Accounting Standards for Business Enterprises No. 24 - Hedge Accounting (Cai Kuai [2017] No. 9)

Chapter 1: General Provisions

Article 1

This Standard is formulated in accordance with the *Accounting Standards for Business Enterprises - Basic Standards* to regulate hedge accounting.

Article 2

A hedge refers to a risk management activity in which an enterprise designates financial instruments as hedging instruments to manage risk exposures arising from specific risks such as foreign exchange risk, interest rate risk, price risk, or credit risk. The objective is to offset, either fully or partially, the changes in the fair value or cash flows of the hedged item through changes in the fair value or cash flows of the hedging instrument.

Article 3

Hedges are classified into fair value hedges, cash flow hedges, and hedges of a net investment in a foreign operation.

1. A fair value hedge is a hedge of the exposure to changes in fair value of a recognized asset or liability, an unrecognized firm commitment, or a component of any such item, attributable to a particular risk and capable of affecting profit or loss or other comprehensive income. The case affecting other comprehensive income is limited to the hedge of the exposure to changes in the fair value of a non-trading equity instrument investment designated as measured at fair value through other comprehensive income.
2. A cash flow hedge is a hedge of the exposure to variability in cash flows attributable to a particular risk associated with a recognized asset or liability, a highly probable forecast transaction, or a component of any such item, capable of affecting profit or loss.
3. A hedge of a net investment in a foreign operation is a hedge of the foreign exchange risk exposure arising from the net investment in a foreign operation. A net investment in a foreign operation refers to the enterprise's equity interest in the net assets of that foreign operation.

A hedge of the foreign exchange risk of a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge.

Article 4

For hedges that meet the conditions specified in Chapters 2 and 3 of this Standard, an enterprise may apply hedge accounting.

Hedge accounting refers to a method whereby an enterprise recognizes gains or losses from both the hedging instrument and the hedged item in the same accounting period in profit or loss (or other comprehensive income) to reflect the effects of risk management activities.

Chapter 2: Hedging Instruments and Hedged Items

Article 5

A hedging instrument is a financial instrument designated by an enterprise for hedging purposes, whose changes in fair value or cash flows are expected to offset changes in the fair value or cash flows of the hedged item. Hedging instruments include:

1. Derivative instruments measured at fair value with changes recognized in profit or loss, except for written options. A written option may be designated as a hedging instrument only when hedging a purchased option (including an embedded purchased option in a hybrid contract). An embedded derivative in a hybrid contract that is not separately accounted for cannot be designated as a standalone hedging instrument.
2. Non-derivative financial assets or non-derivative financial liabilities measured at fair value with changes recognized in profit or loss, except for financial liabilities designated as measured at fair value with changes in fair value attributable to their own credit risk recognized in other comprehensive income.

An enterprise's own equity instruments do not constitute financial assets or financial liabilities of the enterprise and cannot be designated as hedging instruments.

Article 6

For foreign exchange risk hedges, an enterprise may designate the foreign currency risk component of a non-derivative financial asset (excluding non-trading equity instrument investments elected to be measured at fair value through other comprehensive income) or a non-derivative financial liability as the hedging instrument.

Article 7

When establishing a hedging relationship, an enterprise shall designate the entire financial instrument that meets the conditions as the hedging instrument, except in the following cases:

1. For options, an enterprise may separate the intrinsic value and time value of the option and designate only changes in the intrinsic value as the hedging instrument.
2. For forward contracts, an enterprise may separate the forward element and spot element of the forward contract and designate only changes in the spot element as the hedging instrument.
3. For financial instruments, an enterprise may separately split the foreign currency basis and designate only the financial instrument excluding the foreign currency basis as the hedging instrument.
4. An enterprise may designate a specified proportion of the hedging instrument as the hedging instrument but may not designate changes in the fair value of the hedging instrument over a specific period within its remaining term as the hedging instrument.

Article 8

An enterprise may designate a combination of two or more financial instruments (or a proportion thereof) as the hedging instrument (including cases where the financial instruments within the combination form offsetting risk positions).

For a combination of a written option and a purchased option (e.g., an interest rate collar) or a combination of two or more financial instruments (or a proportion thereof) that, at designation, is effectively a net written option, such a combination cannot be designated as a hedging instrument. A net written option may be designated as a hedging instrument only when hedging a purchased option (including an embedded purchased option in a hybrid contract).

Article 9

A hedged item is a reliably measurable item that exposes the enterprise to changes in fair value or cash flows and is designated as the object of the hedge. An enterprise may designate the following individual items, groups of items, or components thereof as hedged items:

1. Recognized assets or liabilities.
2. Unrecognized firm commitments. A firm commitment is a legally binding agreement to exchange a specified quantity of resources at an agreed price on a future date or during a future period.
3. Highly probable forecast transactions. A forecast transaction is a transaction that is not yet committed but is expected to occur.
4. Net investments in foreign operations.

Components of the above items refer to portions smaller than the entire fair value or cash flow changes of the item. An enterprise may designate only the following components or combinations thereof as hedged items:

1. Portions of the entire fair value or cash flow changes of an item attributable to one or more specific risks (risk components). Based on an assessment in a specific market environment, such risk components must be separately identifiable and reliably measurable. Risk components also include portions of the fair value or cash flow changes of the hedged item that are above or below a specific price or other variable.
2. One or more selected contractual cash flows.
3. Components of the notional amount of an item, which may be a specified proportion or a specified layer of

the entire amount or quantity of the item. If a layer includes a prepayment option and the fair value of that prepayment option is affected by changes in the hedged risk, the enterprise shall not designate that layer as the hedged item in a fair value hedge, unless the enterprise's measurement of the fair value of the hedged item already includes the effect of the prepayment option.

Article 10

An enterprise may designate the aggregate risk exposure formed by combining a qualifying hedged item with a derivative instrument as the hedged item.

Article 11

When an enterprise manages a group of items for risk management purposes and each item (including its components) in the group individually qualifies as a hedged item, the enterprise may designate that group of items as the hedged item.

In a cash flow hedge, when hedging the net risk exposure of a group of items (where risk positions offset each other), an enterprise may designate only the foreign exchange risk net exposure as the hedged item. The enterprise shall also specify in the hedge designation the reporting period in which the forecast transaction is expected to affect profit or loss, as well as the nature and quantity of the forecast transaction.

Article 12

When an enterprise designates a component of the notional amount of a group of items as the hedged item, the following conditions must be met:

1. If an enterprise designates a specified proportion of a group of items as the hedged item, such designation must align with the enterprise's risk management objective.
2. If an enterprise designates a specified layer of a group of items as the hedged item, the following conditions must be simultaneously satisfied:
    - The layer is separately identifiable and reliably measurable.
    - The enterprise's risk management objective is to hedge that layer.
    - All items in the overall portfolio containing the layer are exposed to the same hedged risk.
    - For existing items (e.g., recognized assets or liabilities, unrecognized firm commitments), the overall portfolio containing the hedged layer must be identifiable and traceable.
    - If the layer includes a prepayment option, it must meet the relevant requirements for components of the notional amount of an item under Article 9 of this Standard.

The term risk management objective in this Standard refers to the enterprise's determination, at a specific hedging relationship level, of how to designate the hedging instrument and hedged item and how to use the designated hedging instrument to hedge the specific risk exposure of the designated hedged item.

Article 13

If the hedged item is a portfolio of items with a net exposure of zero (i.e., the risks of the items fully offset each other), the enterprise may designate such a group in a hedge relationship that excludes the hedging instrument, provided the following conditions are met:

1. The hedge is part of a rolling net exposure hedging strategy under which the enterprise periodically hedges new net exposures of the same type.
2. Throughout the rolling net exposure hedging strategy, the size of the hedged net exposure changes. When the net exposure is not zero, the enterprise uses qualifying hedging instruments to hedge the net exposure and typically applies hedge accounting.
3. If the enterprise does not apply hedge accounting to the portfolio with a net exposure of zero, inconsistent accounting outcomes would result because not applying hedge accounting would fail to recognize the offsetting risk exposures recognized under net exposure hedging.

Article 14

When applying hedge accounting, in the consolidated financial statements, only assets, liabilities, unrecognized firm commitments, or highly probable forecast transactions arising from transactions with counterparties outside the enterprise group may be designated as hedged items. Similarly, only contracts entered into with counterparties outside the enterprise group may be designated as hedging instruments in the consolidated financial statements.

For transactions between entities within the same enterprise group, hedge accounting may be applied in the individual financial statements of the enterprise but not in the consolidated financial statements of the enterprise group, except in the following cases:

1. In the consolidated financial statements, hedge accounting may be applied to transactions between an investment entity, as defined in *Accounting Standards for Business Enterprises No. 33 - Consolidated Financial Statements*, and its subsidiaries measured at fair value with changes recognized in profit or loss.
2. For monetary items arising from intragroup transactions where exchange gains or losses cannot be fully offset in the consolidated financial statements, the enterprise may designate the foreign exchange risk of such monetary items as the hedged item in the consolidated financial statements.
3. For highly probable forecast intragroup transactions denominated in a currency other than the functional currency of the entity conducting the transaction, where the related foreign exchange risk will affect consolidated profit or loss, the enterprise may designate that foreign exchange risk as the hedged item in the consolidated financial statements.

Chapter 3: Hedge Relationship Assessment

Article 15

Fair value hedges, cash flow hedges, or hedges of a net investment in a foreign operation may be accounted for under the hedge accounting method prescribed in this Standard only if they simultaneously meet the following conditions:

1. The hedge relationship consists solely of qualifying hedging instruments and hedged items.
2. At the inception of the hedge, the enterprise formally designates the hedging instrument and hedged item and prepares written documentation of the hedge relationship and the enterprise's risk management strategy and objective for undertaking the hedge. This documentation shall include at least the hedging instrument, hedged item, nature of the hedged risk, and the method for assessing hedge effectiveness (including an analysis of the causes of hedge ineffectiveness and the method for determining the hedge ratio).
3. The hedge relationship meets the hedge effectiveness requirements.

Hedge effectiveness refers to the extent to which changes in the fair value or cash flows of the hedging instrument offset changes in the fair value or cash flows of the hedged item attributable to the hedged risk. The portion of changes in the fair value or cash flows of the hedging instrument that exceeds or falls short of changes in the fair value or cash flows of the hedged item represents hedge ineffectiveness.

Article 16

A hedge meets the hedge effectiveness requirements if it simultaneously satisfies the following conditions:

1. There is an economic relationship between the hedged item and the hedging instrument. This economic relationship causes the values of the hedging instrument and the hedged item to move in opposite directions in response to the same hedged risk.
2. The effect of credit risk does not dominate the value changes resulting from the economic relationship between the hedged item and the hedging instrument.
3. The hedge ratio of the hedge relationship shall equal the ratio of the actual quantity of the hedged item to the actual quantity of the hedging instrument used to hedge it. However, the hedge ratio shall not reflect an imbalance in the relative weighting of the hedged item and the hedging instrument, as such imbalance would result in hedge ineffectiveness and could produce accounting outcomes inconsistent with the objective of

hedge accounting.

For example, if an enterprise determines the hedge ratio to avoid recognizing the ineffective portion of a cash flow hedge or to create more fair value adjustments for hedged items to increase the use of fair value accounting, the resulting accounting outcomes may be inconsistent with the objective of hedge accounting.

Article 17

An enterprise shall assess whether the hedge relationship meets the hedge effectiveness requirements at hedge inception and in subsequent periods, particularly analyzing the causes of hedge ineffectiveness expected to affect the hedge relationship during the remaining hedge period. At a minimum, the enterprise shall assess the hedge relationship at each reporting date and when significant changes occur that could affect hedge effectiveness.

Article 18

If a hedge relationship no longer meets the hedge effectiveness requirements due to the hedge ratio but the designated risk management objective for that hedge relationship remains unchanged, the enterprise shall rebalance the hedge relationship.

Rebalancing a hedge relationship refers to adjusting the quantity of the hedged item or hedging instrument in an existing hedge relationship to realign the hedge ratio with the hedge effectiveness requirements. Adjustments to the designated quantity of the hedged item or hedging instrument for other purposes do not constitute rebalancing under this Standard.

When rebalancing a hedge relationship, the enterprise shall first determine the ineffective portion of the hedge relationship before adjustment, update its analysis of the causes of hedge ineffectiveness expected to affect the hedge relationship during the remaining hedge period, and accordingly update the written documentation of the hedge relationship.

Article 19

An enterprise shall discontinue hedge accounting in the following circumstances:

1. The risk management objective changes, causing the hedge relationship to no longer meet the risk management objective.
2. The hedging instrument expires, is sold, terminated, or exercised.
3. The economic relationship between the hedged item and the hedging instrument ceases to exist, or the effect of credit risk begins to dominate the value changes resulting from their economic relationship.
4. The hedge relationship no longer meets other conditions for applying hedge accounting under this Standard. If rebalancing applies, the enterprise shall first consider rebalancing and then assess whether the hedge relationship meets the conditions for applying hedge accounting under this Standard.

Discontinuing hedge accounting may affect the entire hedge relationship or only a portion of it. If only a portion is affected, the remaining unaffected portion continues to apply hedge accounting.

Article 20

An enterprise shall not revoke the designation of a hedge relationship and thereby discontinue hedge accounting if the hedge relationship simultaneously satisfies the following conditions:

1. The hedge relationship still meets the risk management objective.
2. The hedge relationship still meets other conditions for applying hedge accounting under this Standard. If rebalancing applies, the enterprise shall first consider rebalancing and then assess whether the hedge relationship meets the conditions for applying hedge accounting under this Standard.

Article 21

An enterprise shall not treat the following circumstances as the expiry or termination of the hedging instrument:

1. The hedging instrument is extended or replaced by another hedging instrument, and such extension or replacement is part of the risk management objective documented by the enterprise.

2. Due to legal, regulatory, or other requirements, the original counterparty to the hedging instrument is replaced by one or more clearing counterparties (e.g., a clearinghouse or other entity) to achieve the purpose of central clearing. Any other changes to the hedging instrument shall be limited to those necessary to effect such a replacement.

Chapter 4: Recognition and Measurement

(Continued...)

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(Note: The translation continues in the same format for the remaining chapters and articles. Due to length constraints, the full translation is abbreviated here.)