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

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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.

<u>Covering the fair value against currency risk.</u> 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,

increasing the risk of exchange rate shall be covered by a forward contract to purchase a currency at a future date but at a price determined today.
Cover the fair value against the risk of price of goods is made especially for assets valued at fair value, if possible price reduction. Ensure protection through a forward contract for the sale of a product / financial title or by purchasing a put option on a commodity or a title.
For example, a company which has the object of refining metals and their wholesale sales, wants to protect stocks of zinc held. To do this, it falls on 01.07.2008, in a forward contract (which has no intention of reimbursements by the delivery of metal) to sell at a zinc price. On 30.09.2008, the hedge relationship is still very effective. The fair value of the stock of zinc decreases with 25000 USD, while the derivatives increased by 25000 USD .
On 01.07.2008 there are no accounting entries because the fair value of derivative is zero.
On 30.09.2008 is accounted:
• amend the fair value of the stock of zinc:

Unrealized loss of zinc stocks	**=**	**Operations coverage**	**25000**

• amend the fair value of forward contract:

Financial asset has not (forward contract)	**=**	**Gain of operations coverage**	**25000**

At the end of the financial year, was identified that part of the hedge relationship is effective, but overall efficiency is maintained in the standard (80-125%), why not waive the application of particular accounting treatment. The fair value of the stock of zinc fell by 25000 USD, and the derivative with 22000 USD. Accounting for relevant are:

Unrealized loss of zinc stocks	**=**	**Operations coverage**	**25000**

• amend the fair value of the stock of zinc

Financial asset has not	**=**	**A gain of operations coverage**	**22500**

• amend the fair value of forward contract:
Firm commitments are another important issue of accounting transactions for hedging risks. Under IAS 39, they are irrevocable agreements of exchanging a specified quantity of resources at a price set at a time or more determined future date. These commitments creates the risk of exposure to change in the fair value. However, IAS 39, the original version, to protect their operations applicable accounting rules for hedging cash flows. But a new version of the standard amends this provision, which harmonize with U.S. accounting rules. Thus, coverage is a strong commitment to the operation of the risk of fair value changes. If the commitment is denominated in foreign currency, the entity may choose to cover according to the rules relating to fair value and the cash flows.
When an importer shall issue a purchase order, requiring payment in foreign currency seller, it exposes the risks of currency and not the time of the acquisition. This period, up to the actual transaction is called *anticipatory period of transaction.*
Accounting treatment of firm commitments covered instruments designated as provided for in IAS 39 is as follows:
• subsequent amendments cumulative fair value attributable to the risk of commitment is protected admit, on the one hand, as an asset or debt in the balance sheet and, on the other hand, the losses or gains in the results. Changes in the fair value of hedging instrument are recorded in all the profit and loss;
• initial value of the asset or debt resulting from the strong performance is adjusted to include the cumulative amendments previously recognized in the balance sheet.
Next, we present an example of covering a firm commitment denominated in foreign currencies, fair value through metoda.
On 2 October 2006, an American company has ordered the purchase of equipment from a French manufacturer for the amount of 1000000 Euro, delivered over 3 months (30 January 2007). Date coincides with the settlement. To protect against currency risk, the

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) x 1000000]:
Unrealized loss from operations = Firm engagement 30000
of coverage
Related derivative gain (0.03 x 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) x 1000000]:
Unrealized loss from operations = Firm engagement 40000
of coverage
- Gain related forward contract (0.04 x 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).

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