Snapshot

by Capital Markets & Accounting Advisory Services

October 2020

MASB published Amendments to MFRS on Interest Rate Benchmark Reform - Phase 2

Applicable MFRS	Amendments to MFRS 9 *Financial Instruments*, MFRS 139 *Financial Instruments: Recognition and Measurement(*)*, MFRS 7 *Financial Instruments: Disclosures*, MFRS 4 *Insurance Contracts* and MFRS 16 *Leases* - Interest Rate Benchmark Reform (Phase 2)
Effective date	Annual periods beginning on or after 1 January 2021

What is the issue?

The replacement of benchmark interest rates such as the London Interbank Offered Rate ('LIBOR') and other interbank offered rates ('IBOR') has become a priority for global regulators. Given the pervasive nature of LIBOR-based contracts, there are significant potential impacts of these changes on financial reporting under MFRS.

Both financial institutions and corporates in Malaysia with foreign currency denominated or LIBOR-based debt instruments and derivative contracts will be impacted by this market-driven reform.

In October 2019, the Malaysian Accounting Standards Board ('MASB') amended MFRS 9, MFRS 139(*) and MFRS 7 to address the pre-replacement issue (Phase 1). These amendments are effective for financial period beginning on or after 1 January 2020 and provide temporary exceptions to specific hedge accounting requirements as outlined in our publication *Snapshot: How does IASB's amendments on IBOR reform impact hedge accounting.*

The Phase 2 amendments issued by the MASB on 30 September 2020 address the financial reporting issues that arise from the implementation of the reforms, including the replacement of one benchmark with an alternative one. The amendments should be applied for annual periods beginning on or after 1 January 2021. Entities planning on making LIBOR-related amendments to contracts in 2020 may choose to early adopt the Phase 2 amendments to take advantage of the reliefs provided.

(*) When entity first applied MFRS 9, it may choose as its accounting policy to continue to apply the hedge accounting requirements of MFRS 139 instead of the requirements in Chapter 6 of MFRS 9. Accordingly, the hedging rules in MFRS 139 remain relevant.

What are the impacts and for whom?

The transition to alternative benchmark rates is likely to have implications for the accounting of financial instruments beyond hedge accounting. It is likely to affect financial instruments that are not designated in hedging relationships as well as the accounting for areas other than financial instruments (e.g. leases).

The amendments provide reliefs to specific requirements in MFRS 9, MFRS 139, MFRS 7, MFRS 4 and MFRS 16. These amendments aim to address issues affecting financial statements when changes are made to the contractual cash flows and hedging relationships as a result of the reform. With these reliefs, modification gains or losses and discontinuation of hedge accounting due to IBOR uncertainty should generally be avoided. However, all hedge ineffectiveness must still be recognised in the profit or loss.

The amendments will affect entities with financial assets and financial liabilities, including lease liabilities, that are referenced to an interest rate benchmark and have been or will be required to replace the interest rate benchmark with an alternative benchmark rate as a result of the reform (e.g. LIBOR-based contracts).

The amendments will also affect entities that apply the hedge accounting requirements in MFRS 9 or MFRS 139 to hedging relationships that are directly affected by interest rate reform and entities that provide disclosures applying the requirements in MFRS 7.

What are the key provisions?

Accounting for changes in the basis for determining contractual cash flows

For instruments measured at amortised cost (e.g. borrowings with LIBOR-based interest), the practical expedient in the Phase 2 amendments require entities to account for the change in the basis for determining the contractual cash flows as a result of IBOR reform by updating the effective interest rate. This is done using the guidance in MFRS 9.B5.4.5 which requires changing the effective interest rate of floating-rate instruments to reflect the movements in market interest rate. As a result, no immediate gain or loss is recognised and the carrying amount of the instrument need not be adjusted on the date of modification.

This practical expedient applies only to a change:

- to the extent the change is necessary as a direct consequence of IBOR reform; and
- the new basis is economically equivalent to the previous basis.

Insurers applying the temporary exemption from MFRS 9 are also required to apply the same practical expedient.

MFRS 16 was also amended to require lessees to use a similar practical expedient when accounting for lease modifications that change the basis for determining future lease payments as a result of IBOR reform (e.g. where lease payments are indexed to an IBOR rate).

What are the key provisions? (continued)

Additional temporary exceptions from applying specific hedge accounting requirements

Changes to designations & hedge documentation	When the Phase 1 reliefs cease to apply, entities are required to amend the hedge documentation to reflect changes required by IBOR reform by the end of the reporting period during which the changes are made. Such amendments do not constitute a discontinuation of hedge accounting.
Accumulated balance in the cash flow hedge reserve	When amending the description of hedged item in the hedge documentation, the amounts accumulated in the cash flow hedge reserve are deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined. Accordingly, the cash flow hedge reserve will only be reclassified to profit or loss when the amended hedged item affects profit or loss.
Retrospective effectiveness test (MFRS 139 only)	In assessing the cumulative retrospective effectiveness, an entity may, on an individual hedge basis, reset to zero the cumulative fair value changes of the hedged item and hedging instrument when ceasing to apply the Phase 1 reliefs.
Group of items	When amending the hedged relationships for a group of items, hedged items are allocated to subgroups based on the benchmark interest rate being hedged, and the benchmark rate for each subgroup is designated as the hedged risk.
Risk components - separately identifiable requirement	An alternative benchmark rate designated as a non-contractually specified risk component, that is not separately identifiable at the date when it is designated, is deemed to have met the requirements at that date - this is if the entity reasonably expects that it will meet the requirements within 24 months from the date of first designation. The risk component will, however, be required to be reliably measurable. The 24-month period will apply to each alternative benchmark rate separately.

End date for Phase 1 relief for non-contractually specified risk components in hedging relationships

The Phase 2 amendments require an entity to prospectively cease to apply the Phase 1 reliefs to a non-contractually specified risk component at the earlier when changes are made to the non-contractually specified component, or when the hedging relationship is discontinued.

What are the key provisions? (continued)

Additional MFRS 7 disclosures

- How the entity is managing the transition to alternative benchmark interest rate, its progress & the risks arising from the transition;
- Quantitative information about derivatives & non-derivatives that have yet to transition, disaggregated by significant interest rate benchmark; and
- A description of any changes to the risk management strategy as a result of IBOR reform.

What are the transition provisions?

The Phase 2 amendments are to be applied retrospectively but entities are not required to restate comparatives. An entity is required to reinstate a discontinued hedging relationship, if, and only if:

- The hedging relationship was discontinued solely due to changes required by IBOR reform and entity would not have discontinued such relationship if the Phase 2 amendments had been applied at that time; and
- At the initial application of Phase 2 amendments, that discontinued hedging relationship meets the hedge accounting qualifying criteria (after taking into consideration Phase 2 amendments).

In the reporting period when an entity first applies the Phase 2 amendments, it is not required to present the quantitative information required by paragraph 28(f) of MFRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Do you need further information on this topic?	Contact: Michelle Loh | Assurance Director from PwC Malaysia CMAAS Email: michelle.s.loh@pwc.com | Tel: +60 (3) 2173 0858
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