</u> for the lessee to exercise, or not to exercise, the option, including any* *expected changes in facts and circumstances from the commencement date until the exercise date of the option….."*

*IFRS 16.*BC 156: *"In the IASB's view, the lease term should reflect an entity's reasonable expectation of the period during which the underlying asset will be used because that approach provides the most useful information."*

We are of the view that with regard to determination of Lease Term, while the IFRS 16 does provide guidance, however, there appears to be lot of confusion in determining the lease term and non-cancellable period of a lease by applying paragraphs 18, B34, B37 and BC156.

Paragraph B34 indicates that contractual provisions are to be considered but paragraphs 19 & B37 indicate non-contractual aspects, such as, economic incentives and compulsions should also be part of the analysis. Further, paragraph BC 156 indicates that lease term should reflect an entity's reasonable expectation of the period during which the underlying asset will be used. However, these paragraphs do not deal with the determination of the enforceable period of the lease.

The term 'enforceable' usually denotes 'legal enforceability' and arises out of contractual provisions, whereas evaluation of term 'reasonably certain' is based on judgement and even if it has a high threshold, it cannot be termed as 'enforceable'. We believe that combining these two terms which are based on different premises is a challenging one.

We have also noted that the Committee concluded that penalty has to be assessed considering the broader economics of the contract and not only the contractual terms. However, the term 'penalty' is not defined in the standard. We believe the term 'penalty' may be defined.

In view of the above, we are of the view that the issue in the TAD is linked to one of the fundamental principle of the Standard, i.e., lease term and the Committee should add the matter to its standard setting activity.

Comments on TAD- Compensation for Delays or Cancellations (IFRS 15)

Following are our concerns on the Tentative Agenda Decision (TAD) - Compensation for Delays or Cancellations (IFRS 15):

1. **Definition of penalty and its accounting**: From the TAD it appears that all the penalties are in the nature of variable consideration unless paid for causing harm or damage as prescribed in paragraph B 33. Moreover, there is no clear definition. We believe that only the penalties that are inherent in determination of transaction price should form part of variable consideration. Accordingly the term 'penalty' shall be defined. This definition will provide better clarity to determine the applicable IFRS Standard.

2. **Whether the amount of deduction/compensation recognised as a reduction of revenue can lead to a negative transaction price or not**: The aforementioned **TAD does not** deal with the situation where the **transaction price becomes negative** because of deduction/compensation recognised as reduction of revenue. The TAD does not prescribe accounting for negative transaction price in such cases. It may be noted that the lack of clarity in this regard may lead to diversity in practices.

   The committee may provide appropriate accounting guidance on the aforesaid issue considering that the deduction/compensation may exceed the amount of consideration received and thus revenue of that particular individual transaction may become negative.

IFRS Interpretations Committee
IFRS Foundation
Columbus Building
7 Westferry Circus
London
E14 4HD

Date 20/08/2019

Subject: Tentative Agenda Decision — Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9 Financial Instruments)

Dear IFRS Interpretations Committee:

On behalf of the International Air Transport Association's ("IATA") Industry Accounting Working Group ("IAWG"), we are writing to comment on the Tentative Agenda Decision - Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9 Financial Instruments) issued on June 21, 2019. IAWG is made up of senior finance professionals of major airlines and represents over 290 IATA member airlines.

IAWG agrees with the Committee's conclusion that a non-financial asset held for consumption may be the hedged item in a fair value hedge subject to the conditions outlined in the tentative agenda decision. We do express concern that some elements of the agenda decision remain open to conflicting interpretations. This results in the tentative agenda decision being seen by some to indicate that a hedge would not be allowed, as there would not a foreign currency risk except in relation to the value of the asset at the time of sale, and that would be difficult to predict. We urge the Committee to provide greater clarity in the agenda decision as explained below.

<u>Could a non-financial asset held for consumption create a foreign currency risk exposure?</u>

IAWG agrees with the conclusion the Committee reached with regard to it being possible for an entity to have exposure to foreign currency risk on a non-financial asset held for consumption that could affect profit or loss when, at a global level, the fair value of a non-financial asset is determined only in one particular currency and that currency is not the entity's functional currency.

We are concerned about the clarity of the wording of the tentative agenda decision with regard to the requirement that "within the context of the particular market structure", the fair value of the asset is determined globally only in one particular currency. For example, commercial real estate in the US (a particular market structure) is globally priced in USD, but commercial real estate is not priced globally in USD. We recommend that the Committee clarify this wording through an illustrative example that will clarify if the asset must only be priced in a single currency in the relevant market or a single currency in all markets.

IAWG is also concerned that some hold a view that the language in IFRS 9 regarding a market structure would require foreign currency to be a "building block" of the price of the asset in order to be an eligible component. Both IAS 39 and IFRS 9 clearly state that foreign currency is an eligible risk component. The foreign currency risk that would be designated as the hedged risk is not priced into the asset, but rather is established by the asset being held by an entity with another functional currency.

Could the foreign currency risk exposure in a non-financial asset held for consumption be separately identifiable and reliably measurable?

IAWG agrees with the conclusion the Committee reached that foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset. This had already been established under IFRS 9 and IAS 39.

Could the designation of foreign currency risk on a non-financial asset held for consumption be consistent with an entity's risk management activities?

IAWG agrees with the Committee's observation that in applying IFRS 9, an entity can apply hedge accounting only if it is consistent with the entity's risk management objective and strategy for managing its exposure. An entity therefore cannot apply hedge accounting solely on the basis that it identifies items in its statement of financial position that are measured differently and are subject to the same type of risk.

IAWG understands this to mean that the tentative agenda decision requires evidence of actual risk and that this be a genuine element of the entity's risk management strategy.

IAWG believes that the risk management strategy and objectives in relation to owned aircraft will differ amongst airlines. An airline is exposed to foreign currency risk whether it consumes an aircraft or sells it as this risk will impact the amount that can be refinanced or the price if sold. Therefore, to mitigate the foreign currency risk on the economic value on an airline's balance sheet, a fair value hedge of foreign currency risk embedded in an aircraft may form part of an airline's risk management strategy.

IAWG is aware of views that consider that when a non-financial asset is priced exclusively in one currency (for large commercial aircraft, that is USD), that the foreign currency risk only arises from translating the price of the asset to the functional currency and therefore an economic risk does not exist. We fundamentally disagree with this assessment.

While there are a number of factors that will influence the purchase and ongoing ownership of an aircraft, the most significant decision is pricing – which is dictated by the USD exchange rate. For example, purchases of the same aircraft by EUR functional currency entities at different points in the FX cycle, even though the USD price is unchanged, will lead to different pricing and competitive outcomes e.g. how the aircraft can be deployed at the lowest cost. These decisions may impact whether an aircraft is purchased, deployed, or re-invested. This would equally occur between US and non-US carriers.

We would highlight that in the case of the aviation industry, aircraft are a dynamic asset category and airlines may make different aircraft sale, fleet or reinvestment decisions (which are typically in USD, regardless of the airlines functional currency) at different points during the lifecycle.

In some cases, significant changes in exchange rates after the purchase of aircraft have led to significant impairments specifically recognized in relation to aircraft, where they have been written down to fair value with reference to USD as part of CGU impairment assessments (reference Qantas 2014). This can occur even when there has been no significant change in the underlying USD price of an aircraft, but there has been a significant shift in the exchange rates since the purchase.

IAWG notes that aircraft values vary based on market factors and an airline owning an aircraft is exposed to that volatility whether it consumes the aircraft or sells it as the value will impact refinancing, sales price and the decision on whether to dispose of or reinvest in the aircraft. While aircraft are generally held for 10-25 years by airlines, the assessment of the value of the aircraft relative to a re-investment (cabin refurbishment, reconfiguration, significant maintenance) or deployment decision are assessed constantly throughout the life of the aircraft and foreign currency movements are a determining factor in those decisions.

The economic net worth of many airlines' balance sheets is dependent on the USD, as commercial aircraft are the dominant asset class and they are only valued and sold in in USD. Consequently, any material change in the USD/functional currency exchange rate could materially impact the collateral the airline can provide or has provided to lenders, regardless of the requirements of paragraph 46 of the staff paper. Therefore, to mitigate the economic risk of the USD/functional currency volatility on the economic value on an airline's balance sheet, a fair value hedge of currency risk embedded in aircraft may form part of an airline's risk management strategy.

Furthermore, IAWG is concerned that the following part of the tentative agenda decision could be read to suggest that an entity would only be able to hedge the portion of the non-financial asset that it expects to sell.

> To the extent that an entity intends to consume a non-financial asset (rather than to sell it), the Committee observed that changes in the fair value of the non-financial asset may be of limited significance to the entity. In such cases, an entity may not be managing or hedging risk exposures on the non-financial asset and, in that case, it cannot apply hedge accounting.

Such an interpretation appears to be inconsistent with the conclusion that a non-financial asset held for consumption may have a foreign currency risk when certain conditions are met. The wording also suggests that non-financial assets, such as aircraft, are either consumed or sold, when in fact they frequently are initially consumed and at a point in time are sold. The fleet management decisions around this are dynamic (cabin refreshes/reconfigurations, heavy maintenance, deployment, etc.) and based on a number of factors that vary over time. So while an airline would at the time of acquisition establish a useful life for that asset consistent with an intention to consume the asset, the airline would review that expectation periodically based on a number of factors that could result in the disposal of the aircraft significantly before the end of the initial estimate of useful life.

IAWG reads the tentative agenda decision as supporting a hedge of FX risk attributable to the current fair value (resale value) or the highly probable future cash flows based on the expected residual value, but notes that the latter would be a cash flow hedge and not a fair value hedge.

Some have interpreted the tentative agenda decision as only allowing for the latter treatment. This would imply that a non-financial asset held for consumption does not hold foreign currency risk with the exception of the residual value component. This is inconsistent with the conclusion of the tentative agenda decision on this issue. We believe that the asset holds foreign currency risk equal to its fair value and that only the portion disposed of will result in a realized foreign currency gain or loss. IFRS does not require the risk to be realized, it is sufficient that there is potential for it to be realized.

IAWG believes the intention of this language in the tentative agenda decision was to convey that non-financial assets held only for consumption and disposal when the value would be insignificant, would not show evidence of a foreign currency risk that an entity would seek to manage.

IAWG would emphasize that unlike hedge accounting that is aligned to specific risks and most often at a transaction level, an entity's risk management strategy is generally focused on many risks simultaneously and at an asset class level. Therefore this evaluation should be addressed by asset class and not an individual asset. For example, if an airline disposed of a significant number of owned aircraft through sale or sale and leaseback transactions resulting in foreign exchange risk being realized, this would evidence a risk exposure for the asset class and that risk would be eligible for hedge accounting from inception for the fair value of the asset, assuming all other criteria is met.

Our view is based on our understanding of paragraph 46 of the staff paper shown below:

> We expect that an entity would manage and hedge exposures to changes in fair value of non-financial assets held for consumption only in very limited circumstances. This may be the case, for example, if (a) the non-financial asset is priced, and its fair value determined, only in a foreign currency; (b) the entity has an established practice of selling the non-financial asset (eg a PPE asset) part-way through its economic life; (c) the expected residual value of the asset at the date of sale is significant; and (d) the entity manages the foreign currency exposure only on the residual value of the item.

IAWG believes this is an example of an eligible hedge and not indicative of the only eligible circumstances where a hedge would qualify. This example illustrates a hedge of the foreign currency exposure of the expected value of a non-financial asset at the date of sale. That would appear to be a cash flow hedge of a highly probable transaction and not a fair value hedge, as noted by several Committee members during the discussion of this issue. The context of the tentative agenda decision is that of a fair value hedge.

IAWG believes that if a non-financial asset contains a foreign currency risk component, that component exists in the fair value of the non-financial asset, including the residual value of the asset as indicated in the tentative agenda decision. Therefore hedge accounting would not be limited to the residual value of the non-financial asset.

While the agenda decision does not use the term "residual value", the staff paper did use this term. IAS 16 uses residual value to refer to the value that remains at the end of the useful life of an asset and is generally referred to as scrap value. It appears that the wording in the staff paper was intended to mean “resale value”. This could be clarified in the agenda decision as some parties are viewing the risk exposure as limited to the value at the time of disposal.

Does IFRS 9 provide an adequate basis to address this issue?

The Committee concluded that the requirements in IFRS 9 provide an adequate basis for an entity to determine whether foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset held for consumption that an entity can designate as the hedged item in a fair value hedge accounting relationship.

We agree with the conclusion in the tentative agenda decision that a non-financial asset that is priced in a single currency has a foreign currency risk component in the asset held and as it can be reliably measured the fair value of that asset is an eligible hedged item if the criteria in IFRS 9 is met including the requirement that the hedge be consistent with the entity’s risk management strategy.

If you would like to discuss our comments further, please do not hesitate to contact Thomas Egan, IAWG Accounting Technical Expert at egant@iata.org. The IAWG would be interested in engaging in a dialogue with the IFRIC staff to clarify any issues related to our submission or the broader issues related to aircraft financing, valuation and transactions related to aircraft.

Yours sincerely,

Oran Har Nevo
Chairman
IATA IAWG

Donal Cahalan
Vice-Chairman
IATA IAWG

easyJet Airline Company Limited
Hangar 89, London Luton Airport
Luton, Beds LU2 9PF, United Kingdom

Chair of the IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

20 August 2019

easyJet plc consultation response: Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9 Financial Instruments).

Dear IFRS Interpretations Committee,

On behalf of easyJet I am writing with regards to the tentative agenda decision published in the June 2019 IFRIC update, specifically on fair value hedging of foreign currency on a non-financial asset.

easyJet welcomes the tentative agenda decision on this point and agrees with the conclusion that provided the specific areas discussed by the committee are met, fair value hedge accounting for foreign exchange should be achievable on non-current assets such as property plant and equipment (PPE). Please see the attached appendix for our specific comments on these points.

We also believe this interpretation helps address an issue introduced from application of IFRS 16 *Leases* whereby foreign exchange volatility can impact the income statement as a result of the retranslation of foreign currency denominated lease liabilities (per IAS 21 *The Effects of Changes in Foreign Exchange Rates)*. Industries such as airlines that have large amounts of non-functional currency denominated lease liabilities have been forced to address this by, in many instances, altering their risk management strategy to mitigate potentially large, unpredictable movements in the income statement.

As a result, IFRS 16 can force management behaviour to focus on the accounting volatility of the future lease liability rather than the risk tolerance of the entity relative to the actual economic foreign exchange exposure. This is due to the impact that the increased volatility could reduce management's ability to accurately forecast future income statements for investors, regulators and interested parties.

We note on paragraph 47 in the Agenda Paper for this committee meeting that "changing the accounting for lease contracts does not change an entity's exposure to the risks arising from such contracts. Therefore, we would not expect an entity's risk management activities to change simply because of a change in accounting requirements." However from evaluation of financial statements for entities in the Airline industry who have adopted the standard we would argue that this is not the case and risk management activities have been forced to change due to the new accounting standard.

Utilising fair value hedging on the related non-financial asset (Right of Use Asset or other owned PPE Asset) would reduce this accounting risk by matching the foreign exchange impacts of the lease liability to the value of the asset held (which could, in theory, be sold).

Registered in England, registered no. 3034606. Registered office: Hangar 89, London Luton Airport, Luton, Beds LU2 9PF United Kingdom

This tentative decision would appear to both be consistent with the principles of hedge accounting within IFRS 9 *Financial Instruments* whilst additionally address this issue from IFRS 16. Furthermore we fully support and agree with the points raised by IATA in their comments letter to this consultation dated 20/08/2019.

If you have any questions or wish to discuss further please feel free to contact me via eJTreasury@easyjet.com.

Yours faithfully

Mike Hirst
Director of Treasury & Tax

Appendix: Specific Comments

Can an entity have exposure to foreign currency risk on a non-financial asset held for consumption that affect profit or loss?

We agree with the conclusion that within certain asset markets, specific currencies are used for valuation and transaction purposes that expose an entity to foreign exchange risk where this is not the functional currency of the entity For example, aircraft assets are priced in, or linked to, USD on a global market scale. Where USD is not the functional currency, the fair value of aircraft held on an entities balance sheet are therefore exposed to movements in foreign exchange were it to sell the asset which would impact the income statement on sale.

If an entity has such exposure, is it separately identifiable and reliably measurable risk component?

As noted by the committee "*IFRS 9 permits an entity to designate a risk component of an item as the hedged item if, 'based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable'.*" We concur that in certain markets where a specific currency (that differs from an entity) functional currency) is used as standard convention for valuation and transaction purposes that foreign exchange is an identifiable component when determining the fair value of an asset.

Continuing the above example, aircraft are nearly always transacted worldwide in USD. We therefore agree that when calculating the fair value of an aircraft asset within a functional currency that is not USD, the inherent 'market structure' means that foreign exchange is an integral part of the fair valuation.

Can the designation of foreign currency risk on a non-financial asset held for consumption be consistent with an entity's risk management activities?

We agree with the tentative conclusions of the committee that in certain circumstances where an asset is held for consumption it is still exposed to fair value risk due to the possibility that the asset *could* be sold at market rates (thereby exposing the income statement to foreign exchange rate translation).

PETROBRAS

Rio de Janeiro, August 20, 2019

CONTRIB 0057/2019

Ms Lloyd, Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD, United Kingdom

Subject: Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets (IFRS 9)

Reference: Tentative Agenda Decision

Dear Ms Lloyd,

Petrobras welcomes the opportunity to comment on the IFRS Interpretations Committee's Tentative Agenda Decision - Fair Value Hedge of Foreign Currency Risk on Non-Financial Assets. We believe this is an important opportunity for all parties interested in the future of IFRS and we hope to contribute to the progress of the IFRS Interpretations Committee's activities.

We do not agree with the Committee's conclusion that the requirements in IFRS 9 provide an adequate basis for an entity to conclude on whether foreign currency risk can be a separately identifiable and reliably measurable risk component of a non-financial asset held for consumption as the hedged item in a fair value hedge accounting relationship.

We understand that additional clarification should be incorporated into the standard. For example, in our opinion, the Committee introduced new information that there weren't in the IFRS 9 to assess whether an entity would manage and hedge exposures to changes in fair value of non-financial assets held for consumption when in the Staff Paper in paragraph 46 explained the following:

> *We expect that an entity would manage and hedge exposures to changes in fair value of non-financial assets held for consumption only in very limited circumstances. This may be the case, for example, if (a) the non-financial asset is priced, and its fair value determined, only in a foreign currency; (b) <u>the entity has an established practice of selling the non-financial asset (eg a PPE asset) part-way through its economic life</u>; (c<u>) the expected residual value of the asset at the date of sale is significant</u>; and (d) <u>the entity manages the foreign currency exposure only on the residual value of the item</u>.*

PETROBRAS

Thus, considering the relevance of the matter and the impact it could have on the entity's financial statements, we suggest that the matter should be added to the standard-setting agenda.

If you have any questions in relation to the content of this letter, please do not hesitate to contact us (contrib@petrobras.com.br).

Respectfully,

/s/ Luis Eduardo Queiroz Castello

By Rodrigo Araujo Alves
Chief Accountant and Tax Officer