

Hedging Solutions: Managing profit volatility

Accounting for economic substance to reflect hedged realities in income statement



Companies engage in hedging transactions to manage economic risks from global business

With appreciating US Dollar, higher oil prices and macro economic factors, Asian currencies have witnessed higher volatility against the US Dollar resulting in exposure to their P&Ls. With the uncertainties in the economic environment expected to persist in foreseeable future, the P&L of companies which global trade or in foreign currency transactions are expected to experience volatility.

Major risks encountered by companies



Foreign Exchange
(e.g. USD, EUR, JPY, etc.)



Interest rate
(e.g. LIBOR, etc.).



Commodity prices
(e.g. oil, coal, metals, etc.)

What companies do to manage their risks

Mitigating variability in cash flows

- **Derivative instruments** exchanging variable with fixed interest rates or swap foreign exchange positions with fixed local currency cash flows, etc.
- **Natural hedging** through offsetting positions, for example: matching collection of foreign currency revenues and loans in similar currency, etc.

Locking market variables driving commodity pricing

- **Derivative instruments** to fix realisation of commodity sales price, or locking purchase price of committed purchases, etc.
- **Natural hedging** through offsetting positions, for example: matching collection of foreign exchange revenues with purchases liability, etc.

Protecting net investment in foreign operations

- **Derivative instruments** to hedge realisation of loans given to foreign investee, etc.
- **Non-derivative instruments** to create offsetting positions, for example: foreign exchange loans of investor offset accounting translation of foreign subsidiaries, etc.

Accounting implications

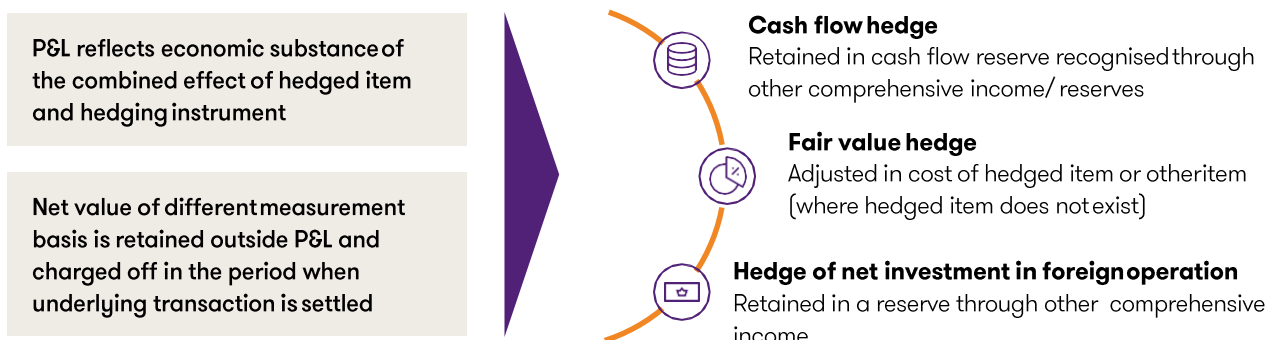
Underlying hedged item is carried at cost, or restated for foreign currency

Derivative instruments are carried at fair value with gains/ losses recognised in profit or loss

Accounting mismatches resulting in volatility in P&L are inevitable

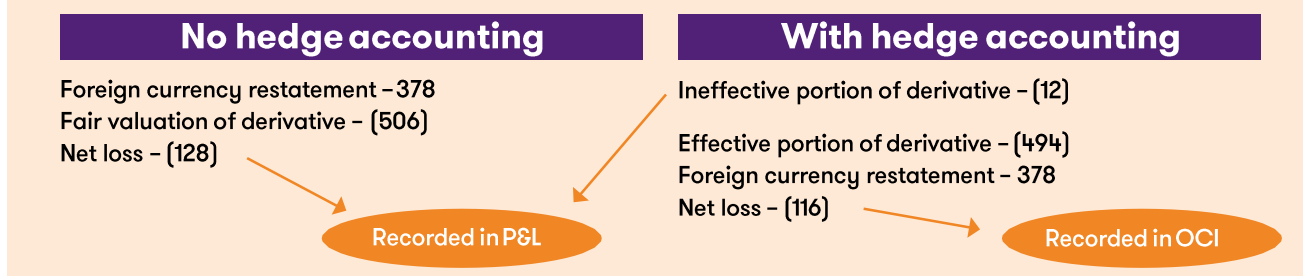
Managing P&L volatility: Hedge accounting

Hedge accounting is an effective tool to eliminate mismatches in P&L that arise from different accounting basis for the underlying hedged item and the hedging instrument.

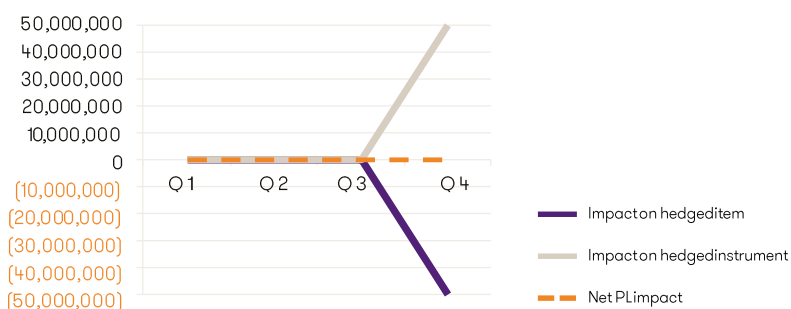
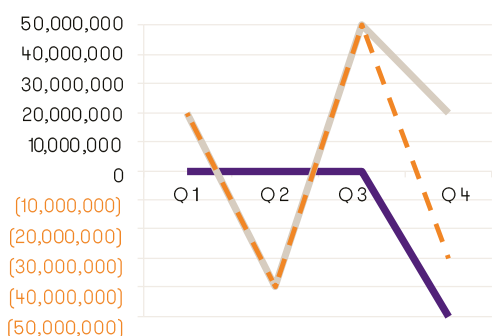


Illustrative impact analysis of hedge accounting

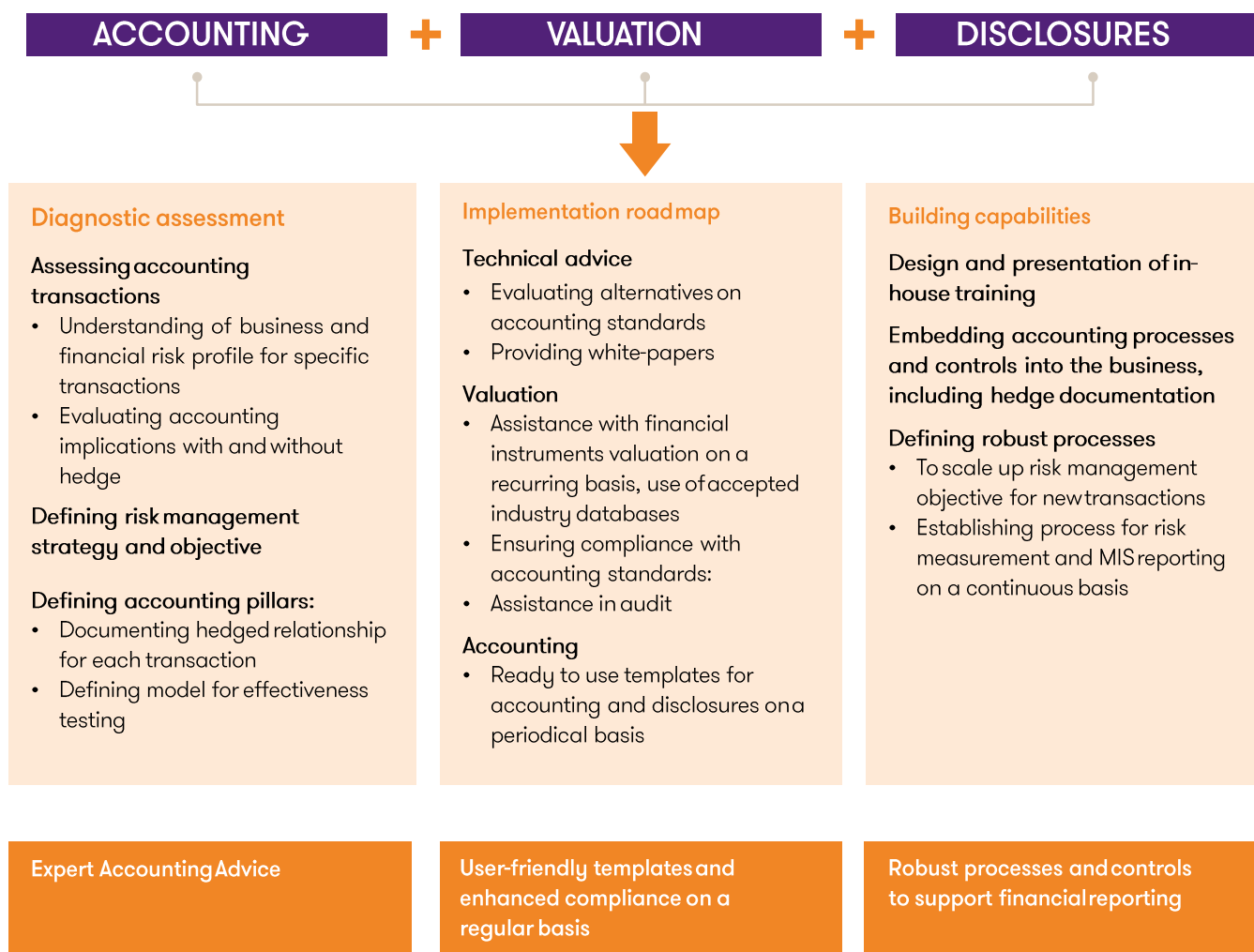
- Underlying exposure: Foreign currency loans at variable interest
- Hedging instrument: Cross currency interest rate swap to hedge currency and variable interest exposure



P&L impact - Periodical trend



Hedge accounting service offerings



Our services

Financial statements are the ultimate report card of fiscal performance. They enable owners and managers to pursue their business objectives for raising capital, acquisition, divestiture or restructure. Therefore, every business activity, through the company's lifecycle, impacts the financial statements and hence, needs to be carefully examined and analysed.

Incorporation

- Setting processes and controls – financial reporting manual
- Selection of financial reporting policies
- Automated management reporting systems
- Assistance in critical financial process reviews to enhance efficiency and track leakages
- Adoption of tax accounting standards

Private capital raising

- Adoption of international accounting standards
- Accounting advice on proposed capital structure
- Structuring stock based compensation arrangements
- Support in financial due diligence exercises

Acquisition of business

- Purchase price allocation accounting
- Preparing completion accounts pursuant to share purchase agreements
- Automation of financial reporting process through implementation of reporting packs
- Post-acquisition support: aligning financial reporting systems and processes

Public capital raising

- Preparing historical financial statements to be included in prospectus for capital raising
- Assistance in prospectus drafting process
- Liaison with intermediaries and reporting accountants
- Post-capital raising support

Financial reporting

- National GAAP transitions
- On-call accounting advisory
- Accounting opinions on complex transactions
- Technical trainings
- Support in external auditing process
- Preparation of GAAP financial statements

About Financial Reporting Advisory Services (FRAS)

In today's competitive business environment and fast changing regulatory & reporting landscape, dynamic organisations face several challenges with respect to financial reporting which could potentially impact the value of the businesses.

There is a greater need for accurate and timely financial information now. As a part of our Audit and Assurance practice, Financial Reporting Advisory Services (FRAS) has developed innovative solutions to make financial reporting process smooth, time-bound and auditable.

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What differentiates us

- We pre-empt problems and draft solutions to them
- Most of our professionals have auditing experience, which helps them appreciate practical complexities in financial reporting
- Our team combines accounting knowledge with technological skills to deliver efficient and sustainable financial reporting solutions
- Our senior professionals are chosen experts with deep technical accounting knowledge and vast experience of advising clients on accounting matters
- Our size and structure create advantages for you. We adapt a flatter structure, with shorter decision making chains, empowered teams and no complex chains of command. Our teams are more responsive.
- Access to wide pool of IFRS experts from our offices in the region as well as our office in US, UK, India and Ireland.

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Rodger Flynn,
CEO, Grant Thornton Singapore Pte Ltd

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