



Hedge accounting

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Short introduction of myself

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Purpose of derivatives

- Hedge [hedging, mechanizm zabezpieczajacy] means to protect against risk
- Market risk stems from price changes; engaging in derivative market minimizes the risk as the price and date of the transaction are agreed earlier



Derivative instruments

- Forward and future contracts [kontrakty terminowe forward / future] are agreements to buy or sell a financial instrument at a fixed price [ustalona cena] on a fixed date [ustalony termin] in the future
- Futures are traded on stock exchanges, whereas forwards are contracts entered into outside of the exchanges
- Futures are therefore standardised [ustandaryzowane] products



Types of derivative contracts


There are different types of future / forward contracts:

- Commodity futures aim at minimising the risk of changes in commodity prices [ryzyko zmian cen towarów]
- Currency futures aim at minimising currency exchange rate risk [ryzyko zmian kursów walutowych]
- Interest rate futures aim at minimising the interest rate risk [ryzyko zmian stóp procentowych]



Options

- Options [opcje] are similar to futures and are traded on the exchanges, but they are not a liability for both parties; options give a right to buy or sell for the buyer of option [nabywca opcji] from the issuer of option [wystawca opcji]
- The buyer must pay a premium [premia] for the right to enter into the contract. If the contract is not exercised, the issuer keeps the premium.



Hedge accounting: What is it?

- Hedge accounting [rachunkowosc zabezpieczen] involves accounting for derivative instruments together with the accounting categories they hedge.
- This is a difference to the general accounting rules that require derivative contracts to be treated as financial instruments.
- This means that changes in value of derivative contracts are shown in P&L account.



Fair value hedging

- Hedge accounting allows the category that is hedged to be shown as one in the financial statements.
- This means that changes in position that is being hedged are offset by the hedged instrument and shown in Other comprehensive income statement [Sprawozdanie ze skumulowanego dochodu].
- The remaining changes in fair value according to IFRS no. 9 are shown in P&L account.



Fair value hedging – example

- Company is an exporter and receives payments in euro. The company expects to receive a payment of €20 000 on Dec. 1.
- To hedge against currency exchange rate risk, the exporter enters into a forward contract for € at an exchange rate of 4,53 PLN / €1.
- This means that on Dec. 1 the exporter will be able to convert the receivable and obtain 90 600 PLN.

Qualifying criteria

- In order to qualify for hedge accounting, the company must:
 - show that derivative instrument effectively hedges the risk of the accounting position,
 - describe the risk management strategies,
 - provide information about hedging instrument [instrument zabezpieczajacy] and hedge instrument [instrument zabezpieczony].

Hedge effectiveness (IFRS no.9)

- Hedge effectiveness requirements:
 - existence of economic relationship [powiazanie ekonomiczne] – see next slide,
 - credit risk [ryzyko kredytowe] does not dominate value changes [dominujacy wplyw na zmiane wartosci nie wynika z ryzyka kredytowego],
 - designated hedge ratio [wskaznik zabezpieczenia] is consistent with risk management strategy (80%-125%).



Economic relationship in hedging

- Economic relationship in hedging means that financial instrument [instrument finansowy] and the value of the hedged item [instrument zabezpieczony] move in the opposite directions, as a result of the common underlying risk [ryzyko bazowe / ryzyko podstawowe].
- It is necessary to make an on-going assessment of whether the hedge meets the hedge effectiveness criteria [kryteria efektywnosci zabezpieczenia / warunki efektywnosci].



Discounted cash flows

- IFRS no. 9 requires the hedging instruments to be measured at either fair value [wartosci godziwej] or amortised cost [zamortyzowany koszt], both of which take into consideration the time value of money.
- IFRS no. 9 also introduced the requirement to measure the hedged item [instrument zabezpieczony] also on a present value basis [wedlug zasady wartosci biezacej].

Short review

Let's try to answer?

- Hedge accounting applies to (what instruments)?
- How would you translate –

Instrumenty pochodne ?

Ryzyko kursu walutowego?

Opcja kupna?

Zaplata za ubezpieczenie od ryzyka kredytowego?



THANK YOU!

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