

Accounting for Derivatives and Hedges

By Steven M. Bragg, CPA

Table of Contents

Chapter 1 – Derivatives and Hedging Transactions.....	1
Learning Objectives	1
Introduction.....	1
What is a Derivative?	1
What is a Hedge?	3
What is Risk?.....	4
Foreign Exchange Risk	5
Interest Rate Risk.....	6
Credit Risk	7
Foreign Exchange Risk Management Alternatives.....	8
Take No Action	8
Avoid Risk.....	9
Shift Risk	10
Time Compression	11
Build Reserves.....	11
Maintain Local Reserves	12
Hedging	12
Interest Rate Risk Management Alternatives.....	12
Take No Action	13
Avoid Risk.....	13
Asset and Liability Matching	13
Hedging	14
Credit Risk Management Alternatives.....	14
Take No Action	14
Alter the Credit Policy.....	14
Enhance Collection Activities.....	15
Foreign Exchange Hedging Instruments.....	15
Loan Denominated in a Foreign Currency	15
The Forward Contract	16
The Futures Contract	17
The Currency Option.....	18
The Cylinder Option	20
Swaps.....	21
Interest Rate Hedging Instruments.....	21
The Forward Rate Agreement	21
The Futures Contract	24
Interest Rate Swaps	26
Interest Rate Options	28
Interest Rate Swaptions	32
Credit Risk Hedging Instruments.....	32
Credit Risk.....	33
Credit Default Swaps.....	35
Summary	35
Review Questions	37
Review Answers	38

Table of Contents

Chapter 2 – Accounting for Derivatives and Hedges	40
Learning Objectives	40
Introduction.....	40
Other Comprehensive Income.....	40
Derivative Accounting	43
Hedge Accounting—General.....	44
Hedge Accounting—Fair Value Hedges	46
Hedge Accounting—Cash Flow Hedges	48
Hedge Accounting—Net Investment Hedges.....	52
Embedded Derivatives	53
Hedging Controls	55
Sample Hedging Procedure	56
Unhedged Foreign Exchange Gains and Losses	60
Derivative and Hedging Disclosures	60
General Disclosures	60
Fair Value Hedge Disclosures	62
Cash Flow Hedge Disclosures.....	63
Summary	64
Review Questions	65
Review Answers	66
Glossary	69
Index.....	73