



AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

Comment Letter

**IFRIC D22**

**Hedges of a Net Investment in a Foreign Operation**

The Austrian Financial Reporting and Auditing Committee (AFRAC) is the privately organised standard-setting body for financial reporting and auditing standards in Austria, and is supported by the competent Austrian authorities. The members of the Austrian Financial Reporting and Auditing Association, AFRAC's parent organisation, are several Austrian Federal Ministries and a number of public institutions. The members of AFRAC represent preparers of financial statements, certified accountants, academics, investors, analysts, and oversight bodies of capital markets and regulated industries.

The AFRAC International Financial Reporting Standards Working Group prepares comment letters on recent IASB publications and on publications of other standard-setting bodies pertaining to IFRS for final approval by AFRAC. Principal authors of this comment letter were David Grünberger, Peter Geyer and Roland Nessmann. More information about the Working Group and AFRAC is available under [www.afrac.at](http://www.afrac.at).

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Austrian Financial Reporting and Auditing Committee – AFRAC  
c/o Kammer der Wirtschaftstreuhänder  
Schönbrunner Straße 222 - 228/1/6  
1120 Wien  
Österreich

Tel: +43 1 811 73 – 228  
Fax: +43 1 811 73 – 100  
Email: [office@frac.at](mailto:office@frac.at)  
Web: <http://www.afrac.at>

## Outline

<b>1. General comments .....</b>	<b>2</b>
<b>2. Specific Comments .....</b>	<b>3</b>

## 1. General comments

The Austrian Financial Reporting and Auditing Committee (AFRAC) welcomes the opportunity to comment on IFRIC's Exposure Draft IFRIC D22 – Hedges of a Net Investment in a Foreign Operation.

The main proposal in the IFRIC draft is to provide guidance on three main questions relating to hedges of investments in a foreign operation:

- Whether an entity may designate a foreign exchange risk only for foreign exchange differences between the functional currency of a parent and the foreign operation or also between a different presentation currency of the parent and the foreign operation.
- Whether, in case of indirect participations, the hedge relationship may include exchange rate differences between the foreign operation and the functional currency of any indirect parent entities at some higher level.
- Whether only a parent entity of the foreign operation or any entity of the group can hold the qualifying hedging instruments.

AFRAC agrees to all three proposed solutions:

Foreign currency risks which only arise from translating financial statements into a particular presentation currency do not truly affect the entity's operations, and the resulting exchange differences may therefore not be included in profit or loss because they *"have little or no direct effect on the present and future cash flows from operations"* (IAS 21.41). Any hedge related to those risks would lack economic substance.

In consolidated financial statements any direct or indirect investments within the consolidated group which establish control are eliminated and the group is presented as if it were a single economic entity (IAS 27.22). If foreign exchange risks resulting from foreign operations affect the financial position or performance in consolidated financial statements, it should be irrelevant which consolidated direct or indirect parent

entity is used to determine the relevant functional currency. The risk of a net investment in a foreign entity may however qualify for hedge accounting only once. Accordingly, hedge accounting by intermediate parents needs to be reversed if the ultimate parent applies hedge accounting as well.

It should be irrelevant which consolidated entity actually holds the qualifying hedging instrument.

## **2. Specific Comments**

We should like to comment on an argument discussed in paragraphs BC6 and BC7 of the draft. BC6 describes a situation where the risk that qualifies for hedge accounting might vary depending on the method of consolidation used (direct consolidation versus step-by-step consolidation). BC7 cites IAS 21.BC18, which states that the choice between different methods of consolidation (direct or step-by-step) would not result in different amounts in the presentation currency. IFRIC therefore concludes that the method of consolidation should not determine which risk qualifies for hedge accounting. We suggest that it should be more strongly emphasised that the method of consolidation does not lead to different results for hedging a net investment in a foreign operation within consolidated financial statements. For one and the same consolidated financial statements, the hedging results should be the same, regardless whether direct or step-by-step consolidation is applied.