Some issues to recall as you contemplate the material and the homework solutions.

Be afraid ... it’s a very complex topic. We will only taste a teensy bit of the material on offer here. The accounting is constantly evolving as we speak (month by month as of this time).

We will consider only 3 types of hedges.

**A: Basic Mechanics**

1. Value underlying at spot rate prevailing on transaction date and mark to market at spot rate on each mark-to-market (usually closing) date.
2. Value hedge at forward rate prevailing on transaction date and mark to market at the relevant forward rate on each mark-to-market (usually closing) date.
3. Compute change in value of hedge and discount the resulting gain or loss to the mark-to-market date.

Note: Hedge gains/losses are discounted since the associated cash flows are to occur in the future. The underlying gains or losses are not discounted since the underlying is valued at spot.
B: Gain/Loss accounting
Treatment of gains or losses depends on type of transaction. Need to distinguish between “fair value” (value) hedges and cash-flow hedges.

“Value Hedges”
- Hedge of existing transaction
- Hedge of firm commitments

“Cash Flow Hedges”
- Hedge of expected/anticipated transactions

All hedge gains/losses are offset against losses/gains on the "underlying." Create a Firm commitment asset or liability if firm commitment.

The "ineffective" component [diff. between hedge gains and losses and underlying gains and losses for the period] is handled differently for value and cash flow hedges.
- For value hedges, the ineffective part is closed to net income.
- For cash flow hedges, the ineffective part is closed to other comprehensive income.

C: Balance Sheet Disclosures
Accounts Payable or Receivable (FC/Home C)
Forward Contract Receivable & Payable (FC/HC)
Firm Commitment Asset or Liability