



Hedge accounting

Banking Accounting Advisory

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Market insights



Hedge accounting strikes fear in the hearts of many because...

- it is viewed as a **highly technical topic** due to its **complexity**, various applications and the specific skillset and experience;
- results in **key person risk** as only a select few in a Finance and/or Treasury function understand hedge accounting;
- can be challenging to apply and **difficult to operationalise**;
- requires hedge accounting solutions that have **strong end user controls** ('EUCs') and/or **clear audit trails** to enable ease of audit; and
- **significant efforts** are required to produce hedge accounting **Management Information** ('MI') to explain the movements in the balance sheet and volatility in the profit and loss ('P&L').



What we see in the market

01 Limited understanding and experience

Finance and Treasury teams generally have **limited understanding and experience** of the applications of hedge accounting under IAS 39 or IFRS 9. There is commonly a strong reliance on a specific individual or limited number of individuals, to produce, report and explain the hedge accounting results.

02 Lack of controls and governance

Hedge accounting models exist either as **"black boxes"** and/or **complex spreadsheets** with **limited EUCs** making it hard to audit / verify whether hedge accounting has been applied in accordance with the relevant accounting standards.

03 Manual overlay and efforts

Existing hedge accounting models generally require **significant manual overlays and workarounds** particularly when there are de-designation and re-designation of the hedges ('de and re'), unexpected prepayments or swap modifications / terminations.

04 Ineffective hedge accounting MI

Sufficient or reliable information are generally **not available** (or require significant effort to produce) for forecasting, reporting and strategic decision-making. The need to **manipulate the data for MI production** increases the risks of **human errors** and **material misstatement**.

Organisation's desired outcomes

- **Access to deep and wider knowledge and insights** of the appropriate **accounting application** and **best market practices** under IFRS 9: Financial Instruments ('IFRS 9') and IAS 39 Financial Instruments: Recognition and Measurement ('IAS 39') ensuring that they **align** to the organisation's **hedging strategy**.
- **Experienced team with subject matter expertise and experience** in **designing** and **implementing** an appropriate hedge accounting **target operating model** ('TOM').
- **Compliant and transparent hedge accounting solution with embedded controls and governance** that has a comprehensive user manual and limited training requirements to **reduce reliance on specific individual(s)**. Important aspects of the hedge accounting solution should include:
 - **minimum or a one-time verification** of the solution's functionalities which will enable the external audit process to be more efficient;
 - ability to generate amortisation of fair value hedged adjustments and/or cash flow hedge reserves and journal entries for **booking** into the **general ledger**; and
 - **provide insightful MI** that can determine the cause of P&L volatility allowing the organisation to identify and implement improvements rather than the processing.

How KPMG can help you



Provide technical accounting guidance for new hedging strategies and/or structures and if needed, undertake deep dives to help optimise hedging strategies.



Provide end-to-end ('e2e') review of hedge accounting implementation / application.



Provide assistance in validating existing (or new) hedge accounting tool / solution*



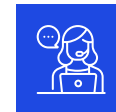
Provide a state-of-the-art hedge accounting solution with embedded controls and governance that is easy to validate, use and can significantly reduce the reporting cycle.



Provide technical subject matter expertise ('SME') support in review and update of overall treasury operating model and/or accounting (including hedge accounting) processes controls.



Perform / Prepare hedge accounting policy and / or documentation reviews to highlight deficiencies and propose improvements.



Provide hedge accounting resource support to assist during specific reporting periods or if needed, managed services for a period of time.



Assist in quantitative and qualitative assessment on application of hedge accounting including the impact of the new IFRS 9 Fair Value Hedge Accounting or Dynamic Risk Management guidance when the draft standard is published.



Provide comprehensive hedge accounting training.

** For third party hedge accounting solution, our validation / review is performed using KPMG's own hedge accounting solution.*

Example hedge accounting support

Our experience gained through various hedge accounting projects as well as the development of Hedge Accounting ('HA') solutions will enable us to effectively and efficiently deliver to your specific needs. We will assist you in implementing HA solution that will be proportionate and effective for your purpose as follows:



Our high-level approach for MFVH solution implementation

- Undertake a Proof of Concept ('PoC') to demonstrate if the HA solution is fit for purpose to implement hedge accounting or replace the existing tool / solution.
- Provide data extraction support (including the provision of tools and accelerators), accounting advisory and SME support on technical accounting applications, key assumptions, model parameters, etc.
- Assist in stakeholder engagement including participating in discussions with the external auditors to explain the approach and work undertaken.
- Implement our HA solution to integrate with our client's assumptions, policies and valuation methodologies.

Deliverables

- HA Solution (Excel or non-Excel)
- Amortisation Model, if required (Excel or non-Excel)
- HA User Guides and Technical Specifications
- Review / drafting of hedge accounting policy and / or documentation



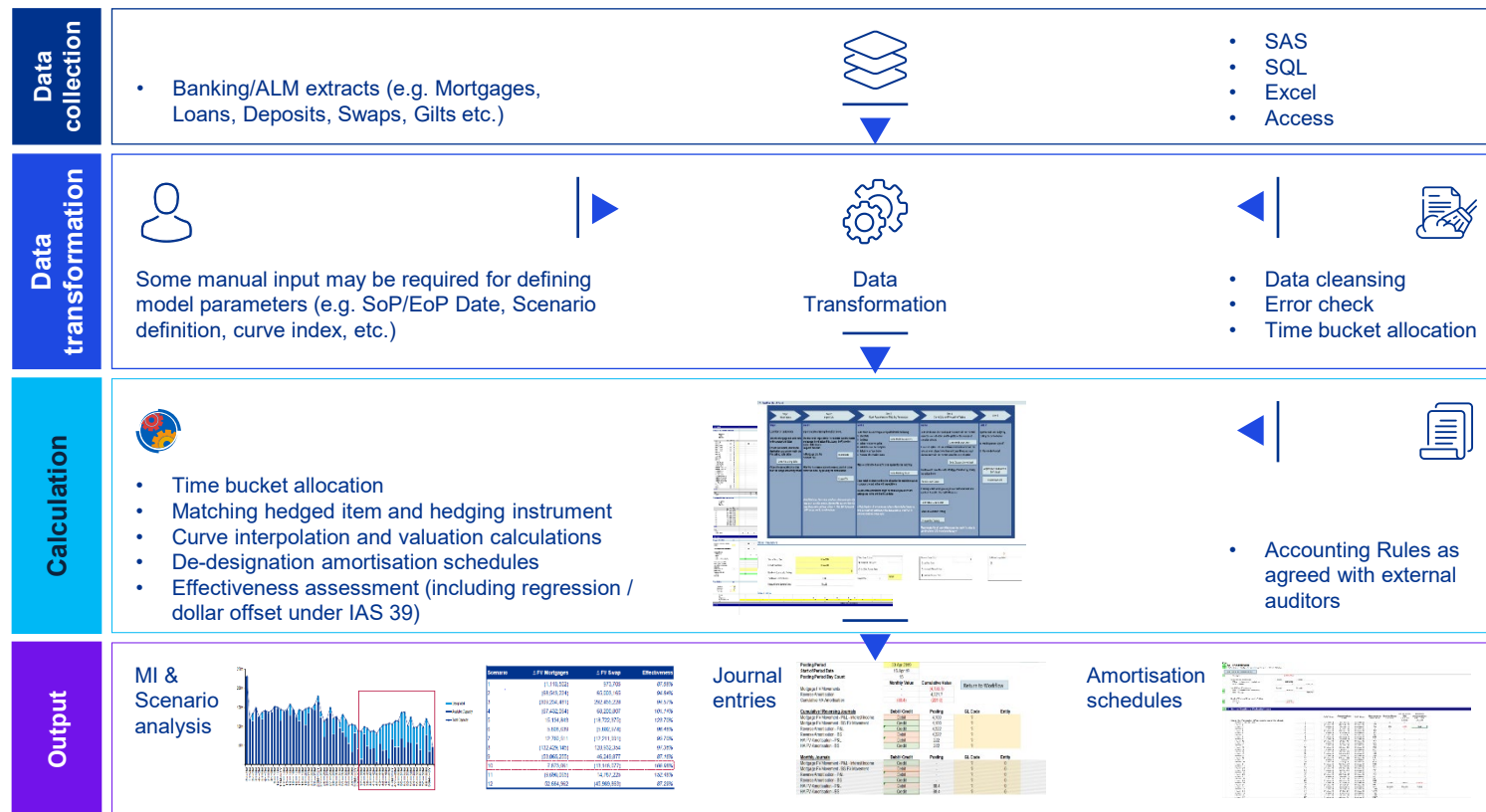
Why KPMG

- We have experience in delivering hedge accounting solutions at clients of different scale and complexities.
- Our solutions have been implemented across a number of financial institutions for their business-as-usual ('BAU') use.
- We have selected a team that have experience in designing and implementing hedge accounting solutions within global and UK banks as well as building societies.
- We can flex our approach to accommodate the availability of our clients' resources and systems infrastructure.
- We have a proven track record in dealing with external auditors, and providing training and knowledge transfer to upskill relevant resources and embed the hedge accounting solution within an organisation.

Hedge Accounting Model

Our Hedge Accounting solutions (“our solutions”) have been developed to reduce the operational complexity of hedge accounting and enable financial institutions to adopt optimal method of minimising P&L volatility in their financial statements. Our solutions are currently deployed at a number of large UK retail and challenger banks and building societies and are designed as an e2e hedge accounting solution built and designed to comply with the **current requirements** of IAS 39 and IFRS 9 hedge accounting. Built-in controls (e.g. error checks, approver’s log etc.) and User Guidance Notes will also be provided to ensure maximum transparency, audit trail and ease of use requiring minimal staff training.

Hedge Accounting Model Solution



Key Benefits

- **Plug & play** with minimal implementation time required.
- Can be implemented in **Excel** or as a desktop application (**Non-Excel version**).
- Capacity assessment, built-in optimisation engine and rebalancing to **minimise P&L volatility**.
- Ability to apply **either regression or dollar offset** method for hedge effectiveness testing and assessing economic relationship.
- **Built-in MI** to visualise the **cause of ineffectiveness**.
- **Produces amortisation** schedules across different time buckets for **tracking** purposes and ensure **accurate accounting journal postings**.
- Ability to use the carve-out or full IAS 39.
- Ability to use a **variety of benchmark rates** (e.g. SONIA, ESTR, SOFR, SARON)

Short form engagement credentials



**UK
challenger bank**

Provided accounting advice and modelling assistance and performed a PoC with scenario analysis to ascertain whether implementing macro cash flow hedge accounting will reduce P&L volatility.



**UK
Building Society**

Phase 1: Performed high level review of the existing approach and application of various hedge accounting models and hedge documentations to identify areas of improvements and refinements.
Phase 2: Implemented new hedge accounting models post a PoC.



**Large UK
Building Society**

Provided accounting support to ensure that the configuration of the new Treasury Finance system for effective interest calculation and accounting for certain treasury products are compliant with IAS 39.



**Multinational
infrastructure group**

Provided accounting advice and modelling assist in the Client's development of a micro fair value hedge accounting model.



**Specialist
Mortgage Lender**

Reviewed Client's hedge effectiveness testing to ascertain compliance with the requirements of IAS 39 including the accuracy of journals for the hedge adjustments.



**Foreign commercial
bank in the UK**

Provided accounting advice in relation to the implementation of MFVHA under the EU carve-out.



**American
multinational
investment bank**

Provided on-call accounting advisory services in relation to the applicability of hedge accounting under IAS 39 on various front office transactions



**European
multinational
investment bank**

Reviewed certain macro cash flow hedge accounting models for compliance with IFRS 9 general hedge accounting requirements.



Your KPMG team



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KPMG UK have access to hedge accounting teams across our KPMG international network to serve our international / global clients





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