Case 19-4
Giant Manufacturing

Giant Manufacturing LLC (Giant) is a public entity that manufactures power transmission belts and fluid power product.

Giant owns a 100 percent direct interest in subsidiaries Small Sub 1 and Small Sub 2.

Giant has U.S. dollar (USD) functional currency. Small Sub 1 and Small Sub 2 have euro (EUR) functional currencies.

Organizational Chart

Case Facts

Because of its consolidated interest in EUR-denominated subsidiaries, Giant is exposed to the risk of adverse changes in the EUR/USD exchange rate in its consolidated financial statements. Changes in the EUR/USD exchange rate affect the currency translation account that is recorded within other comprehensive income.

As part of its risk management program to hedge its exposure to the EUR/USD exchange rate, Giant plans to use (1) a EUR/USD cross-currency swap (the “Cross-Currency Hedging Instrument”) and (2) a Euro-denominated note that is issued and outstanding with third parties and is not reported at fair value (the “EUR Debt-Hedging Instrument”) to protect the value of designated monetary amounts of its net investments in EUR functional currency subsidiaries (i.e., Small Sub 1 and Small Sub 2) against changes in the EUR/USD exchange rate.

Giant entered into the receive floating rate (3-month USD LIBOR plus a fixed spread) pay floating rate (3-month EUR EURIBOR plus a fixed spread) Cross-Currency Hedging Instrument on March 17, 2019. Between the hedge designation date and the maturity date of the Cross-Currency Hedging Instrument, Giant is using the Cross-Currency Hedging Instrument to hedge the risk of changes in the USD equivalent value of a portion of its
net investment balance in Small Sub 1 attributable to changes in the EUR/USD exchange rate.

The EUR Debt-Hedging Instrument is an outstanding note that was issued by Giant, has a EUR 240 million notional amount, is due July 15, 2027, and pays interest at a rate of 5.75 percent per annum. Between the hedge designation date and the maturity date of the EUR Debt-Hedging Instrument, Giant is using the EUR Debt-Hedging Instrument to hedge the previously unhedged risk of changes in the USD equivalent value of a portion of its net investment balance in Small Sub 2 attributable to changes in the EUR/USD exchange rate.

See Handout 1 and Handout 2 for a summary of Giant’s hedging documentation considerations for the Cross-Currency Hedging Instrument and EUR Debt-Hedging Instrument, respectively.

Giant wants to apply hedge accounting to both hedging relationships.

The assessment of hedge effectiveness, if applicable, will be on a pretax basis.

On August 28, 2017, the FASB issued Accounting Standards Update No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities (ASU 2017-12). For public business entities, the amendments in ASU 2017-12 are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early application is permitted in any interim period after issuance of ASU 2017-12. Giant has made this election.

Required:

1. Define the type of hedging arrangement that Giant is attempting to use with the Cross-Currency Hedging Instrument and EUR Debt-Hedging Instrument to hedge against changes in foreign currency exposure. In other words, are these cash flow hedges, fair value hedges, or net investment hedges?

2. What documentation requirements must Giant meet for its hedges to qualify for hedge accounting? Identify the appropriate Codification reference to support your response.

3. Does the hedging relationship associated with the Cross-Currency Hedging Instrument qualify for hedge accounting? Assume that Giant prepared its hedge documentation at the inception of the hedging relationship.

4. Does the hedging relationship associated with the EUR Debt-Hedging Instrument qualify for hedge accounting? Assume that Giant prepared its hedge documentation at the inception of the hedging relationship.