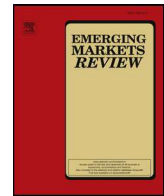


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## Hedge accounting choice as exchange loss avoidance under financial crisis: Evidence from Brazil<sup>☆</sup>

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### ABSTRACT

Cash flow hedge accounting is an accounting choice and may avoid reported losses due to deferrals in other comprehensive income (OCI), promoting better earnings disclosure. Provided that managers have incentives to avoid losses, we investigate whether firms' high financial exposure to currency risk, the high exchange rate depreciation derived from the financial crisis verified in Brazil, and the option to defer taxes on exchange earnings affected hedge accounting choice for 379 Brazilian listed firms from 2010–2017. Our results provide compelling evidence of loss avoidance and tax-aggressiveness through cash flow hedge accounting choice, primarily designed by standards to reduce volatility instead.

### 1. Introduction

The popularity of commodity and financial futures have renewed the academic and financial interest in hedging theories (Kroner and Sultan, 1993), and 2008's financial crisis has raised economically significant and politically charged questions on the role of financial reporting for derivatives and other financial instruments in firm's internal management and external evaluation (Ryan, 2012). Derivatives, retained residual securities and various other contractual and non-contractual positions in structured finance transactions have small value and concentrated risks, due to the financial leverage embedded (Ryan, 2012), creating significant reporting challenges, as under regular accounting rules, gains and losses resulting from derivatives for hedge purposes and from the hedged items are often accounted for differently, and not reported simultaneously.

In this context, 'hedge accounting' is a set of special rules designed to ensure derivatives and hedged items timely recognition in firm's earnings, to prevent volatility not economically justified (Glaum and Klöcker, 2001), which is constantly monitored by analysts (Antônio et al., 2018b) and penalized by investors (Heinle and Smith, 2017). However, hedge accounting influences directly the disclosure of firm's exposure to financial and currency risks, and many companies do not apply the correspondent accounting rules correctly or consistently (Chang et al., 2016), so lessons and merits of changes in said disclosure are still debated and represent a major accounting policy issue (Tessema, 2016).

Hedge accounting rules were provided by IAS (International Accounting Standards) 39<sup>1</sup> of IASB (International Accounting Standards Board), as well as by SFAS (Statement of Financial Accounting Standards) 133 of FASB (Financial Accounting Standards Board), and foresee three categories: (i) fair value hedge, (ii) hedge of a net investment in a foreign operation, and (iii) cash flow

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<sup>1</sup> Substituted by International Financial Reporting Standard (IFRS) 9 (Accounting Standard CPC 48 in Brazil) as of January, 2018.

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