HMRC - CFM24430 - Accounting For Interest Rate Swaps Held To Manage Interest Rate Risk Under Old UK GAAP (Excluding FRS 26)

This guidance applies for Old UK GAAP (excluding FRS 26).

Accounting for interest rate swaps held to manage interest rate risk

Interest rate swaps are contracts under which a periodic series of cashflows will be made or received, calculated by reference to a nominal amount, and defined interest rates. Typically businesses use such contracts to manage risk associated with interest bearing borrowing or investments. For example, a business borrowing money might have a floating rate bank loan, and enter into an interest rate swap to give it certainty over future cashflows in the event of interest rates increasing. Under such a contract:

The business would make periodic payments (e.g. monthly) at a fixed rate, based on a nominal amount (e.g. £10m)

The business would receive periodic payments at a floating rate at the same time, based on the same nominal amount (in practice the contract may stipulate that one net sum is paid/received each month).

There is no specific accounting standard dealing with the accounting for interest rate swaps under Old UK GAAP (excluding FRS 26). However, in practice where such instruments are held for hedging purposes, the normal treatment is to account for the swaps “off balance sheet” - i.e. at historic cost (usually nil) with periodic cashflows recognised on an accruals basis. This enables the holder to recognise the periodic cashflows in profit and loss in a manner consistent with the usual recognition of interest income/expense on the underlying item which is being hedged.

See CFM13000+ for more detail on forwards and how they work.

Note on the accounting for interest rate swaps with IFRS, New UK GAAP and FRS 26 under Old UK GAAP

Interest rate swaps are derivative contracts, which are required to be measured at fair value in the balance sheet at each reporting date. In general, profits and losses arising on these contracts are recognised in profit and loss, apart from when designated as the hedging instrument in a cash flow or net investment hedge and hedge accounting applies (see CFM27000).

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