

COMMENTS / SUGGESTIONS OF BHOPAL BRANCH OF CIRC OF ICAI

Exposure Draft: Risk Mitigation Accounting - Proposed Amendments to IFRS 9 and IFRS 7

The Bhopal Branch of CIRC of ICAI appreciates the efforts of the International Accounting Standards Board (IASB) in developing the proposed Risk Mitigation Accounting model. The proposed model represents an important attempt to better reflect in financial statements the manner in which entities dynamically manage repricing risk on a net basis.

We broadly support the objective of the proposals. However, considering the complexity of the proposed framework and its potential implementation implications, particularly for entities with varying levels of risk-management sophistication, we submit the following suggestions for consideration.

1. Explicit Proportionality Guidance and Practical Expedients

Relevant to Question 1 - Objective and Scope of Risk Mitigation Accounting

We note that an important consideration in developing the proposed model is that its requirements should be capable of being applied proportionately, having regard to the sophistication of an entity's business and risk-management activities.

We support this objective. However, we believe that the principle of proportionality should be made more explicit and operational in the final Standard.

Although application of Risk Mitigation Accounting is proposed to be voluntary, once an entity elects to apply the model, it may be required to undertake several complex processes, including determination of net repricing risk exposure across repricing time bands, estimation of expected repricing dates, construction and measurement of benchmark derivatives, measurement of the Risk Mitigation Adjustment and compliance with related documentation and disclosure requirements.

Entities applying IFRS Accounting Standards differ considerably in their size, complexity, systems and sophistication of risk-management activities. Accordingly, a uniform level of modelling and systems capability should not inadvertently become necessary for all entities.

We suggest that the IASB should:

- incorporate an explicit principle of proportionality in the final requirements;
- provide simplified methodologies or practical expedients for entities having relatively less complex portfolios and risk-management activities;
- provide illustrative examples demonstrating application of the requirements by entities having different levels of risk-management sophistication;
- clarify the minimum level of modelling, documentation and frequency of reassessment expected for relatively simple portfolios; and
- clarify that proportional application does not require an entity with relatively simple risk-management systems to develop models equivalent to those maintained by large and sophisticated financial institutions, provided that the methodology adopted faithfully represents its risk-management activities.

Such guidance would facilitate consistent implementation, reduce unnecessary compliance costs and make the model accessible to a broader range of entities without compromising the objective of providing useful financial information.

2. Conceptual Basis and Presentation of the Risk Mitigation Adjustment

Relevant to Question 6 - Recognition and Measurement of Risk Mitigation Adjustment and Question 10 - Disclosure Requirements

We believe that further consideration and clarification are required regarding the proposed recognition and presentation of the **Risk Mitigation Adjustment (RMA)**.

Under the proposals, the RMA would be recognised in the statement of financial position and presented as part of assets when it has a debit balance and as part of liabilities when it has a credit balance.

At the same time, the Basis for Conclusions acknowledges that the Risk Mitigation Adjustment does not itself meet the definition of an asset or liability under the Conceptual Framework. In our view, this creates an important conceptual and presentation issue.

Presentation of an amount within assets or liabilities naturally conveys information to users regarding the economic resources or obligations of an entity. Consequently, presenting an amount that does not independently meet those definitions could result in users misunderstanding the economic nature of the RMA, particularly where the balance becomes material.

We therefore recommend that the IASB reconsider the presentation requirements or, if the proposed approach is retained, provide a more explicit conceptual basis and appropriate safeguards.

In particular, we suggest that the final Standard should:

- clearly explain the conceptual basis for recognising the RMA notwithstanding that it does not independently meet the definition of an asset or liability;
- require the RMA to be clearly distinguished from financial assets and financial liabilities;
- ensure that the terminology and presentation do not imply that a debit RMA represents an independently recoverable economic resource or that a credit RMA represents an independently payable obligation; and
- require a transparent reconciliation of the RMA showing, at a minimum, the opening balance, movements arising from risk-mitigation activities, amounts recognised or reclassified to profit or loss and the closing balance.

We recognise that the RMA performs an important accounting function in reflecting the timing effects arising from an entity's risk-mitigation activities. Nevertheless, achieving that objective should be accompanied by sufficient presentation and disclosure requirements to preserve the clarity and understandability of the statement of financial position.

3. Adequate Transition Period Before Withdrawal of IAS 39 Macro Hedge Accounting Requirements

Relevant to Question 8 - Withdrawal of IAS 39 Requirements and Effective Date

The proposed Risk Mitigation Accounting model represents a significant change from the existing accounting framework for entities presently applying the macro hedge accounting requirements of IAS 39.

Implementation of the proposed model may require substantial changes to systems, processes, internal controls and documentation. Entities may need to develop or modify processes relating to expected repricing dates, repricing time bands, behavioural assumptions, identification of net repricing risk exposures, benchmark derivatives and measurement of the Risk Mitigation Adjustment.

Such implementation may also require coordination between accounting, treasury, risk-management, information-technology and audit functions.

We therefore recommend that sufficient time should be provided between issuance of the final requirements and mandatory withdrawal of the relevant IAS 39 requirements.

We suggest that the IASB consider providing an implementation period of at least 24-36 months from the date of issuance of the final Standard before mandatory application/withdrawal of the existing IAS 39 macro hedge accounting requirements.

Early application may continue to be permitted for entities that have the necessary systems and processes in place. An adequate transition period would enable entities to modify their systems, test methodologies and assumptions, establish appropriate internal controls, train personnel and ensure the reliability of information before implementation.

Overall Recommendation

The Bhopal Branch of CIRC of ICAI supports the IASB's objective of developing a Risk Mitigation Accounting model that better reflects the economic effects of dynamic repricing-risk management.

At the same time, we believe that the effectiveness and acceptance of the proposed model would be significantly enhanced by: **(i)** making proportionality operational through practical guidance and expedients; **(ii)** strengthening the conceptual basis, presentation and disclosure requirements relating to the Risk Mitigation Adjustment; and **(iii)** providing an adequate implementation period before withdrawal of the existing IAS 39 macro hedge accounting requirements.

These measures would, in our view, improve understandability and consistency of application while reducing unnecessary implementation burden, without compromising the fundamental objective of faithfully representing an entity's risk-management activities.

For Bhopal Branch of CIRC of ICAI