

**GETTING A GRIP ON ACCOUNTING FOR DERIVATIVES:
A GUIDE FOR THE PERPLEXED**

Atlanta, Georgia

Sunday, June 6 (1:30 p.m. – 2:20 p.m.)

- I. Introduction
- II. Nature and purpose
 - A. What is a *derivative*?
 - B. What are the defining characteristics of a derivative?
 - 1. Settlement factors
 - 1. Reference rate
 - 2. Notional amount or payment provision
 - 2. Leverage
 - 3. Net settlement
 - C. What can be used for a reference rate?
 - D. How are derivatives used in practice?
 - 1. Investments
 - 2. Tools to reduce volatility
 - E. How can derivatives reduce volatility?
- III. Accounting and financial reporting
 - A. How should a derivative be reported?
 - 1. Economic resources measurement focus/accrual basis of accounting
 - 1. Fair value
 - 2. Change in fair value *normally* a resource inflow/outflow
 - 2. Current financial resources measurement focus/modified accrual basis of accounting (governmental funds)
 - 1. Not reported as such
 - B. When are changes in fair value *not* reported as a resource inflow/outflow?
 - C. What happens to the deferred amounts?
 - 1. Commodities contracts
 - 2. Refundings
 - 3. Financial instruments that are not re-exposed to risk
 - 4. Other termination events
 - D. Do *all* hedges qualify for hedge accounting?
 - E. How does a government determine whether a hedge is effective?
 - 1. Consistent critical terms method
 - 2. Acceptable quantitative method
 - F. How does the *consistent critical terms method* work?
 - G. What *quantitative* methods can a government use to determine whether a hedge is effective?
 - 1. Synthetic instrument method
 - 2. dollar-offset method
 - 3. Regression analysis
 - 4. Other methods with same qualitative characteristics

- H. How does the *synthetic instrument method* work?
- I. How does the *dollar-offset method* work?
- J. What results must be achieved using *regression analysis* to qualify as an effective hedge?
- K. Are there any limitations on the choice of method?
- L. What happens if a hedge is determined to be ineffective?
- M. What is an embedded derivative?
- N. How should embedded derivatives be treated?
- O. Are any potential derivatives excluded from the scope of this guidance?
 1. Normal purchases and sales contracts
 2. Nonexchange-traded contracts
 3. Insurance contracts
 4. Financial guarantee contracts
 5. Loan commitments