

# NETWORK NEWS

**CIMA**

Chartered Institute of  
Management Accountants

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**HEDGE  
ACCOUNTING  
JUST GOT EASIER**



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## Contents

3-4	Network news feature
5	Local Irish news
13	Business development news
14-15	Branch events
16-19	Student news

## Welcome to the December 2009 edition of Network News.

Your comments and ideas are always welcome. So, if you have any suggestions on how we can improve the delivery of your local news, please contact [kate.o'mahony@cimaglobal.com](mailto:kate.o'mahony@cimaglobal.com)

A guide to changing your personal details via the website by using **MY CIMA**:

You will need to log onto MY CIMA via this link [www.cimaglobal.com/mycima](http://www.cimaglobal.com/mycima) click on my details.

Click on my personal and employment details (you will need to re-enter your contact ID and password).

You will be taken to your personal details screen, where you are able to amend or update relevant information.

Under each section you will see a grey box with the word 'change' - simply click on this box and you will then be able to make the necessary changes.

# Hedge accounting - just got easier.



The introduction of IAS 39 (financial instruments: recognition and measurement), IAS 32 (financial instruments: presentation), and IFRS 7 (financial instruments: disclosures) resulted in significant headaches and increased workload for many accountants and treasurers. It is worth noting that when applying these standards, hedge accounting is a choice that each entity makes for each hedge that it has in place.

*'The choice reflects the trade off between the cost of achieving hedge accounting and the benefit achieved by reducing the volatility in earnings.'*

Those who elect for hedge accounting face a major challenge in demonstrating that they qualify and in measuring hedge effectiveness on an ongoing basis. Initially, systems solutions were either unavailable or inadequate.

However *'specialist treasury system providers have since developed specific solutions that meet these requirements'* and significantly reduce workload.

Those who did not opt for hedge accounting avoided the administrative hassle but left themselves exposed to market valuations affecting earnings. For many firms, this has become a critical issue as the valuations can dwarf profit levels.

### What is all the fuss about?

Take Sterling exposure as an example: in December 2008 Company A forecast GBP10M sales for August 2009 with settlement in October 2009. It hedged at the then forward rate of EUR/GBP 0.92. By June 2009 rates moved to 0.85 and at month end reporting the mark to mark value was a liability of EURO.9M. In the absence of hedge accounting, the company is required to record this valuation on the income statement. If the company applies hedge accounting effectively the valuation can be taken to reserves.

*'Nasty or unexpected rate movements (which regularly occur) result in companies facing major shocks at reporting dates.'*

### Questions to ask?

1. Do I have to adopt these accounting standards?  
No - companies that do not fair value their derivative instruments on an ongoing basis can also avoid doing so in their year end financial statements. A detailed description of the derivative and its fair value should be disclosed in the notes to the accounts

2. Are we required to apply hedge accounting in every case?

No - each case should be considered separately. We would suggest that an analysis is performed of each individual hedging scenario in the format below, considering the impact on earnings:

CASH FLOW HEDGE OF FUTURE PURCHASES		
CURRENT ACCOUNTING	IFRS (No hedge accounting)	IFRS (100% effective hedge accounting)
No impact	FV of FX contract to IS	FV of FX contract to reserves

3. Should I consider the accounting implications when hedging?

Yes - although the origins of hedging are economic, it is also necessary to consider the accounting implications. Many companies hedge net exposures for cost effectiveness reasons. However, net exposure hedging does not qualify for hedge accounting. An alternative solution is to designate part of the underlying exposure equal to the net position as the hedged item.

*Example: Company A has assets GBP100 and liabilities GBP75, net position hedged is GBP25, therefore designate that GBP25 of assets hedged by hedging instrument.*

4. Will derivatives always qualify as hedged items?

No - IAS39 generally precludes derivatives from being hedged items. You must keep this in mind when developing hedging strategy.

*Example: A USD fixed rate borrowing is hedged to EUR floating rate via an interest rate swap. The variable interest rates are subsequently hedged via an interest rate option. The hedging of the borrowing with the interest rate swap may qualify as a fair value hedge, however, the fair value movements on the interest rate option will be recorded in the income statement as the hedged item is a derivative.*

5. Is it recommended to get auditor buy-in?

Yes - once you decide your approach we recommend bringing proposals to your auditor for their agreement. This may not be as simple as you think.

## Essential steps - easy as 1,2,3...

### A. Initials set up Complete hedge documentation as follows.

- Date of designation.
- Description of hedging instrument.
- Description of underlying hedged item.
- Nature of risk being hedged.
- Risk management objective and strategy.
- Method of assessing and measuring hedge effectiveness and ineffectiveness (retrospectively and prospectively).

### B. Ongoing requirements Undertake hedge effectiveness testing.

- Demonstrate at the outset that the hedge will be highly effective (within the range of 80-125%) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk. This is the prospective test and it must be repeated at each reporting date.
- Undertake retrospective effectiveness testing at each reporting date to demonstrate that the hedge has been effective.

## Role of technology - problem solved.

For many companies the absence of suitable technology has been a key contributor to the nightmare faced.

*'Using spreadsheets to demonstrate to your auditor that you qualify for hedge accounting is a recipe for disaster.'*

From our extensive experience with Irish and international organisations it is far easier to achieve hedge accounting and auditor sign off when you utilise best practice treasury systems interfaced with market information systems and accounting/ERP systems.

### A good system will:

- record hedge documentation
- record and link the underlying exposures and hedging instruments
- utilise a market data feed for foreign exchange rates, yield curves and commodity prices
- provide suitable valuation techniques to provide mark to market valuations
- provide prospective effectiveness assessment from the outset
- test hedge effectiveness at each reporting date prospectively and retrospectively
- provide effectiveness results in several output forms
- quantify ineffectiveness, if any
- deliver the related accounting entries to your accounting system.

## Conclusion

In July 2009 the IASB published an exposure draft titled *Financial Instruments: Classification and Measurement*. The exposure draft is part of a project to replace the existing IAS39 and is being done in an effort to reduce the complexity surrounding the classification and measurement of financial assets and liabilities.

*'Accountants and treasurers must live with the reality of hedge accounting and manage the risks involved. Technology will continue to be vital and the good news is that affordable treasury systems solutions are now available that meet your requirements.'*



### Marie Clarke, Manager Finance, FTI.

FTI is the leading independent treasury services firm and provides cost effective treasury systems solutions for hedge accounting purposes. Marie has over ten years experience in accounting and auditing and specialises in treasury accounting.

# Joint initiative between Engineers Ireland and CIMA will enable engineers to gain a fundamental knowledge in business and finance.

Engineers Ireland, the professional members' body for all qualified engineers in Ireland, in conjunction with CIMA, have recently announced a joint initiative that will offer the 24,000 members of Engineers Ireland a thorough grounding in business and finance, through the CIMA Certificate in Business Accounting.

By undertaking the certificate, Engineers Ireland members will gain a range of financial skills in areas of key importance to the engineering and construction sector, including accounting for property, plant and equipment, start-up costs, borrowing costs and joint ventures.

At the launch of the CBA initiative in October, John Power, Director General of Engineers Ireland said that this is an excellent opportunity for members of Engineers Ireland to improve their skills set. This certificate is suitable for all engineers and provides a significant foundation in the areas of business and finance which will benefit every engineer particularly in today's climate. We are happy to be linked with CIMA Ireland as they, like Engineers Ireland, have pedigree in providing the highest educational standards, from which our members can only benefit.

The Certificate in Business Accounting is a recognised qualification on a stand-alone basis and represents the cornerstone of the CIMA Professional Qualification. Through teaching the language of business, the certificate will provide engineering professionals with an excellent grounding in the different areas of accounting and how these relate practically



L-R: Mick O'Callaghan from Value Added Consulting, member of Engineers Ireland and also a CIMA member, John Power, Director General, Engineers Ireland and Denis McCarthy, Divisional Director, CIMA Republic of Ireland.

to the business world; an increasingly important asset in today's economic environment.

Denis McCarthy, Divisional Director, CIMA Republic of Ireland said that Engineers Ireland is a body of considerable professional integrity with a strong reputation and a broad membership base. I am confident that CIMA's Certificate in Business Accounting will become a valued educational resource for the organisation. CIMA works with some of the world's leading employers and offers the highest quality learning resources which in this instance will help Irish engineers in their professional development.

The CIMA qualification is open to all members of Engineers Ireland and on entering members will be exempted from one of the five modules – Business Mathematics. Members of Engineers Ireland can enter the course at any time and the assessments may be taken in any order and through any combination of subjects to suit individual needs.

In order to cater for Engineers Ireland membership throughout Ireland there are Computer Based Assessment Centres conveniently located at nine centres across Ireland and Northern Ireland. The Certificate in Business Accounting can also be a stepping stone to the CIMA Professional Qualification for those interested in becoming a Chartered Management Accountant.

