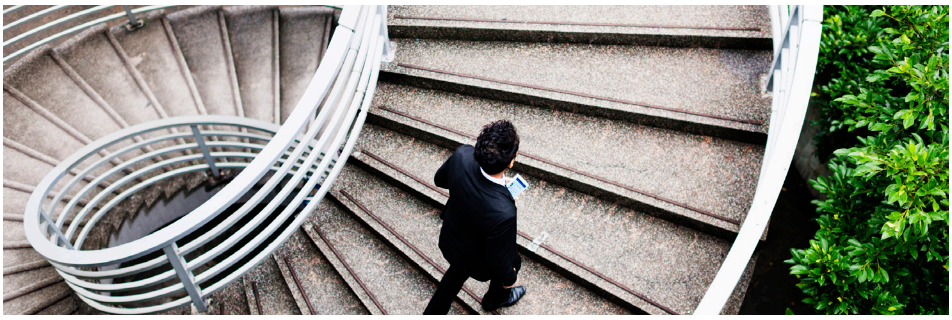

HEDGE ACCOUNTING MAY FINALLY MAKE SENSE – IRON ORE PRODUCERS AND OTHERS TAKE NOTE

Many entities to date have not applied hedge accounting to derivative contracts because the requirements to hedge account under AASB 139 *Financial Instruments: Recognition and Measurement* are onerous:

- It is too difficult to meet the 80-125 per cent effectiveness testing rules
- Resource producers and consumers are unable to hedge components of non-financial items, such as the benchmark iron ore index component of an iron ore sales contract or the benchmark gas oil price component of diesel purchases.

Although AASB 9 Financial Instruments only applies to annual reporting periods beginning on or after 1 January 2018, you may want to consider early adopting AASB 9 because qualifying for hedge accounting under AASB 9 is far more achievable than is the case under the current rules in AASB 139.

Please refer to our article, 'Hedge accounting may finally make sense' which includes examples of how an **iron ore producer** could benefit from applying the new AAB 9 hedge accounting rules. The examples could equally apply to purchases or sales of other commodities contracts (such as sugar, wheat, coffee) where the contract price includes a benchmark component and illustrate the following:

- Example one – Accounting results hedge accounting vs. no hedge accounting
- Example two – Hedging a component of a non-financial item (Iron ore index rather than the whole supply contract which includes pricing adjustments for quality, freight and other elements)
- Example three – Hedging a component of a non-financial item (Diesel price index without adjustment to terminal gate price for excise duties, freight, insurance and terminal charges).

Reasons hedge accounting under AASB 9 is more attractive than AASB 139

Some of the areas where hedge accounting under AASB 9 is simpler include:

- Removal of the 80-125 per cent threshold for effectiveness testing
- Easier prospective testing - If the derivatives are entered into for the same quantity, timing and pricing index as the forecast sales/purchases (i.e. the critical terms match), it may be sufficient to only carry out a forward looking qualitative test without the need to perform any further mathematical calculations
- Benchmark price components of non-financial items can be hedged
- Ability to use options.

Transition

Selective adoption of earlier versions of AASB 9 (e.g. just adopting the classification and measurement requirements without adopting later versions) is no longer possible after 30 June 2015 (and for December year ends after 31 December 2015). This means that if you decide to adopt the new hedge accounting rules after 30 June 2015 (for June year ends) or after 31 December 2015 (for December year ends) you will be required to adopt the whole of AASB 9, including:

- Classification and measurement of financial assets
- Classification and measurement of financial liabilities and derecognition
- Hedge accounting
- Impairment.