

**Case 14-04
Spartan Casino**

On January 1, 2015, Spartan Casino, a public business entity (Spartan or the “Company”), executed a \$250 million revolving credit facility with Uber Bank AG (Uber). The rate of interest on the credit facility is USD LIBOR + 650 basis points (bps) for the first two years. Spartan has a choice of 1M-, 3M-, and 6M-USD LIBOR each time it draws down on the credit facility. Interest payments on the borrowing are settled on the basis of the LIBOR tenor selected (e.g., if Spartan selects three-month USD LIBOR as the referenced rate, interest is due every three months on that borrowing). Principal borrowed is *typically* due five years from the drawdown date, but each drawdown will contain a specified maturity date.

Upon finalizing the terms of the credit facility, Spartan immediately drew down \$50 million on January 1, 2015, at 3M-USD-LIBOR + 650 bps, due on December 31, 2019. Spartan’s interest rate risk management policy requires that at least 75 percent of its outstanding debt be fixed rate (either directly or indirectly through the use of derivatives). In order to maintain compliance with its policy, Spartan entered into an interest rate swap to “convert” the borrowing from variable to fixed interest.

The Company designated the interest rate swap as a hedge of forecasted interest payments associated with changes in 3M-USD-LIBOR on the first previously unhedged \$50 million of 3M-USD-LIBOR based debt. The Company has no other debt. Specifically, Spartan executed the following interest rate swap transaction:

Interest Rate Swap 1:

- Notional amount: \$50 million
- Trade date: January 1, 2015
- Effective date: January 1, 2015
- Maturity date: December 31, 2019
- Pay leg: 8.0 percent
- Receive leg: 3M-USD-LIBOR + 650 bps
- Initial LIBOR: 1.00 percent
- Payment dates: Each March 31, June 30, September 30, and December 31
- Variable reset dates: Quarterly, each March 31, June 30, September 30, and December 31

Six months later, on July 1, 2015, Spartan needed to again raise capital to continue construction on its new City Focus hotel and high-end retail development. The Company

borrowed another \$75 million at 3M-USD-LIBOR + 650 bps, due on June 30, 2020. Similar to the first drawdown, Spartan executed a second interest rate swap with the following terms:

Interest Rate Swap 2:

- Notional amount: \$75 million
- Trade date: July 1, 2015
- Effective date: July 1, 2015
- Maturity date: June 30, 2020
- Pay leg: 8.5 percent
- Receive leg: 3M-USD-LIBOR + 650 bps
- Initial LIBOR: 1.25 percent
- Payment dates: Each September 30, December 31, March 31, and June 30
- Variable reset dates: Quarterly, each September 30, December 31, March 31, and June 30

Spartan designated this interest rate swap as a hedge of forecasted interest payments associated with changes in 3M-USD-LIBOR on the first previously unhedged \$75 million of 3M-USD-LIBOR based debt.

After two years, Spartan continues to pay interest on the \$125 million borrowings on time, in addition to settling the interest rate swap each quarter. However, on December 31, 2016, Spartan decides to pay \$25 million of the \$125 million it has borrowed from Uber to date. The debt is prepayable without penalty. The Company makes no other changes to its capital structure of derivatives.

Required:

1. Define the type of hedge that Spartan would need to designate. In other words, are these cash flow hedges, fair value hedges, or net investment hedges?
2. Identify the criteria that Spartan would need to meet and document to ensure the interest rate swaps achieve hedge accounting that is based on the provisions of ASC 815, *Derivatives and Hedging Activities*.

3. Determine the appropriate journal entries to account for the two hedging relationships for the year ended December 31, 2015. Use the details below to aid in entry determination, and assume that both hedging relationships are perfectly effective.

Date	3M-USD-LIBOR	Swap 1 Fair Value*	Swap 2 Fair Value*
March 31, 2015	1.00% (reset 12/31)	\$250,000	n/a
June 30, 2015	1.10% (reset 03/31)	\$750,000	n/a
September 30, 2015	1.25% (reset 06/30)	\$1,200,000	\$900,000
December 31, 2015	1.18% (reset 09/30)	\$1,100,000	\$775,000

* Note that the fair values are after the quarterly settlements are made.

4. Briefly describe the implications of Spartan paying down \$25 million of the \$125 million total borrowing on the two hedging relationships.