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First Notes

Amendments to IFRS pursuant to benchmark interest rate reform

22 October 2019

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

Background

In December 2018, the International Accounting Standards Board (IASB) added a project to consider the effects of the unprecedented reform which involve replacement of existing interest rate benchmarks, such as Inter-Bank Offer Rates (IBORs) with alternative, nearly risk-free interest rates (alternate interest rates), on financial reporting. There were two groups of issues that were identified to have significant financial reporting implications:

- **Pre-replacement issues:** Issues affecting financial reporting in the period before replacement of IBOR with an alternate interest rate, and
- **Replacement issues:** Financial reporting issues arising once the IBOR had been replaced.

The IASB considered these issues as part of two different projects. In its meetings in the months of February 2019 and March 2019, it considered the pre-replacement issues and the possible impact on hedge accounting requirements. It evaluated how these issues would create uncertainties[1] regarding the amount and timing of future cash flows of the hedged items and hedging instruments. These uncertainties could result in discontinuation of hedge accounting for hedging relationships that would otherwise qualify for hedge accounting, or prevent entities from designating new hedging relationships.

Accordingly, in May 2019, the IASB proposed amendments to certain accounting standards which deal with hedge accounting and thereby, issued an exposure draft *'Interest Rate Benchmark: Proposed amendments to International Financial Reporting Standard (IFRS) 9 and International Accounting Standard (IAS) 39'* (exposure draft).

[1]Uncertainties would be created with regard to decisions of what will be the alternate interest rate, and when will the existing IBOR be replaced.

New development

On 26 September 2019, the IASB issued amendments to IFRS 9, *Financial Instruments*, IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 7, *Financial Instruments: Disclosures.*

The amendments modify some specific hedge accounting requirements to provide relief from potential effects of the uncertainty caused by the IBOR reform. Additionally, the amendments require companies to provide additional information to investors about their hedging relationships which are directly affected by these uncertainties.

The table below provides a summary of the amendments:

Issue covered	All companies with hedges affected by IBOR reform are required to…
The 'highly probable' requirement	• Assume that the interest rate benchmark on which hedged cash flows are based is not altered as a result of IBOR reform when assessing whether the future cash flows are highly probable. • For discontinued hedging relationships also, the above assumption is applied while determining whether the hedged future cash flows are expected to occur.
Prospective assessments[2]	• Assess whether the economic relationship between the hedged item and the hedging instrument exists based on the assumptions that the interest rate benchmark on which the hedged item and the hedging instrument are based is not altered as a result of IBOR reform.
Retrospective assessments (IAS 39)	• Not discontinue a hedging relationship during the period of uncertainty arising from IBOR reform solely because the actual results of the hedge are outside the range of 80-125 per cent.
Eligibility of certain risk components[3] (for a hedge of a non-contractually specified benchmark component of interest rate risk)	• Apply the separately identifiable requirement[4] only at the inception of the hedging relationship. A similar exception is also provided for redesignation of hedged items in hedges where dedesignation and redesignation take place frequently, e.g. macro hedges.
End of application	• Prospectively cease applying the exceptions at the earlier of: a) When the uncertainty regarding the timing and the amount of interest rate benchmark based cash flows is no longer present and b) The discontinuation of the hedging relationship (or reclassification of all amounts from the cash flow hedge reserve). • The assessment of uncertainty should be performed on an item-by-item basis for hedges involving groups of items.
Disclosures (for hedging relationships directly affected by IBOR reform)	• Disclose the following: a) The significant interest rate benchmarks to which hedging relationships are exposed b) The extent of risk exposure that is affected by IBOR reform c) How the transition to alternative benchmark interest rates is being managed d) A description of significant assumptions or judgements made in applying the amendments and e) The nominal amount of the hedging instruments in those hedging relationships.

(Source: KPMG International's web article on *'IBOR reform – First-phase amendments issued'* dated 27 September 2019)

Effective date

The amendments will be effective for annual reporting periods beginning on or after 1 January 2020. Early application is permitted.

[2]The condition of existence of an economic relationship (as per IFRS 9) or that the hedge is highly effective (as per IAS 39) is collectively referred to as 'prospective assessment'.

[3]Risk component includes the changes in the cash flows or fair value of an item attributable to a specific risk or risks.

[4]To be eligible for designation as a hedged item, a risk component needs to be separately identifiable, and the changes in the cash flows or fair value of the item attributable to changes in that risk component should be reliably measurable.

Our comments

The amendments are expected to provide relief to financial instruments qualifying for hedge accounting in the lead up to IBOR reform. It is to be noted that the exceptions envisaged through amendments are intended to address only the uncertainties arising from the IBOR reform. Accordingly, if a hedging relationship fails any of the other criteria, then the entity must discontinue hedge accounting as required by IFRS 9 or IAS 39.

Given the large volume of transactions and contracts that are based on LIBOR in India, similar amendments are expected in Indian Accounting Standard (Ind AS) 109, *Financial Instruments*. Entities should start assessing the impact of the changes and accordingly, should develop systems and processes to cater to the possible challenges.

The IASB has started deliberations on the second phase of the project i.e. addressing the issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate (replacement issues). Entities should keep a watch on the developments in this area.

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KPMG in India's IFRS institute

Visit KPMG in India's IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 38 – September 2019

The topics covered in this issue are:

- Ind AS 116, *Leases* - Impact analysis of Nifty50 companies
- Ind AS 116, *Leases*: Emerging implementation challenges
- Presentation of dividend distribution tax
- Regulatory updates.

First Notes: ITFG clarifications' bulletin 21

14 October 2019

The Institute of Chartered Accountants of India (ICAI) constituted the Ind AS Technical Facilitation Group (ITFG) under the aegis of its Ind AS Implementation Committee. The ITFG has issued its clarifications' bulletin 21 on 18 September 2019. The bulletin provides clarifications on five issues in relation to implementation of Ind AS 116, *Leases.*

Ind AS 116 is applicable in respect of annual reporting periods commencing on or after 1 April 2019. It requires a lessee to recognise a lease liability and a right-of-use asset in respect of every lease subject to certain exemptions.

This issue of First Notes provides an overview of the clarifications issued by the ITFG in its bulletin.

Voices on Reporting

KPMG in India is pleased to present Voices on Reporting (VOR) – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 10 October 2019, KPMG in India organised a VOR webinar to discuss key financial reporting and regulatory matters that are expected to be relevant for stakeholders for the quarter ended 30 September 2019.

Click here to access the audio recording (mp3) and presentation (pdf).

Feedback/queries can be sent to aaupdate@kpmg.com

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