Overview

The financial markets have been experiencing significant volatility resulting from a number of factors including the US China trade dispute, Brexit, and most recently Covid-19. Companies are facing increasing volatility in interest rate, foreign exchange rate and commodities prices causing fluctuations to their profit or loss. For instance, the exchange rate between USD to SGD increased from 1.35 from 1 January 2020 to 1.39 as of 10 March 2020 (approximately 3% within a span of 2 months). A company with functional currency in SGD would have experienced an increase in liabilities denominated in USD and unrealised FX losses by approximately 3%. Therefore, economic hedging has become essential in the market, as well as the application of hedge accounting under the requirements of IFRS 9 to reduce its exposure to risks and fluctuation in the profit or loss.

Hedge accounting

While a lot of companies are implementing economic hedges to reduce the volatility, this may not translate to lower income volatility unless the company has adopted hedge accounting under IFRS 9.

Under IFRS 9, the application of hedge accounting (pursuant to meeting specific criteria prescribed by IFRS 9) allows entities to modify the basis of recognising gains or losses on hedged item and hedging instrument, to allow recognition of both in the same accounting period. This introduces a 'matching concept' which reduces volatility in your profit or loss and other comprehensive income. Otherwise, the fair value gains or losses of the hedging derivative will be recognised in the profit or loss, creating additional volatility.

“Cost of Hedging”

Even if you have adopted hedge accounting under the old FRS 39, you may still experience fluctuations in the profit or loss due to ineffectiveness. Volatility in the currency basis spreads or forward points in the current volatile environment may have caused ineffectiveness in hedge accounting.

Under IFRS 9, the standard was revised to allow the optional application of “cost of hedging”, which will help companies reduce the profit or loss volatility in your books from the impact above. Under this approach, entities may exclude the forward element of a forward contract or the currency basis spread from the hedge relationship and amortise this portion into the profit or loss in line with the impact and nature of the hedged item.

![Forward/Basis Spread Element Recognition to P&L](image)
PwC contact

PwC provides support in hedge accounting under IFRS 9 which covers the following areas:

- Implementation of hedge accounting (includes providing support in assessing the eligibility of hedge accounting, preparing the hedge documentation and consider the cost of hedging requirements into your business);
- Develop hedge accounting policy and operational framework for financial reporting processes;
- Review the application of hedge accounting for the existing hedge relationship and its relevant accounting entries; and
- Upskilling you and your business team on requirements of hedge accounting pursuant to IFRS 9.

To speak to one of our experts about hedge accounting, please contact:

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