

Basis for Conclusions on AASB 2020-9

This Basis for Conclusions accompanies, but is not part of, AASB 1060. The Basis for Conclusions was originally published with AASB 2020-9 Amendments to Australian Accounting Standards – Tier 2 Disclosures: Interest Rate Benchmark Reform (Phase 2) and Other Amendments.

Introduction

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in this Standard. It sets out the reasons why the Board developed the Standard, the approach taken to developing the Standard and the bases for key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Tier 2 Simplified Disclosures – amendments to AASB 1060

BC2 In September 2020, the Board issued AASB 2020-8 *Amendments to Australian Accounting Standards – Interest Rate Benchmark Reform – Phase 2* to help entities to provide financial statement users with useful information about the effects of the interest rate benchmark reform on those entities’ financial statements. New paragraphs 24I and 24J were added to AASB 7 *Financial Instruments: Disclosures* to require an entity applying the amendments to disclose information about:

- (a) the nature and extent of risks to which the entity is exposed arising from financial instruments subject to interest rate benchmark reform, and how the entity manages these risks; and
- (b) the entity’s progress in completing the transition to alternative benchmark rates and how the entity is managing the transition.

BC3 The amendments also give relief from providing the information otherwise required by AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraph 28(f) in the reporting period in which the entity first applies the amendments made by AASB 2020-8 through new paragraph 44HH of AASB 7.

Reasons for not adding any disclosures to AASB 1060

BC4 The Board considered whether the new disclosures should also apply to entities that intend to adopt AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*. The Board referred to the principles used when developing the disclosures in AASB 1060, in particular:

- (a) the disclosures in the *IFRS for SMEs* Standard should be retained where the recognition and measurement (R&M) requirements and options are the same or similar in the *IFRS for SMEs* Standard and full IFRS Standards (and therefore Australian Accounting Standards);
- (b) where R&M options or treatments in the *IFRS for SMEs* Standard are not available in full IFRS Standards (and therefore Australian Accounting Standards), the related *IFRS for SMEs* disclosures are removed; and
- (c) where the R&M principles in full IFRS Standards (and therefore Australian Accounting Standards) are significantly different from those in the *IFRS for SMEs* Standard or certain topics are not addressed in the *IFRS for SMEs* Standard, disclosures may be added. To determine whether to add any disclosures, the Board refers to the principles applied by the International Accounting Standards Board (IASB) in developing the disclosures in the *IFRS for SMEs* Standard, which are set out in paragraph BC5.

In addition to applying these principles, the Board also considers whether to add disclosures to address matters of public policy or to reflect Australian-specific issues.

BC5 The principles applied by the IASB in developing the disclosures in the *IFRS for SMEs* Standard consider that users of the financial statements of for-profit entities that are not publicly accountable are particularly interested in information about:

- (a) short-term cash flows and obligations, commitments or contingencies, whether or not recognised as liabilities;
- (b) liquidity and solvency;

- (c) measurement uncertainties;
- (d) accounting policy choices; and
- (e) disaggregations of amounts presented in the financial statements.

The principles further note that some disclosures in full IFRS Standards are more relevant to investment decisions in public capital markets than to transactions and other events and conditions encountered by entities without public accountability.

BC6 Based on these principles of the Board and the IASB, the Board agreed to use the following approach when considering whether to add to or amend disclosure requirements in AASB 1060 in relation to amendments made by the IASB to full IFRS Standards:

- (a) if the amendments introduce significant R&M differences between full IFRS Standards and the *IFRS for SMEs* Standard, apply the principles applied by the IASB in developing the *IFRS for SMEs* Standard, as summarised in paragraph BC5; and
- (b) if the amendments do not introduce significant R&M differences, no further action is required unless the disclosures address a matter of public policy or are of particular relevance in the Australian environment.

BC7 The Board therefore considered whether the amendments made to AASB 9 *Financial Instruments*, AASB 4 *Insurance Contracts*, AASB 16 *Leases* and AASB 139 *Financial Instruments: Recognition and Measurement* by AASB 2020-8 will result in significant R&M differences to the *IFRS for SMEs* Standard.

Differences arising from the practical expedient for particular changes to contractual cash flows

BC8 The Board noted that the *IFRS for SMEs* Standard does not deal with the impact of interest rate benchmark reform on financial reporting or provide a practical expedient for similar situations. The amendments to AASB 9 mean that the changes made to the basis for determining the contractual cash flows as a result of interest rate benchmark reform are accounted for in the same way as the re-estimation of future interest payments on variable-rate financial assets and financial liabilities. In particular, the rules on accounting for modifications of contractual cash flows in AASB 9 do not apply.

BC9 Paragraph 11.37 of the *IFRS for SMEs* Standard addresses substantial modifications only in the context of the derecognition of financial liabilities. However, given the IASB concluded that it would be unlikely that the transition to an alternative benchmark rate alone would result in the derecognition of a financial instrument, these requirements are not relevant for the assessment outlined in paragraph BC6. In terms of accounting for other modifications under the *IFRS for SMEs* Standard, an entity's management would need to apply paragraph 10.4 and use its judgement in developing and applying accounting policies that result in relevant and reliable information. Paragraph 10.6 further states that in making the judgement, management may also consider the requirements and guidance in full IFRS Standards dealing with similar and related issues. The Board considered this could include the practical expedient for the interest rate benchmark reform in AASB 9.

BC10 The Board also noted that AASB 4 is not addressed in AASB 1060 as the majority of the entities applying AASB 4 would have public accountability. In respect of the amendments made to AASB 16 in relation to lease modifications required by interest rate benchmark reform, the Board considered that the *IFRS for SMEs* Standard does not discuss how to account for lease modifications. For the same reasons as set out in paragraph BC9, the Board concluded that the expedient introduced by the amendments to AASB 16 should not result in a significant R&M difference. In any case, the Board noted that there are no additional disclosures associated with the application of the practical expedient for leases.

BC11 The Board therefore concluded that the modifications arising as a result of interest rate benchmark reform should not result in significant R&M differences between the amended IFRS Standards and the *IFRS for SMEs* Standard that would warrant additional disclosures for Tier 2 entities applying the new Simplified Disclosures framework in AASB 1060.

Differences arising from the relief from specific hedge accounting requirements

BC12 The Board noted that the *IFRS for SMEs* Standard permits hedge accounting only for four specific types of instruments listed in the Standard, including interest rate swaps. While the *IFRS for SMEs* Standard is less restrictive regarding the types of risks that can qualify for hedge accounting and hedge ineffectiveness, it requires an entity to discontinue hedge accounting if:

- (a) the hedging instrument expires or is sold or terminated;

- (b) the hedge no longer meets the conditions for hedge accounting specified in paragraph 12.16; or
- (c) the entity revokes the designation.

- BC13 In the IFRS *Interest Rate Benchmark Reform—Phase 2* amendments, the IASB observed that amending the formal designation of a hedging relationship to reflect changes required by the reform would result in the hedging relationship being discontinued. The Board noted this is because both AASB 9 (paragraph 6.4.1) and AASB 139 (paragraph 88) require the formal designation of a hedging relationship to be documented at inception as part of the qualifying criteria for hedge accounting to be applied. The hedge documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess hedge effectiveness. Although in limited circumstances AASB 9 permits the hedge documentation to be updated without resulting in the discontinuation of hedge accounting, AASB 139 requires hedge accounting to be discontinued when any amendments are made to the hedge designation as documented at the inception of the hedging relationship.
- BC14 The Board further noted that the term “at inception” is a notable omission in the *IFRS for SMEs* Standard. Given the absence of an explicit reference to the formal designation and documentation at the inception of a hedge in the *IFRS for SMEs* Standard, the Board took the view that changes to hedge designations and hedge documentation that are required as a result of the reform would not necessarily result in the discontinuation of hedge accounting under the *IFRS for SMEs* Standard. The relief from specific hedge accounting requirements introduced by the amendments to AASB 9 and AASB 139 is therefore unlikely to result in significant R&M differences.

Other considerations

- BC15 The *IFRS for SMEs* Standard also permits accounting under IAS 39 *Financial Instruments: Recognition and Measurement* but does not require any additional disclosures beyond what is in the *IFRS for SMEs* Standard. The Board noted in the IASB’s Request for Information on the *Comprehensive Review of the IFRS for SMEs Standard* that the IASB is considering replacing the option of applying IAS 39 with an option to apply IFRS 9 *Financial Instruments*, while still retaining the disclosures from the *IFRS for SMEs* Standard. The Board considered this further supports the argument that no additional disclosures from AASB 2020-8 should be required, as an entity applying the *IFRS for SMEs* Standard and IAS 39 or IFRS 9 would apply the *Interest Rate Benchmark Reform—Phase 2* amendments and not be required to provide any additional disclosures under the view in the Request for Information.
- BC16 The Board further considered whether the new disclosure requirements added to AASB 7 address a matter of public policy or are of particular relevance to the Australian environment but did not consider this to be the case. Finally, the Board noted that should interest rate benchmark reform have a material effect on an entity such that knowledge about the financial effects is necessary for an understanding of the financial statements, disclosure would still be required under the general provisions of paragraph 91 in AASB 1060.
- BC17 On that basis, the Board took the view that the additional disclosures introduced by AASB 7 paragraphs 24I and 24J should not be added to AASB 1060.

Reasons for providing disclosure relief in AASB 1060

- BC18 The Board noted that the IASB decided not to require entities to provide the disclosures otherwise required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraph 28(f) because the cost of providing quantitative information about the effect of the changes in accounting policy that are associated with the amendments to IFRS Standards could outweigh the benefits. The Board took the view that this would similarly apply to entities reporting under AASB 1060 and therefore decided to introduce a similar exception into AASB 1060 by adding a new paragraph 107A.

Tier 2 Reduced Disclosure Requirements

- BC19 The Board also considered whether the new disclosure requirements in AASB 7 should be reduced for entities reporting under the Tier 2 Reduced Disclosure Requirements (RDR) framework (Tier 2 RDR entities). In doing so, the Board referred to the ‘user need’ and ‘cost-benefit’ principles set out in the ‘Tier 2 Disclosure Principles’ document of the RDR decision-making framework. These principles were also based on the principles applied by the IASB in developing the disclosures in the *IFRS for SMEs* Standard and are the same as those summarised in paragraph BC5.
- BC20 The Board noted the disclosures would affect only those Tier 2 RDR entities with financial instruments such as variable-rate loans that are referenced to the interest rate benchmarks, including those that have designated hedging instruments in a hedge relationship, lessees with IBOR-linked leases and insurance companies

applying the temporary exemption from AASB 9 with IBOR-linked insurance contracts. The Board does not expect many Tier 2 entities to be affected.

- BC21 The Board further considered that the disclosure requirements in paragraphs 24I and 24J(a) and (c) of AASB 7 provide further detail about the entity's risk management and hedging strategy. Tier 2 entities already disclose this information under paragraphs 22A and 22B of AASB 7. The additional disclosures are therefore consistent with the current level of RDR disclosures.
- BC22 While Tier 2 entities applying RDR are not otherwise required to disclose quantitative information such as that required by paragraph 24J(b) of AASB 7, the Board considered that the information is expected:
- (a) to be available to an entity as a result of the implementation of the interest rate benchmark reform and therefore the preparation of such disclosure is not expected to be burdensome;
 - (b) not to be onerous as the requirements allow entities to choose the basis for disclosing the quantitative information, thereby being able to leverage information already available, which would reduce costs while still providing useful information; and
 - (c) to be required only for a limited period of time, as the application of the amendments in Phase 2 is associated with changes to financial instruments or hedging relationships subject to a particular reformed benchmark interest rate.
- BC23 The disclosure requirements in paragraphs 24I and 24J of AASB 7 also require further information about the disaggregation of amounts presented in financial statements and the transactions and other events encountered by these entities. The Board referred to the Tier 2 Disclosure Principles summarised in paragraph BC5 and considered that where the amounts in question are material, user needs and the benefits of the information would outweigh the limited cost of preparing the disclosures.
- BC24 The Board further considered that entities applying the amendments should not be required to disclose the information otherwise required by paragraph 28(f) of AASB 108. As this relief is provided to entities reporting under the Tier 1 framework, the Board took the view that it should also be available for Tier 2 entities applying RDR so that they are not disadvantaged compared with entities reporting under Tier 1.
- BC25 The Board noted that the proposals would result in different disclosure requirements for Tier 2 entities applying the RDR framework compared with Tier 2 entities applying the Simplified Disclosure framework under AASB 1060. However, the Board considered this outcome would be consistent with the different approach used in developing AASB 1060 and the different starting points of the two Tier 2 disclosure frameworks. It demonstrates that the principles applied in developing the simplified disclosures can successfully reduce the disclosures for Tier 2 entities. Furthermore, the Board does not expect many Tier 2 entities to be affected by interest rate benchmark reform and noted that Tier 2 entities would be able to apply AASB 1060 early if they preferred not to make these particular disclosures. Therefore, the Board considered the proposed disclosure requirements would not impose a significant burden on Tier 2 RDR entities.
- BC26 On that basis, the Board took the view that the additional disclosure requirements introduced by AASB 7 paragraphs 24I and 24J should not be reduced for Tier 2 RDR entities but that the relief from disclosing information about the financial effects of changes in accounting policy in paragraph 44HH should be available to such entities. This approach means that no further changes need to be made to AASB 7 in relation to Tier 2 RDR.

Issue of ED 304 Interest Rate Benchmark Reform – Phase 2: Tier 2 Disclosures

- BC27 The Board's proposals were exposed for public comment in October 2020 through Exposure Draft ED 304 *Interest Rate Benchmark Reform – Phase 2: Tier 2 Disclosures*. Noting that there may be entities intending to early adopt AASB 1060, the Board agreed on a short exposure period of 30 days from the day of issue of the ED to ensure the relief would be available when needed. The Board did not receive any written submissions on the ED, but did receive verbal feedback from one stakeholder that was generally supportive of the proposed amendments, other than the proposal for differing disclosure outcomes for the two types of Tier 2 entities. The Board reaffirmed the considerations set out in the Basis for Conclusions on this matter and decided to finalise and approve the amendments as proposed.