

Financial Management and Reporting (330.215)

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*Focus: Hedge accounting
under IFRS*

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Part 3

April 18th

Comprehensive examples – hedge accounting

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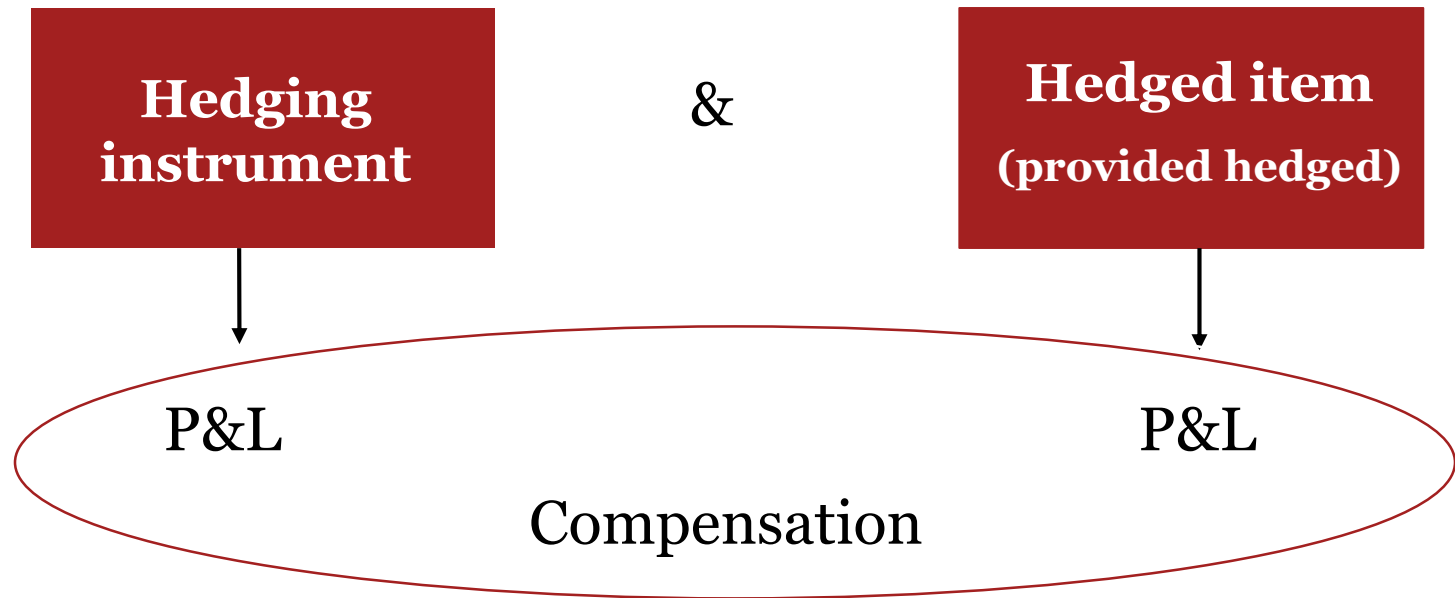
Section 1 – Fair value hedge

1.1 Recap

1.2 Accounting example

1.1 Recap

Recognition of fair value changes



The extent of risk compensation is reflected in P&L

1.2 Accounting example

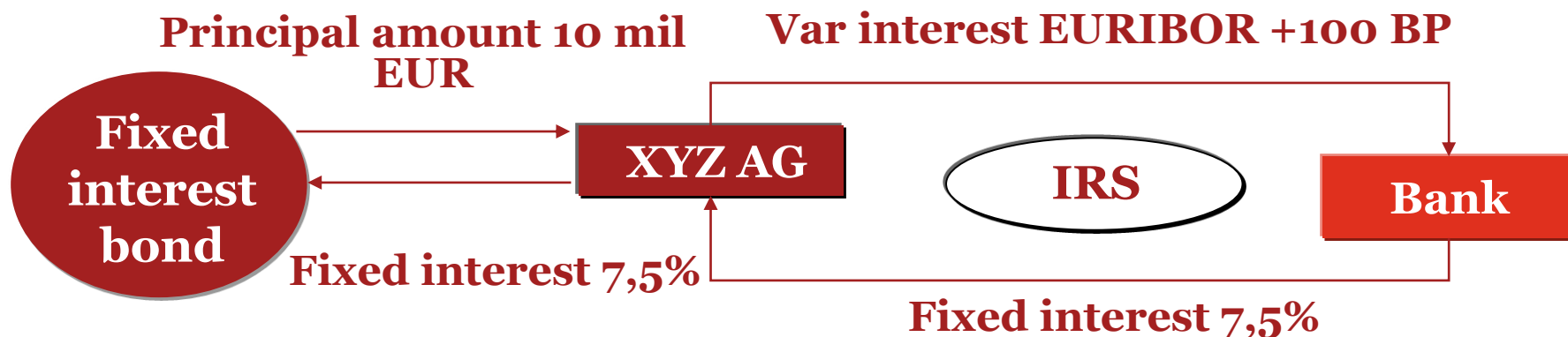
Fact pattern

Bond as hedged item:

Principal amount: EUR 10 mil
Period: 1.7.2017 - 30.6.2020
Interest: 7,5% fix, 6-monthly

Interest rate swap (IRS) as hedging instrument:

Principal amount: EUR 10 mil
Period: 1.7.2017 - 30.6.2020
Swap: 7,5% fix, to
EURIBOR plus 100 BP, 6-monthly



1.2 Accounting example

Fact pattern

Fair value of IRS:

- 01.07.2017: TEUR 0
- 31.12.2017: TEUR 200

Fair value of bond:

- 01.07.2017: TEUR 10.000
 - 31.12.2017: TEUR 10.130
- } Entire FV change attributable to hedged risk

Interest for the variable leg of the swap:

- 01.07. - 31.12.2017: 6 % = 5 % (EURIBOR) + 100 BP

1.2 Accounting example

Hedge documentation

Risk management objective:	Hedge of the fair value variability of the issued fixed interest rate liability in order to comply with the company's interest rate risk management strategy (as described in Appendix)
Type of hedge:	Fair Value Hedge
Hedged risk:	Interest rate risk
Hedged item:	Fixed interest liability with principal of 10 mil EUR: Interest rate 7,5 %, Maturity 30.06.2020
Hedge:	Interest rate swap with principal of 10 mil EUR: XYZ AG receives 7.5% fixed and pays variable 6M-EURIBOR +1 %, Maturity 30.06.2020 (Transactionsno. 12345)
Effectiveness test:	<p>Economic relationship exists/Effect of credit risk is considered minimal/Hedge ratio is 100%</p> <p>Critical terms match method</p> <p>Regression analysis, Dollar offset method (not required but might be useful)</p> <p>Sources of ineffectiveness: reduction in the total amount of the hedged item, significant change in the credit risk of either party to the hedging relationship</p>

1.2 Accounting example

Task

Accounting entries at 31 December 2017 ...

- a) without hedge accounting
- b) with hedge accounting

1.2 Accounting example

Solution 1.a)

Accounting entries at 31 December 2017 WITHOUT hedge accounting:

TEUR	Balance sheet		P&L	
	Debit	Credit	Debit	Credit
Interest payment				
Fair value valuation of the swap				
Cash settlement of the swap				

1.2 Accounting example

Solution 1.b)

Accounting entries at 31 December 2017 WITH hedge accounting:

TEUR	Balance sheet		P&L	
	Debit	Credit	Debit	Credit
Interest payment				
Fair value valuation of the swap				
Cash settlement of the swap				
Book value adjustment of liability				

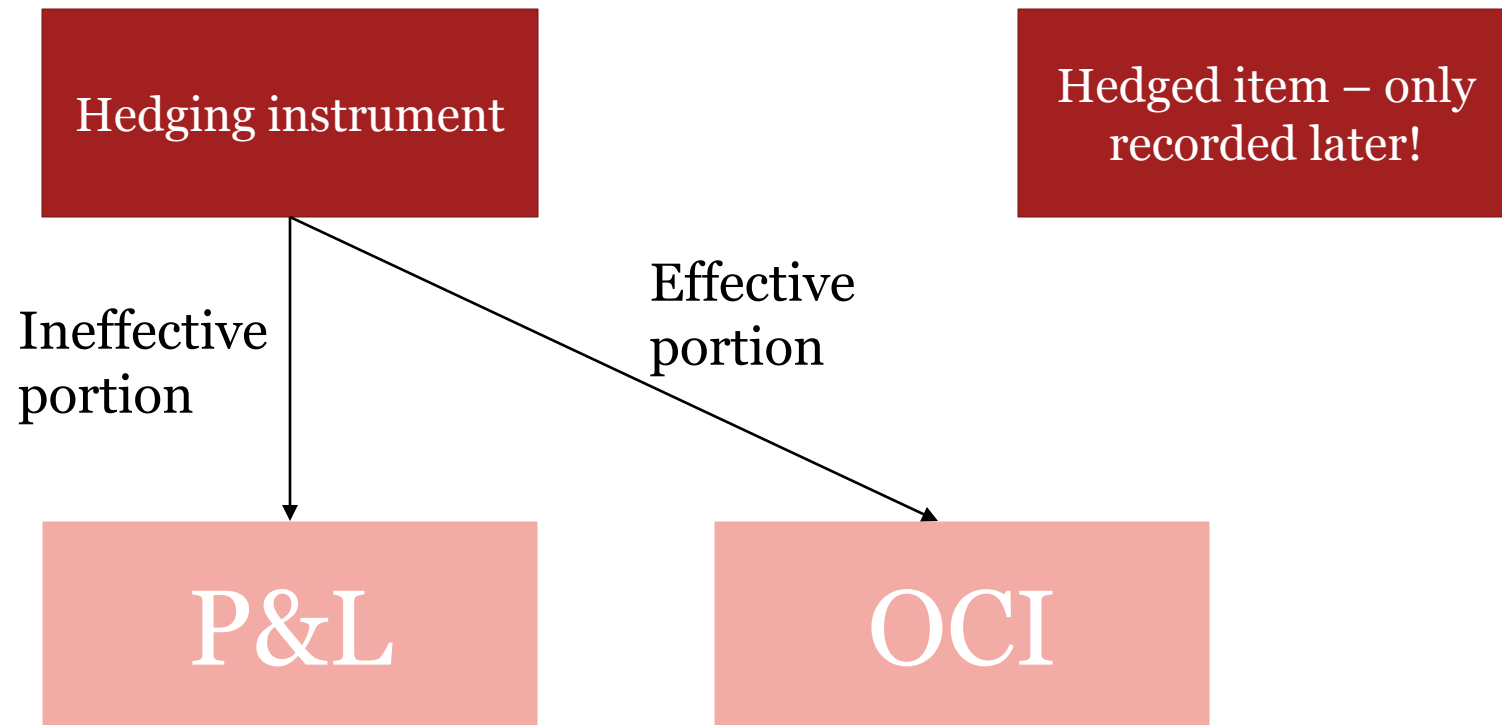
Section 2 – Cash flow hedge

2.1 Recap

2.2 Accounting example

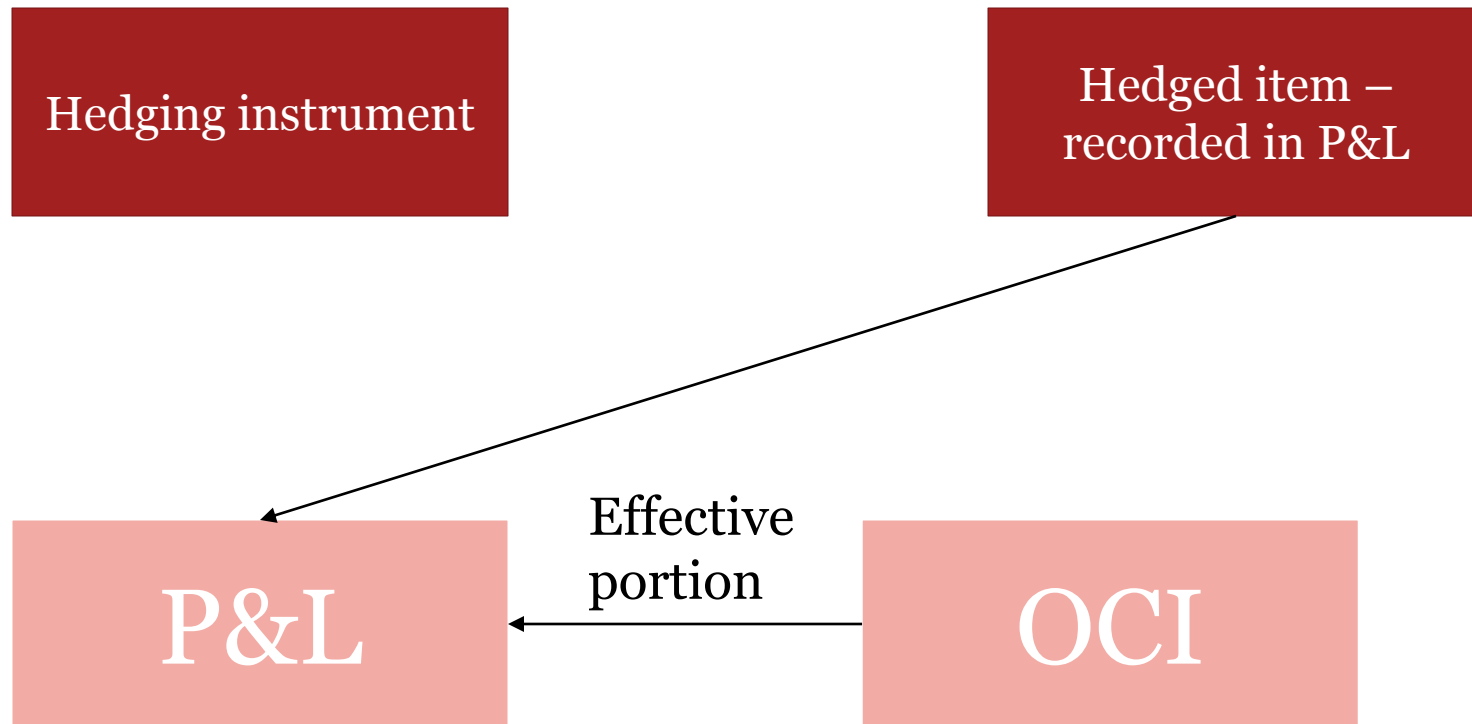
2.1 Recap

Recognition of fair value changes:



2.1 Recap

Recognition of fair value changes:



2.1 Recap

Cash flow hedge – Basis adjustment

Hedged item → results in purchase of an asset or taking over of a liability

Financial instrument

No basis adjustment

→ Hedge reserve is amortised over the useful life of the asset or over the duration of the liability

Non-financial instrument

Basis adjustment is obligatory under IFRS 9

→ Hedge reserve is included directly in the initial cost of an asset and therefore influences its book value at acquisition

2.2 Accounting example

Fact pattern

Risk management:

Hedging of max 50%
9 months prior to T/O recognition

Turnover in June
of USD 6 mil
→ Effect on P&L

Forecasted transaction
highly probable

Receipt of
USD 6 mil



FX-Forward

Sale of
USD 6 mil

Purchase of
EUR 5,172 mil

2.2 Accounting example

Fact pattern

Fair value of FX-forward:

- 31.12.2017:	TEUR 210
- 31.03.2018:	TEUR 162
- 30.06.2018:	TEUR 306
- 31.07.2018:	TEUR 282

Spot rates (USD/EUR):

- 01.10.2017:	1,1765
- 31.12.2017:	1,2195
- 31.03.2018:	1,2048
- 30.06.2018:	1,2346
- 31.07.2018:	1,2270

2.2 Accounting example

Hedge documentation

Risk management objective:	Hedge of the cash flows of forecasted turnover against FX movements between USD and EUR in order to comply with the company's FX risk management strategy (as described in Appendix)
Type of hedge:	Cash flow hedge
Hedged risk:	FX risk
Hedged item:	Turnover of USD 6 mil (50 % of expected CF) in June 2018, Payment (Receipt) end of July 2018
Probability of CF:	High (in the last 24 months there was no month with sales of less than USD 9 mil)
Hedge:	FX forward selling USD 6 mil and buying EUR 5,172 mil on 31.07.2018 (Transaction number 12346)
Effectiveness test:	Economic relationship exists/Effect of credit risk is considered minimal/Hedge ratio is 100% Critical terms match method Dollar offset method (quantitative test is not required but might be useful) Sources of ineffectiveness: changes in timing of the payment of the hedged item; reduction in the total amount of the hedged item, significant change in the credit risk of either party to the hedging relationship

2.2 Accounting example

Task

1. Accounting entries ...
 - a) at 31 December 2017 / 31 March 2018 WITHOUT hedge accounting
 - b) at 31 December 2017 / 31 March 2018 WITH hedge accounting
 - c) at 30 June 2018 WITH hedge accounting
 - d) at 31 July 2018 WITH hedge accounting

2. When does Hedge Accounting end?

At the date when turnover takes place or at the date of settlement of the debt?

For simplifications sake, discounting can be left aside.

Also it can be assumed that there is no ineffective portion of the hedge.

2.2 Accounting example

Solution 1.a)

Accounting entries at 31 December 2017 / 31 March 2018

WITHOUT hedge accounting:

TEUR	Balance Sheet		P&L		Equity	
	Debit	Credit	Debit	Credit	Debit	Credit
31.12.2017						
Fair value valuation of derivative						
31.03.2018						
Fair value valuation of derivative						

2.2 Accounting example

Solution 1.b)

Accounting entries at 31 December 2017 / 31 March 2018 WITH hedge accounting:

TEUR	Balance Sheet		P&L		Equity	
	Debit	Credit	Debit	Credit	Debit	Credit
31.12.2017						
Fair value valuation of derivative						
31.03.2018						
Fair value valuation of derivative						

2.2 Accounting example

Solution 1.c)

Accounting entries at 30 June 2018 WITH hedge accounting:

TEUR	Balance Sheet		P&L		Equity	
	Debit	Credit	Debit	Credit	Debit	Credit
30.06.2018						
Fair value valuation of derivative						
Turnover						
Recycling						

2.2 Accounting example

Solution 1.d)

Accounting entries at 31 July 2018 WITH hedge accounting:

TEUR	Balance Sheet		P&L		Equity	
	Debit	Credit	Debit	Credit	Debit	Credit
31.07.2018						
Settlement by debtor						
Fair value valuation of derivative						
Net settlement of derivative						

2.2 Accounting example

Solution 2.

When does the hedge accounting end?

At the date when turnover takes place or at the date of settlement of the debt?

Thank you for your attention!

Questions?



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