

NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS: QUALITATIVE DISCLOSURES

ANDREI Monica, OPREA Margareta

Academy of Economic Studies of Bucharest

mona_andrei@yahoo.com, oprea_margareta@yahoo.com,

Key words: financial risk, financial position, accounting standards

Abstract: Disclosure is an effective mechanism to expose financial risk management practices to market discipline. Disclosure should be sufficiently comprehensive to meet the needs of users within the constraints of what can reasonably be required. Improved transparency through better disclosure may reduce the chances of a systemic financial crisis or the effects of contagion because creditors and other market participants will be better able to distinguish between the financial circumstances that face different institutions or countries.

During this last decade, the accountability of the financial assets and debts has experienced a real revolution as a result of the fact that the accountability norms regarding the acknowledgement and evaluation of the financial instruments. The provisions of the mentioned standards, elaborated with the declared aim to bring the accountability practices at the level of the most recent evolutions that have taken place on the global financial markets have significantly changed the way of accountabilisation of the financial assets and debts and of the instruments of the own capitals, of the derivatives or of the operations of risks covering, as being a direct reflect of the nature of the transactions developed in the modern economy.

The complexity of the new rules contained by the norms generated animated debates and challenged the practitioners involved in preparing and drafting the financial balances, for whom applying the requests referring to: the acknowledgement of all the derivatives of the balance, the evaluation of many of the financial assets and debts at their real value, the criteria that must be observed to annul the acknowledgement or the use of the special accountability treatment applicable to the protection operations against the financial risks etc. was, in most of the cases, an absolute novelty.

Covering the fair value against currency risk. Unlike operations cover other types of risks, the coverage in a relationship of this kind may originate among nederivatelor. This is explained by the fact that, in general, changes in exchange rates are reflected for financial assets and liabilities in the profit and loss.

Exceptions are non-monetary items (such as shares) denominated in foreign currency and classified in the category of assets available for sale to fair value changes recorded in equity. In this case, the exchange differences are recognized in profit or loss. Although IAS 39 does not prohibit the designation of such elements as tools for hedging currency risk, the relationship is unlikely to be effective.

Due to the requirements of IAS 21 to assess all elements of the monetary exchange rate at the close of the financial year and to record changes in the profit and loss accounting operations risk coverage is not needed. Non-monetary items (assets or financial liabilities) record exchanged differences relating to equity, where the transfer results in the cancellation only in the recognition of such items. These rules have the consequence of using a less extended accounting operation of a fair value hedge against currency risk.

The most frequently used instrument for hedging currency risk is the *forward contract*. If holding an asset denominated in a declining exchange rate is covered by a contract of sale of foreign currency on time. In the possession of a debt denominated in foreign currency,

company enters into a forward contract of 1 Euro = 1.23 USD. To establish the effectiveness of the relationship using the "dollar offset". Evolution rates during the coating operation is shown in Table 1.1.

Table 1.1.

	02.10.2006	31.12.2006	30.01.2007
Spot rate	1 Euro = 1,20 USD	1 Euro = 1,25 USD	1 Euro = 1,20 USD
Forward rate	1 Euro = 1,23 USD	1 Euro = 1,26 USD	1 Euro = 1,23 USD
Home	0,03 USD	0,01 USD	-
Change:			
- Spot rate	0,05 USD	+0,05 USD	=0,10 USD
- Forward rate	0,03 USD	+0,04 USD	=0,07 USD
- Premium	0,02 USD	+0,01 USD	=0,03 USD

The accounting records are:

- on October 2, when contracts are derived, there is no record because the its fair value is zero;

- December 31:

- the associated lossis recognized of firm value due to the adjustment of the fair as a result of fluctuations forward rate $[(1.26 - 1.23) \times 1000000]$:

Unrealized loss from operations = Firm engagement 30000
of coverage

Related derivative gain (0.03×1000000) :

Financial asset (forward contract) = Unachieved gaining 30000

- 30 January:

- Loss of commitment attached firmly established on the basis of forward rate $[(1.30 - 1.26) \times 1000000]$:

Unrealized loss from operations = Firm engagement 40000
of coverage

- Gain related forward contract (0.04×1000000) :

Financial asset (forward contract) = Unachieved gaining 40000

- Purchase of equipment at the rate of 1.23 set in the forward contract:

% = Accounts at banks 1300000

Equipment 1230000

Firm engagement 70000

Net settlement of derivative:

Accounts at banks = Financial Assets 70000

If the item covered against risk is a financial asset or financial debt, it may be an item covered against the risks to the risks associated with only a portion of the cash flows and its fair value - such as one or more flows Treasury selected the contract or a portion thereof, or a percentage of fair value - provided that effectiveness can be assessed.

Thus, a portion of identifiable and can be evaluated separately from the exposure rate to produce an active interest which may be classified as risk covered (such as interest rate risk or without a standard rate of interest of the total exposure rate of a financial instrument covered against risk).

References

[1] ***, IAS 39 „Financial Instruments: Recognition and Measurement”, *Official Journal of the European Union*, L 363/9.12.2004, <http://europa.eu.int>.

[2] Huian M.C.,(2008), „Instrumente financiare: tratamente si optiuni contabile”, *Editura CECCAR*, Bucuresti, Pp. 262

- [3] Hartwell C.H.(2003), "*Business Combinations and International Accounting*", Thomson South-Western, Ohio, Pp. 281.
- [4] Andrei Monica, "*Impact of IT and technology on Compensation and Benefits Management*", Conferinta IBIMA - Knowledge Management and Innovation in Advancing Economies (IBIMA), ISBN: 978-0-9821489-2-1, 9-10 Noiembrie 2009, Maroc,
- [5] Oprea Margareta, "*Accounting coverage operations against risks. Coverage relationships of fair value*", Conferinta IBIMA - Knowledge Management and Innovation in Advancing Economies (IBIMA), ISBN: 978-0-9821489-2-1, 9-10 Noiembrie 2009, Maroc,
- [6] Ristea M., Dumitru C., Carpan A., Manea L., Nichita M., Sahlian D.,(2007) „Politici si tratamente contabile privind activele imobilizate”, *Editura Tribuna Economica*, Bucuresti.