EX 19. Financial Instruments – Exercises

1. Companies use derivative contracts to mitigate their exposure to the market risks associated with financial instruments. Describe the three types of market risk that they seek to manage.

2. What are the three types of hedges that companies use to manage the risks associated with the financial instruments that they hold. Describe each of these and the risks that they are designed to mitigate.

3. How are changes in the fair value of derivative financial instruments designated as hedges accounted for? Describe this for each of the three types of hedge.

4. Which of the following give rise to a financial instrument?

1. a credit sale transaction
2. A firm commitment to purchase or sell goods or services at a future date
3. A forward contract to purchase a commodity at a specific price at a future date
4. An option to purchase or sell goods at a future date for a specific price
5. A planned future contract