

## Hedging explained

Hedging is a risk management strategy used by organisations to limit or offset the risk of loss from changes in the prices of commodities, currencies or securities, foreign exchange risk, and interest rate risk – it is a financial tool used by organisations to minimise their exposure to unwanted risk.

The objective of hedge accounting is to represent, in the financial statements, the financial effect of an entity's exposure to risk as well as management's activities that use financial instruments to manage those exposures and its combined affect on its profit or loss. An organisation may choose to use hedge accounting to reflect the management of those risks in the financial statements.

Hedging has become common business practice and many investors feel the need to better understand the risks an entity faces, what management is doing to manage those risks, and how effective those risk management strategies are.

In addition to integrating the hedge accounting requirements with an entity's risk management activities, the new proposals seek to simplify the accounting for an entity's hedge relationships through simplifications to IAS 39's requirements for the assessment of hedge effectiveness. The proposals also include additional disclosure requirements that are designed to assist users in understanding the effect that an entity's hedging activities have on the amount, timing and uncertainty of future cash flows.

Finally, there are proposed changes to the mechanics of fair value hedge accounting so that the re-measurement of the hedged item is presented separately. It is also proposed that information about fair value hedges (similar to cash flow hedges) is reflected in other comprehensive income (OCI). This will improve transparency for investors by including all information about hedging in OCI.