CPA Australia Ltd
ABN 64 008 392 452

Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia

GPO Box 2820 Melbourne
VIC 3001 Australia

T 1300 737 373
Outside Aust +613 9606 9677
cpaaustralia.com.au

17 June 2019

Mr Hans Hoogervorst
IFRS Foundation
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

By online submission:- www.ifrs.org

Dear Hans

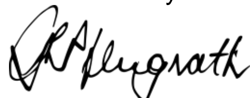
Exposure Draft ED/2019/1 – Interest Rate Benchmark Reform: Proposed amendments to IFRS 9 and IAS 39

CPA Australia represents the diverse interests of 164,000 members working in 150 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia supports the IASB's proposals to provide specific exceptions to hedge accounting requirements in IFRS 9 and IAS 39 to address uncertainties that may arise from interest rate benchmark reform. We also support the IASB's decision to address only the issues that may affect financial reporting prior to the replacement of an existing interest rate benchmark with an alternative interest rate.

In the attachment to this letter, we have provided responses to specific questions raised in the Exposure Draft. If you require further information on the views expressed in this submission, please contact Ram Subramanian, Policy Adviser – Reporting, on +61 3 9606 9755 or at ram.subramanian@cpaaustralia.com.au.

Your sincerely



Dr. Gary Pflugrath
Head of Policy and Advocacy

CPA AUSTRALIA

Attachment

Specific questions/ comments

Question 1 [paragraphs 6.8.4–6.8.6 of IFRS 9 and paragraphs 102D–102F of IAS 39]

Highly probable requirement and prospective assessments

For hedges of interest rate risk that are affected by interest rate benchmark reform, the Board proposes amendments to IFRS 9 and IAS 39 as described below.

(a) For the reasons set out in paragraphs BC8–BC15, the Board proposes exceptions for determining whether a forecast transaction is highly probable or whether it is no longer expected to occur. Specifically, the Exposure Draft proposes that an entity would apply those requirements assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform.

(b) For the reasons set out in paragraphs BC16–BC23, the Board proposes exceptions to the hedge accounting requirements in IFRS 9 and IAS 39 so that an entity would assume that the interest rate benchmark on which the hedged cash flows are based, and/or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform when the entity determines whether:

(i) there is an economic relationship between the hedged item and the hedging instrument applying IFRS 9; or

(ii) the hedge is expected to be highly effective in achieving offsetting applying IAS 39.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

Eligibility criteria for hedge accounting under both IFRS 9 and IAS 39 require forward-looking analysis. While IFRS 9 criteria require an economic relationship between the hedged item and the hedging instrument, under IAS 39 criteria the hedge is expected to be highly effective. Where contractual cash flows of hedged items and hedging instruments are based on existing interest rate benchmarks such as Interbank Offer Rate (IBOR), whilst interest rate benchmark reform is continuing, uncertainties will exist regarding the timing and amount of future cash flows of the hedged items and hedging instruments. This is likely to present challenges when determining the economic relationship (IFRS 9) or the effectiveness of the hedge (IAS 39), in some cases requiring the discontinuation of hedge accounting for hedging relationships that would otherwise qualify for hedge accounting.

To address the above, CPA Australia considers proposed amendments (a) and (b) as both appropriate and reasonable. Both amendments allow for hedge accounting to continue as usual when faced with the uncertainty of interest rate benchmark reform. In circumstances where hedging relationships of interest rate risk are affected by interest rate benchmark reform, the question arises as to whether those cash flows can be regarded as highly probable beyond the date when an interest rate benchmark such as an IBOR is replaced with an alternative interest rate. Proposed amendments (a) and (b) allow the reporting entity to assume that IBOR-based cash flows remain unchanged as a result of any IBOR reform, allowing for the highly probable requirement to still be met.

Question 2 [paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39]

Designating a component of an item as the hedged item

For the reasons set out in paragraphs BC24–BC27, the Board proposes amendments to the hedge accounting requirements in IFRS 9 and IAS 39 for hedges of the benchmark component of interest rate risk that is not contractually specified and that is affected by interest rate benchmark reform. Specifically, for such hedges, the Exposure Draft proposes that an entity applies the requirement—that the designated risk component or designated portion is separately identifiable—only at the inception of the hedging relationship.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose instead and why.

In our view it is a counterintuitive outcome for an entity to have to de-designate a separately identified component that is designated as a hedged item in a hedging relationship, due to uncertainties arising from interest rate benchmark reform. Accordingly, we agree with the proposed amendments that the separately identifiable component test should only occur at the inception of the contract.

Question 3 [paragraphs 6.8.8–6.8.10 of IFRS 9 and paragraphs 102H–102J of IAS 39]

Mandatory application and end of application

(a) For the reasons set out in paragraphs BC28–BC31, the Board proposes that the exceptions are mandatory. As a result, entities would be required to apply the proposed exceptions to all hedging relationships that are affected by interest rate benchmark reform.

(b) For the reasons set out in paragraphs BC32–BC42, the Board proposes that the exceptions would apply for a limited period. Specifically, an entity would prospectively cease applying the proposed amendments at the earlier of:

(i) when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows; and

(ii) when the hedging relationship is discontinued, or if paragraph 6.8.9 of IFRS 9 or paragraph 102I of IAS 39 applies, when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.

(c) For the reasons set out in paragraph BC43, the Board is not proposing an end of application in relation to the separate identification requirement.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

We generally agree with all proposed amendments to ‘Mandatory application and end of application’. However, we suggest clarifying the guidance provided in paragraph BC41. The example in BC41 illustrates that a hedged item benchmark (e.g. LIBOR) is amended to an alternative interest rate. Consequently, uncertainty regarding the timing and the amount of cash flows is eliminated and as a result the entity would cease applying the exception for the hedged item. The exception can continue to be applied to the hedging instrument until uncertainty is resolved. In our view, it may not be practical to perform a prospective assessment for the hedged item based on an alternative interest rate at the time the change occurs from IBOR to an alternative interest rate as there may not be sufficient

liquidity and historical observations to postulate meaningful scenarios for prospective scenario analysis. Accordingly, an entity may need to continue applying the exceptions for the hedged item until such time that the uncertainty regarding the timing and the amount of cash flows is eliminated in relation to the hedged item. We suggest clarifying this point in paragraph BC41.

We suggest providing clarification in cases where both hedged item and hedging instrument reference interest rates are replaced. It is unclear from the proposals if an entity is allowed to re-designate the hedged cash flow and hedging instrument cash flow from IBOR to an alternative interest rate without having to discontinue the existing hedging relationship.

In our view, the mandatory exception for interest rate reform results in consistent application by reporting entities and the limited period with regards to discontinuation is reasonable and practical.

Question 4 [paragraph 6.8.11 of IFRS 9 and paragraph 102K of IAS 39]

Disclosures

For the reasons set out in paragraph BC44, the Board proposes that entities provide specific disclosures about the extent to which their hedging relationships are affected by the proposed amendments.

Do you agree with these proposed disclosures? Why or why not? If not, what disclosures would you propose instead and why?

We agree with the proposed disclosures.

Question 5 [paragraphs 7.1.9 and 7.2.26(d) of IFRS 9 and paragraph 108G of IAS 39]

Effective date and transition

For the reasons set out in paragraphs BC45–BC47, the Board proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2020. Earlier application would be permitted. The Board proposes that the amendments would be applied retrospectively. No specific transition provisions are proposed.

Do you agree with these proposals? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

In our view, the proposed effective date for annual periods beginning on or after 1 January 2020 is optimistic as committing to an effective date which is effectively 6 months away may not provide entities sufficient time to assess the operational requirements for capturing relevant information. We suggest delaying the effective date by one year, with earlier application permitted.