



KPMG ENTERPRISE

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES:

New Transition Election for Hedge Accounting

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Businesses often buy or sell financial instruments for the specific purpose of offsetting or restricting the risk involved in commodity price, interest rate or exchange rate fluctuations. Hedge accounting allows a business to recognize the offsetting gains, losses, revenue and expenses in net income in the same period or periods, when these items would otherwise be recognized in different periods resulting in income volatility. Given that hedge accounting departs from the conceptual framework for the recognition of such gains, losses, revenue and expenses, there are restrictive criteria under existing Canadian generally accepted accounting principles that govern the use of hedge accounting; relatively few private businesses attempt to qualify for its use under these criteria.

Accounting standards for private enterprises (ASPE) provide a simplified model for hedge accounting; however, arrangements entered into before the date of transition¹ to ASPE that had not been designated as a hedging relationship prior to transitioning to ASPE did not qualify for hedge accounting upon transition.

At its July 13, 2011 meeting, the Accounting Standards Board (AcSB) announced a special provision that will allow a company to retrospectively apply hedge accounting when it transitions to ASPE. The transition relief will be available for any qualifying hedging relationship initiated before December 31, 2011, provided that the relationship meets all of the requirements for hedge accounting in ASPE, other than designation and documentation at inception. The hedging relationship must still be in existence at the company's next reporting date following inception.

¹ The date of transition is the beginning of the earliest period for which an entity presents full comparative information under ASPE.

Under ASPE, the following relationships may qualify for hedge accounting:

- An anticipated purchase or sale of a commodity hedged with a forward contract to mitigate the effect of future price changes of the commodity
- An anticipated transaction denominated in a foreign currency hedged with a forward contract to mitigate the effect of changes in future foreign currency exchange rates
- An interest-bearing asset or liability hedged with an interest rate swap to mitigate the effect of changes in interest rates
- A foreign currency denominated interest-bearing asset or liability hedged with a cross-currency interest rate swap to mitigate the effect of changes in interest rates and foreign currency exchange rates, and
- The net investment in a self-sustaining foreign operation hedged with a derivative or non-derivative financial instrument to mitigate the effect of changes in foreign currency exchange rates.

Both at the inception of the hedging relationship and throughout its term, the entity must have reasonable

assurance that the critical terms of the hedging item and the hedged item are the same. When the hedged item is an anticipated transaction, it must be probable that the anticipated transaction will occur at the time and in the amount designated.

Private companies that hedge exposures to changes in commodity prices, exchange rates or interest rates will want to consider whether to avail themselves of this new transition opportunity. While the change is subject to a final written ballot by the AcSB, it is expected to be adopted and available for companies in the year of transition to ASPE.

KPMG Enterprise practitioners are skilled in ASPE and the proposed changes. They are ready to help you with your transition project now to ensure you have the time to consider your accounting policy choices and transition options and select and implement those that are best for your company.

Should you have any questions, please do not hesitate to contact your adviser directly or our Concierge Services at **1-888-99-ADVSR**.

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