HMRC - CFM26090 - SSAP 20: Hedging A Non-Trading Transaction

This guidance applies to companies which have adopted SSAP 20 under Old UK GAAP.

SSAP20 and hedging contracts

SSAP20 allows a company that has a trading transaction covered by a related or matching forward contract to translate the trading transaction at the rate implied by the contract (see CFM26080). But companies often use forward currency contracts to hedge the exchange risk inherent in non-trading transactions involving foreign currencies. For example, a company may use a forward contract to fix, in sterling terms, the amount it will have to pay for a fixed asset, or the amount it will receive when a loan is repaid.

And companies do not only use forward contracts to hedge exchange risks - they may use exchange-traded currency futures, or currency options or currency swaps (see CFM13390 for more about managing exchange risks).

SSAP20 does not spell out how companies should account for the transaction, and the associated derivative contract, in such circumstances. But in practice many companies interpret ‘trading transaction’ broadly. Where a forward contract has been taken out specifically to hedge a particular foreign currency asset or liability, it is usual for a company adopting SSAP20 to account for that asset or liability at the rate implied by the forward contract.

Example

Uzubay plc makes a loan to a subsidiary of €2 million, repayable in 12 months. At the same time, it contracts with its bank to sell €2 million for £1,230,000 in 12 months’ time. Thus the company has no real exposure to euro/sterling exchange rates: whatever the exchange rate does, it will receive £1,230,000 when the loan matures. The company is likely to translate the loan at the rate implied by the forward contract, showing it at £1,230,000 throughout, and not recognising any exchange differences.

In the above example, the company might use a euro/sterling currency swap to hedge the loan instead of a currency forward. Most companies will, in such circumstances, use the rate implied by the currency swap to account for the loan, in a precisely similar way.

Currency options - although they can be used as a hedge - are different. It would be misleading to translate an asset or liability at the rate implied by a currency option (the strike price), because the company is under no obligation to exercise the option. The currency option and any related transaction, asset or liability will be accounted for separately - see CFM24420.

Note on IFRS, New UK GAAP and FRS 23 under Old UK GAAP

The position is different for companies adopting IFRS, New UK GAAP or FRS 23 under Old UK GAAP. The contracts will be recognised separately and measured at fair value. Any resulting fairly gains and losses should largely offset any exchange gains or losses on the underlying monetary asset or liability. It may also be possible that the company designates the contract as a formal hedge and apply hedge accounting (See CFM27000). If you are unsure about the accounting for hedging contracts under IFRS, New UK GAAP or FRS 23, please consult an HMRC Compliance Accountant.

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