MOORE ASIA PACIFIC NEWSLETTER

July 2020

CHAIRMAN'S MESSAGE

Dear Colleagues,

"Coming together is a beginning.
Keeping together is progress.
Working together is success."

Welcome to the 2nd issue of the Moore Asia Pacific newsletter. I wish to open this message with a quote from Henry Ford, the American industrialist who founded the Ford Motor Company. Coming, keeping, and working together, or in short, co-operation and teamwork, is the foundation of so much of what we do as individuals, firms and networks, be it with our colleagues, clients, or as a network.

Over the past few months, the regional council has been actively establishing and promoting the development of sub-committees in an effort to bring our firms closer together by establishing more opportunities for inter-firm connection, to facilitate the discovery of inter-firm opportunities and synergies. We have already set up 10 sub-committees to explore opportunities in various industries and service lines, and are ready for more if the opportunities arise. This parallels developments at the global network level. As you are aware, the network has recently launched Moore Media, a collaboration of Moore member firms with media expertise, as well as Global Corporate Finance, a collaboration of nine core firms that will support the broader corporate finance function of the network. This is on top of established collaborations such as Moore Shipping, from which we have already witnessed the development of the Moore Maritime Index.

An important area of collaboration involves the sharing of expertise, whether in business or technical matters. In this respect there is no shortage of talent even within the regional network. In terms of business expertise, each of our firms have our unique strengths in our respective service lines, industries and sectors and I am confident that we can learn much from each other. In terms of technical expertise, there is also no lack of resources within the regional network. In the past couple of months, the Regional Technical Panel within Asia Pacific has been formed, and I am aware that there are significant active contributors within the Asia Pacific region to the global Technical and Financial Reporting specialist groups within the network.

To kickstart such collaborations, we will be featuring various leaders and experts within the network in this and upcoming issues of the newsletter. For this issue, we are pleased to showcase Patrick, who leads a wide range of advisory services within Moore Hong Kong, and David, who leads technical advisory and training in Moore Australia and is also a member of the Australian Accounting Standards Board. We wish to thank both Patrick and David for kindly agreeing to be interviewed and featured in this newsletter.

In addition, our spotlight on countries and firms within the regional network extends, in this newsletter, to feature Moore Markhams New Zealand and Moore Shisei from Japan. We wish to thank the firms for agreeing to be featured, and for providing the introductory write-ups to their respective firms.

Although we continue to navigate challenging times, the regional council remains committed towards supporting our member firms and we welcome suggestions and opportunities to where we might assist and collaborate together. I look forward to hearing from you.

Stay safe, strong and healthy.

With best wishes,

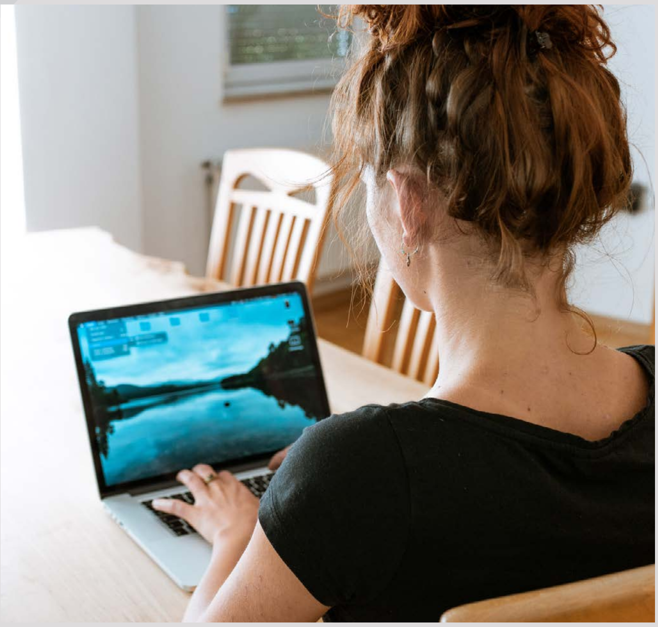
MICK AW
CHAIRMAN

Moore Asia Pacific Regional Council

TOP 4 EVOLVING RISKS AND WHAT YOU CAN DO ABOUT IT

Jack Ma once said "Today is hard, tomorrow will be worse. But the day after tomorrow, it will be sunshine."

The coronavirus pandemic ("COVID") has made the day hard for businesses and disrupted the global economy, which is projected to shrink by 3% in 2020 based on the world economic outlook of the International Monetary Fund. With this trajectory of the global economy and coupled with the second COVID wave currently sweeping across several countries, we can expect tomorrow to get worse. But all is not lost. Whenever there is a crisis, there will always be an opportunity. Let us consider the top 4 evolving risks and think about what we can do to take advantage of the uncertainties.



1. PEOPLE RISK - CHANGES TO THE HUMAN RESOURCE LANDSCAPE

One of the greatest workplace challenges brought about by the COVID comes in the form of massive telecommuting as governments around the world are forced to implement strict movement restrictions to control the infections of COVID. Even after movement restrictions are relaxed, working-from-home has become the default approach recommended by governments to lower the impact should there be subsequent waves of outbreaks.

While companies are eager to get their employees to come back to the office, 239 scientists from all over the world have signed an open letter to the World Health Organisation calling for a new set of safety recommendations in the light of evidence that the virus can be airborne. Telecommuting demands a high level of trust. While some employees may relish the newfound freedom and independence in a work-from-home model, others struggle with balancing the needs of work against domestic challenges from working at home. Businesses either gain from increased work efficiencies from a more disciplined and collaborative workforce, or suffer from productivity loss of a disengaged labour force with remote burnout.

Consumers' buying behaviour and spending pattern have also changed. Online ordering of goods and subscriptions to services has a newfound rhythm and is quickly becoming the new norm. Businesses without any means to accept and process orders online will lose their relevance. After exiting from lockdowns, even though the more traditional physical means of outreach to consumers can resume albeit with some restrictions (requiring safety/social distance), consumers have already developed certain expectations and gotten used to ordering goods and services online. In fact, with each generation becoming more digitally savvy, e-commerce and home delivery will feature strongly in people's lives and business offerings.

This means that one will need to think about how to factor in these changes and revisit how we can engage employees and consumers. Building workforce resilience and driving an omnichannel e-commerce strategy for customers will be key. This approach will demand a change in thinking and the re-engineering of business processes to adapt to the new business landscape.

- Protect and support employees

Communicate and collaborate. Communicate early and often, even if you do not have all the answers as silence often feeds the rumour mill. Remain visible, authentic and committed. People are almost always at the heart of all problems as well as solutions to those problems. Reskill and upskill employees to support operational changes. Training needs to tap on technology and transform. There are various government grants available to help reduce costs. As Alvin Toffler said" The illiterate of the 21st century will not be those who cannot read and write. It will be those who cannot learn, unlearn and relearn."

- Omnichannel e-commerce strategy for customers

This means investing in foundational digital enablers to learn about the customers and enhance their experience. This entails automated measurement through the use of data analytics, omnichannel platforms and back-end interfaces to engage the customers. Businesses which offer alternatives for easy and fast access to quality products and services are the ones which will be able to ride the wave of recovery in the new normal.

2. PROCESS RISK - CHANGES TO THE BUSINESS LANDSCAPE

COVID has drastically slowed down international trade and exposed the frailties of businesses. Supply chains have been disrupted globally, since production activities which require physical presence of workers cannot be carried out during lockdowns. With zero or reduced output, exports have been affected and many countries needed to reassess their self-sufficiency and diversify sources of imports to reduce the impact of such disruptions. In the new normal, businesses need to reduce over-reliance on any individual source of supply and demand.

As businesses exit the lockdown periods and resume operations in the new normal, this may be the best time to update the enterprise risk frameworks pertaining to supply chain management, business process improvement and business continuity/ disaster recovery plans.

- Supply Chain Management

This ranges from inventory recovery, which entails alternative sourcing of supplies, updating of inventory policies and purchase parameters, to securing of transportation for inventory. Businesses can consider building up an intelligence engine underpinned by key data points on inventory management and production. This will facilitate quicker updates of the risk profile in a continuous manner and ensure that management is able to get the right intelligence that they need to make timely decisions.

- Business Process Improvement

Processes may need to be redesigned to maximise operational effectiveness and efficiency, supported by an optimal level of automation and digitisation. Existing policies and standard operating procedures ("SOP") may need to be re-engineered to effect a more optimal level of resource utilisation, if utilisation levels have changed due to the COVID disruption. Controls may need to be redesigned to cater to the new normal. Management should consolidate and refine these updates into a clearly-defined plan prior to implementation for a smooth execution and transition to the improved processes.

- Business Continuity Plan ("BCP")/ Disaster Recovery Plan ("DRP")

Businesses need to be predictive and proactive in updating BCP and DRP plans. Other than the employees and customers engagement and supply chain management discussed above, businesses will also need to better protect their IT assets and recover critical data as well as evaluate overall short-term liquidity. Without cashflow discipline, any form of cashflow forecasting is impotent.

3. TECHNOLOGY RISK - CHANGES TO THE DIGITAL LANDSCAPE

With the rapid advancement of technology, the potential hazards from IT threats also grows. While digitalisation can bring about benefits such as having more streamlined processes, stronger collaboration among employees and greater outreach to consumers, it also opens up vulnerabilities to cyberattacks as points of interactions shift online.

- Cybersecurity

Critical digitalised processes such as transaction processing are often targets for cyberattacks. As such, it is critical that businesses get the assurance that their technology infrastructure and designs are resilient, for example, through vulnerability assessments and penetration tests. At a minimum, reviews on cybersecurity controls or IT general controls should be done to enable management to have a baseline for assessing risks against the cost of preventive measures so that an optimal approach in line with management's risk appetite can be formulated.

- Data Protection

Telecommuting brings about the possibility of employees connecting to networks without the same cyber security settings from that of the workplaces. Should the employees use workstations issued by the company to connect to vulnerable websites or web access points (e.g. unsecured Wifi hotspots), the probability of getting workstations infected with malware will increase exponentially. Effective IT awareness training is imperative to inculcate a robust culture of cyber awareness and resilience . In addition, periodic cybersecurity scans based on stateof-the-art tools can be an effective defence against cyber-threats that would have ordinarily bypassed traditional virus detection tools.

Despite the above, entities should not be deterred from digitalisation due to the significant benefits that effective digitalisation can provide. To support the push for digitalisation, many like Singapore have implemented some form of digitalisation assistance schemes for enterprises across the globe.

However, entities should note that a thorough understanding of existing processes, procedures and business objectives should be in place before embarking on digitalisation of any specific components so that efforts will not be wasted in pursuing technologies that are misaligned with an organisation's strategies.

4. FRAUD RISK - CHANGES TO THE SAFETY LANDSCAPE

The widespread use of technology has opened up a pandora box of cybercrimes as a side effect as discussed earlier. The tsunamis of COVID disruptions during this period have also thrown businesses into a whirlwind of business emergencies where existing controls may be circumvented and fraud risk "red flags" overlooked as resources are transferred into operations or have been significantly cut, leaving the compliance/prevention function understaffed.

People may also face greater pressure to commit fraud as they struggle with poor financial performance in their businesses, adverse changes in remuneration or even the loss of jobs. When coupled with the perception that employers do not provide adequate support nor treat employees fairly, it become "rationalisation" to justify fraud. The intense financial reporting pressure may also cause one to "finally cross the line" and embark on "window-dressing" of results. Fraud typically occurs when pressure, opportunity and rationalisation are aligned. Key measures which can be adopted include:

- Fraud Risk Re-Assessment

Re-define fraud risks and revise existing anti-fraud and compliance frameworks. Keep employees attuned to fraud risk by sending reminders on core values with a focus on integrity, communication and support. Updates to insurance coverage should also be done.

- Third Party Risks

More counterfeits will also flood the market due to supply chain disruptions and people's fear of shortage. As businesses diversify their supply chains, new suppliers and business partners may be onboarded with proper due diligence checks. As such, a due diligence process to cover background checks and market reputation should not be side-stepped. Automation of vendor onboarding can also promote compliance and prevent any side-stepping of the due diligence process.

CONCLUSION

To conclude, enterprises cannot ignore the risks arising in the new landscape brought on by COVID. The silver lining, however, is that this is also an opportunity for transformation and adaptation. Businesses that stay alert, nimble and can adapt to new opportunities, while successfully navigating the accompanying risks and pitfalls, could very well surge ahead of competitors by riding on this time of opportunity and enjoy sunshine.

LAO MEI LENG

DIRECTOR

MS Risk Management Pte. Ltd.

PUA SHUAN YANG

ASSISTANT MANAGER

MS Risk Management Pte. Ltd.

MS Risk Management Pte. Ltd., is an associate firm of Moore Stephens LLP who is a member firm of Moore Global Network Limited ("MGNL"). To understand more about how we can support your business to help you achieve your business objectives, contact us today.

SPOTLIGHT ON PEOPLE

In this and forthcoming issues of the Moore Asia Pacific newsletter, we will be featuring selected interviews of key individuals in the Moore Asia Pacific network. For this issue, we are excited to share a feature on Patrick Rozario from Moore Hong Kong, and David Holland from Moore Australia.

Patrick currently leads Firm Advisory Services in Moore Hong Kong, supported by over 25 years of experience in large international accounting firms and the commercial sector, including substantial experience in the areas of governance and risk advisory experience.

David is the National Head of Technical Accounting at Moore Australia, and looks after client and in-house technical training and accounting technical advice. David is concurrently a board member of the Australian Accounting Standards Board (AASB), and is supported by over 20 years of experience encompassing technical advice and training, corporate development and strategic planning.

Patrick Rozario

MANAGING DIRECTOR - ADVISORY SERVICES

Moore Advisory Services Limited, Hong Kong

Question: Can you share with us on your key responsibilities and roles in Moore Hong Kong?

Patrick: Currently, I am the head of Firm Advisory services in Moore Hong Kong, which currently comprises of 2 service teams. One service team provides risk management, governance and internal audit services to our clients. The other service team provides financial due diligence and valuation services to support our clients with their mergers and acquisitions transactions. Recently, we also brought in a team of experienced insolvency practitioners to form our firm's Recovery Practice.

Question: What are your thoughts on how the Moore Global network can better enhance collaboration in your areas of expertise?

Patrick: I think supporting cross-border mergers and acquisitions transactions is one key area in which the Moore Global network can better collaborate. In my view, there will be a lot of opportunities in the areas of Corporate Finance and Mergers and Acquisitions in the post- Covid-19 business environment. Preparing ourselves for this, by gearing up our global capabilities and capacity in these service lines, will provide the network with a strategic edge in supporting global clients in this key service area.

Question: What kind of activities do you enjoy outside of work?

Patrick: I spend a lot of time on matters associated with the Luso-Asian community, which refers to people of Portuguese and Asian descent. Both my paternal and maternal families hail from a long history of Luso-Asian descent, with linkages to Macau, Malacca, Singapore, Shanghai, Goa, Ceylon and Timor over a few centuries. I am currently President of Club Lusitano in Hong Kong, which provides us with strong links to Portugal and other Portuguese-speaking countries, as well as the global Luso-Asian communities.

Question: Can you share with us your favourite quote and the reason why it appeals to you?

Patrick: The quote I wish to share is from Luís de Camões, who is, to date, considered the greatest Portuguese poet. He is best remembered for his epic work Os Lusíadas. In fact, the official name for the National Day of Portugal is translated as "Day of Portugal, Camões, and the Portuguese Communities", and is celebrated on 10 June to commemorate Camões.

A good quote from Camões for the present time is "*Mudam-se os tempos, mudam-se as vontades, Muda-se o ser, muda-se a confiança; Todo o mundo é composto de mudança, Tomando sempre novas qualidades.*"

In English, this translates to "*Time changes, and our desires change. What we believe—even what we are—is ever-changing. The world changes, which forever takes on new qualities.*"

This quote reminds us that the world constantly evolves, and we must continuously prepare ourselves for new challenges.

David Holland

NATIONAL HEAD OF TECHNICAL ACCOUNTING

Moore Stephens Australia - Melbourne

Question: Can you share with us on your key responsibilities and roles in Moore Australia?

David: My main responsibility is to provide technical training and advice on specific accounting issues to both the Moore Australia as well as the Moore Global network. In addition, I am a board member of the Australian Accounting Standards Board (AASB), which ensures the accounting standards meet the needs of not only listed and large organisations but also the public sector (government) as well as small, medium-sized and not-for-profit entities in Australia. Through this role at AASB, our clients can get direct input into the standard-setting process and a deeper understanding of how/why certain accounting standard amendments are developed and to be applied.

A significant part of my work over the last two years has been to assist clients and staff deal with the application of the accounting standards IFRS 9, IFRS 15 and IFRS 16, which prescribe the accounting for financial instruments, revenue and leases respectively. These 3 pronouncements represent, in my view, the most significant changes in the financial reporting arena in over a decade.

Question: What are your thoughts on how the Moore Global network can better enhance collaboration in your areas of expertise?

David: I think that in the technical arena, there are some truly wonderful and talented professionals within our network, each supporting their respective organisations. A coordinated effort to harness our global efforts in this area and improve collaboration can mean greater opportunities for cross-border consultation and sharing of technical views. It can also minimise duplication of technical effort across the network and enhance the potential for smaller firms to leverage on global efforts, for example in thought leadership, methodology development, and formulation of training.

Question: What kind of activities do you enjoy outside of work?

David: Golf is my favourite sport. I enjoy the challenge offered by the sport, and it also provides enjoyable social connection. I grew up playing at the same club as Stuart Appleby and Robert Allenby (PGA tour professionals), and particularly enjoy playing the old course at St Andrews Scotland, where my wife's parents happen to live. Among my goals in life are to play at the Augusta National, and attend the Masters as a spectator.

Besides golf, I enjoy woodwork, because it is challenging, and also offers a useful and enjoyable tangible result. I particularly enjoy working with my dad on woodwork projects. My most challenging project is actually to build my own billiard table!

Question: Can you share with us your favourite quote and the reason why it appeals to you?

David: My favourite quote is "Either you run the day, or the day runs you."

This quote reminds us of the importance of focusing our efforts on, and prioritising, what is most important to each and every one of us. Without such focus, there is a risk that we may fail to achieve anything meaningful despite being endlessly busy.

The editorial team will like to take this opportunity to thank Patrick and David for the candid and thought-provoking sharing sessions, and their thoughts on strengthening network growth and collaboration.

SPOTLIGHT ON MOORE MARKHAMS NEW ZEALAND

SMALL, SIMPLE, SMART

It's small in size, but when it comes to innovation, intelligence, integrity and ease of doing business, New Zealand is a big hitter.

Moore Markhams New Zealand is ideally placed to help you get the most out of your business investment in this dynamic, well-connected and agile economy.

INNOVATION

Kiwis have long been known for their resourcefulness – developed through necessity due to our size, population and relative isolation from other countries. That ingenuity fuels our people and businesses. Technology is now our third largest export sector; while New Zealand-made technology helps local firms build their competitive advantage globally.

New Zealand is a world-leading food producer. We combine the best of nature with cutting-edge thinking to produce food and beverages that are globally synonymous with quality. New Zealand is the largest lamb and dairy exporter in the world, and produces enough food for 40 million people close to ten times its population.[1]

INTEGRITY

Integrity and equality are central to the New Zealand way of life. We are ranked first in the world for both corruption transparency[2] and government budget transparency[3]. We live in a stable, representative democracy and our legal system is based on Commonwealth common law. This allows our businesses to operate in an environment of high-trust and certainty.

EASE OF DOING BUSINESS

In New Zealand, we keep it simple and we try to be flexible so businesses can flourish.
New Zealand has ranked first out of 190 countries for ease of doing business[4] for four years running, based on its business regulatory system. Our tax system is uncomplicated and relatively lightweight, compared to other economies.

New Zealand's time zone gives it a competitive advantage, as it is compatible with business hours across Asia and in the United States and is 12 hours ahead of Greenwich Mean Time.[5]

INTELLIGENCE

New Zealand's famed natural beauty, ease of living and stable but dynamic business environment make it an attractive destination for skilled migrants. Net migration is high, and in 2018 more than half the net gain in migration came from Asia, especially China and India[6]. New Zealand's workforce is highly skilled and educated. We are seventh out of 130 economies, and first in East Asia and the Pacific, for developing and deploying talent[7].

OPPORTUNITIES

New Zealand has Free Trade Agreements with 15 Asian countries, creating access to more than two billion consumers. Free Trade Agreements with the European Union and India are currently under negotiation.

Within our borders, infrastructure investment presents a major opportunity. New Zealand is a young nation with a growing population and is investing heavily in physical infrastructure – with NZ$129 billion of projects scheduled in the next ten years [8]. Auckland, our biggest city, will be a major hub of development activity after experiencing population growth of 35 per cent from 2000 to 2016.

MOORE MARKHAMS IN NEW ZEALAND

Moore Markhams has a strong presence throughout New Zealand, with six firms spread over eight locations in the North and South Islands. We are specifically skilled to cater to New Zealand's biggest industries – agriculture and horticulture, and also specialise in providing services to the construction and development, legal, healthcare and other sectors.

We offer audit and assurance, business advisory, business recovery, consultancy, corporate finance and taxation services.

Moore Markhams New Zealand's clients include overseas-listed firms with global business interests, and we effectively leverage our international network to provide the best service possible.

We work closely with all our clients to help them achieve their business goals, whatever they may be. We understand the specific needs of our international clients, and draw on our expertise and connections locally and globally to maximise their outcomes.

To develop or strengthen your business investment in this exciting economy, contact Moore Markhams New Zealand.

FACT BOX

Gross Domestic Product 2019: US$215.975 billion [9]

GDP per capita: US$ 43, 746 [10]

Population: 4.9 million

Population density: 18 per square kilometre (47 per square mile)

Median age: 37.4 years

1 Ministry for Primary Industries mpi.govt.nz.
2 Transparency International, Corruption Perception Index 2019.
3 International Budget Partnership, Open Budget Survey 2019.
4 World Bank Group, Doing Business Report 2019; Ministry of Business, Innovation and Employment.
5 Investor Guide to the New Zealand Tech Sector 2019, Ministry of Business, Innovation and Employment.
6 Statistics New Zealand.
7 Human Capital Report, World Economic Forum 2017.
8 Treasury – Infrastructure 2019
9 https://data.oecd.org/gdp/gross-domestic-product-gdp.htm
10 https://data.oecd.org/gdp/gross-domestic-product-gdp.htm

SPOTLIGHT ON
MOORE SHISEI

Contributed by the Moore Japan Desk

A FULL SERVICE MEMBER FIRM

We are pleased to announce that Moore Shisei group changed its corporate brand name to 'Moore' as of January 1, 2020.

Moore Shisei, a member of Moore Global since 1992, is a full service accounting firm that began operations in 1978, and has provided over 40 years of high-quality professional services to our clients.

Located in the heart of Tokyo, Moore Shisei is comprised of 15 partners and more than 70 staff members, the majority of whom are either Certified Public Accountants or Licensed Tax Accountants.

Moore Shisei has a wealth of experience in a wide variety of industries, including specialized knowledge in many areas and countless achievements in providing services to Japanese and international clients. By combining this diverse experience with Moore Shisei' s own style of personal service, we are confident of our ability to consistently offer high-quality professional services.

Moore Shisei serves as a key firm in Moore Asia Pacific by providing leadership and business connections within and across the region and providing a strong presence on the JICPA committee.

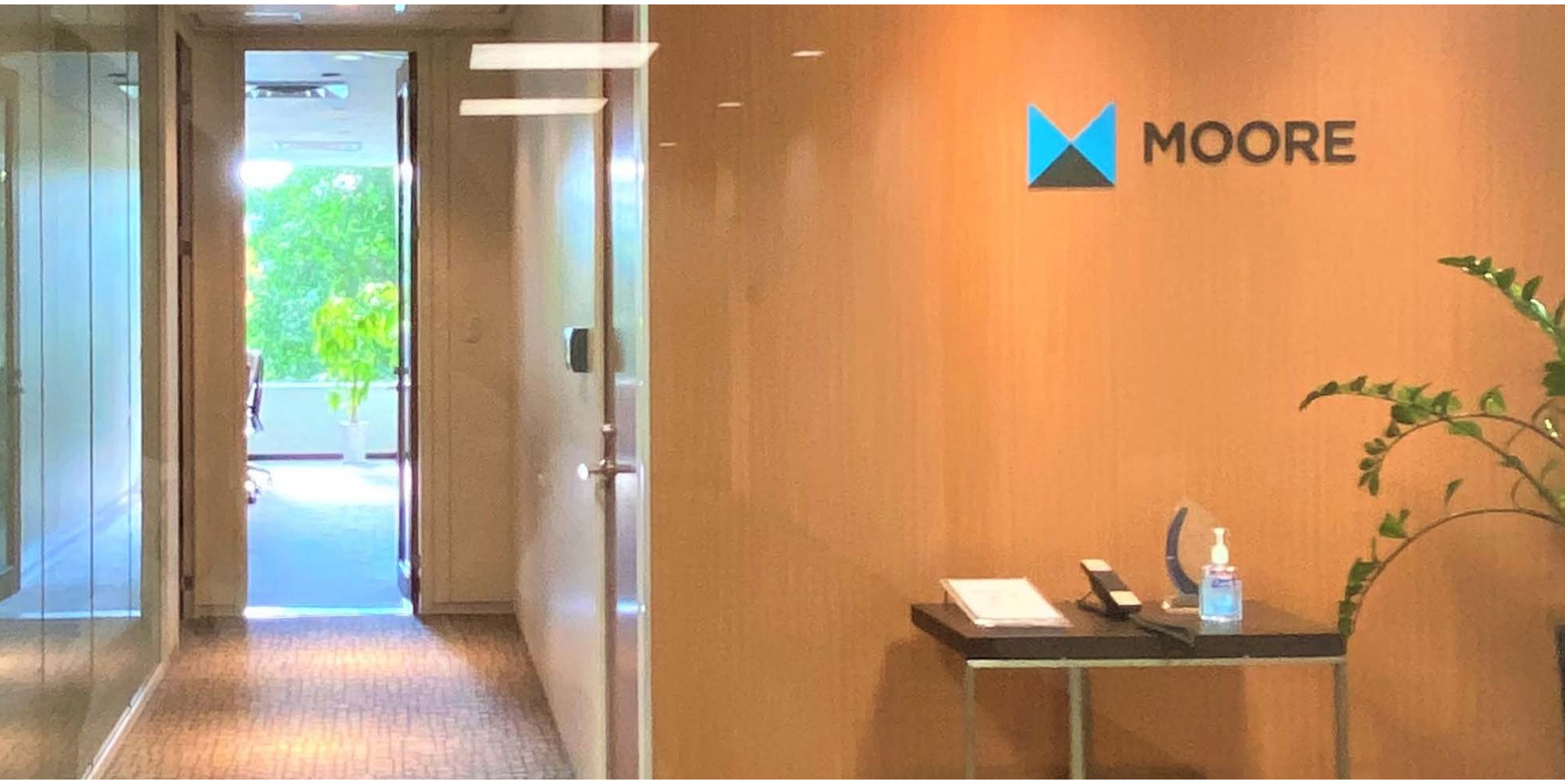
Mika Yamada, serves as the representative partner for the international team in addition to her regional counsel position within Moore Asia Pacific and as the global tax leader for the organization.

We are always keen to develop business and relationships in the following areas even in light of the current difficult circumstances present across the world.

INBOUND AND OUTBOUND INVESTMENT

Foreign investment in Japan has been increasing in recent years in part due to the 2020 Tokyo Olympic Games and the 2025 Osaka World Expo. We have been closely working with global clients in almost every industry who desire to take a part in these events.

At Moore Shisei, we have a Japan desk to offer support to our clients and other Moore Global member firms in coordinating the business for existing and potential Japanese clients, mainly to help solve business culture and communication problems.



GLOBAL EXPANSION BY SMES

Historically, Japanese businesses have been growing steadily with technology invented by SMEs and unlisted companies. The growth of these companies continues even under the current severe economic circumstances across the world. Many SMEs continue to expand operations worldwide.

We have established a strong reputation for providing services to SMEs in the areas of corporate tax consultation, compliance, and transfer pricing.

MORE GLOBAL TAX AND ADVISORY SERVICE

Often, global companies choose to work with the Big 4 because of the brand names. However, Big 4 firms are often not able to meet all of their client's expectations as they fail to provide prompt attention to their client's business needs. Moore Shisei Tax Corporation has an international team who are able to support their client's continuous growth by providing services such as, day-to-day accounting, payroll, advisory, tax services, and coordination with legal professionals.

Moore Shisei is ready to be your business connection in Japan!

1978
Japan

>40
Years

15
Partners

70
Professionals

FINANCIAL REPORTING CHANGES IN PHASE 2 OF THE INTEREST RATE BENCHMARK REFORM

"...the substitution of inter-bank offered rates will have important implications for accounting and auditing of certain financial instruments, leases and insurance contracts..."

On 9 April 2020 the International Accounting Standards Board (IASB) published an Exposure Draft (ED), Interest Rate Benchmark Reform – Phase 2, Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16. In Singapore, the Accounting Standards Council (ASC), opened its invitation for comments on the same date. The comment periods have ended in May 2020.

The Exposure Draft is a follow up to the Phase 1 amendments made to IFRS 9, IAS 39 and IFRS 7, in September 2019 to provide specific accounting relief, as global financial supervisory boards undertake to substitute existing Interbank Offered Rates (IBORs) with alternative benchmarks for risk-free rates (RFRs). Potential RFRs that are been considered across the globe include, inter alia, the EONIA in the Eurozone, SOFR in US, and SORA in Singapore. The substitution of IBORs for these RFRs have important implications for accounting and auditing of certain financial instruments, leases and insurance contracts. Although the amendments have not been finalised, being only in ED stage, the final amendments are expected to be made effective in less than half a year from the date of this article, by 1 January 2021, with earlier application permitted, underlining its urgency for affected companies. This article aims to provide a high-level overview of the issues and the proposals in the ED.

MODIFICATION OF FINANCIAL INSTRUMENTS

A wide variety of financial instruments rely on IBORs as a basis for determining interest costs, including insurance, loan and lease contracts, as well as other financing instruments. With the IBOR reform, it is expected that these will transition from IBORs to RFRs at some point. Unfortunately, the process is unlikely to be a straightforward substitution of one rate for another. This is because the RFRs are intended to be nearly risk-free, in many cases representing an overnight rate, whereas the IBORs are not nearly as risk-free and can represent various lending terms from overnight to 1 year. It is likely that some other aspect of the contract will have to change to make up for the different risk profiles represented by IBORs vs RFRs. For example, a fixed spread may be added to compensate for the additional risks previously captured by IBOR, or the interest reset periods/ reset dates could be changed.

In the absence of any specific relief, these changes are likely to be accounted for as either asset modification, or derecognition followed by re-recognition of a new replacement asset. In either case, changes to the carrying value of the existing instrument on the balance sheet may result.

The ED attempts to resolve this matter by offering a practical expedient to allow such contractual changes to be treated similarly to changes in floating interest rates arising from market interest movements, which means that the differences in interest costs are simply charged to income with no significant impact on the carrying amount of the instrument on the balance sheet.

For some contracts, fallback provisions may have already been pre-built into the contracts, with a hard-coded hierarchy of interest rate benchmarks that the contract will successively fall back on if a designated benchmark cannot be applied for any reason. The activation of such fallback provisions as a result of the IBOR reform, will also qualify for the above practical expedient.

In practice, the application of this expedient may, in our view, be complicated by the requirement in the ED that the expedient can only be applied to contractual changes that are determined on an "economically equivalent" basis as the previous contractual terms based on IBORs. Any additional changes over and above those considered to be "economically equivalent", should be accounted for in accordance with existing requirements (i.e. as modifications that may or may not result in derecognition, which may alter existing book values).

However, the new contractual terms will be a result of economic re-negotiations between the parties involved, and may encompass considerations beyond "economic equivalence". Accounting judgment will be required to differentiate "economically equivalent" contractual changes, which will not impact book value of the underlying debt contract, from the others.

The practical expedient is also expected to apply to insurance contracts that are exempted from IFRS 9 by the provisions of IFRS 4, as well as to IBOR-based lease contracts under IFRS 16.

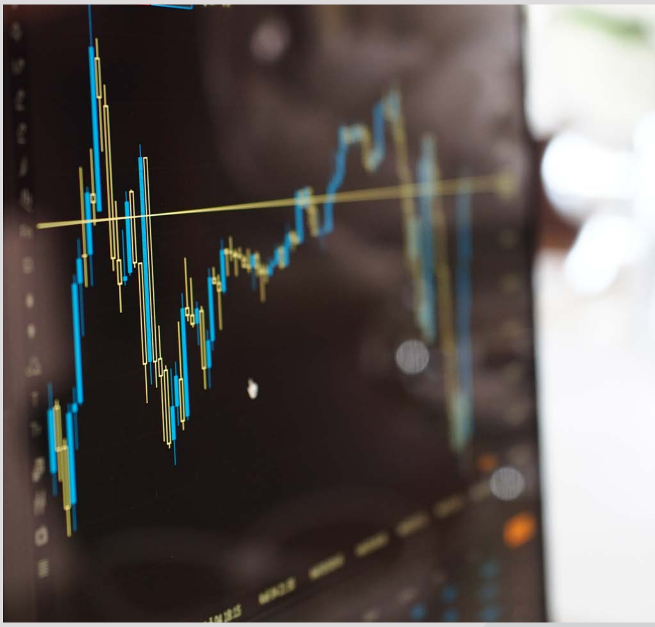
HEDGING

The most extensive impact arising from the IBOR reforms is expected in hedge accounting.

Firstly, with the changes made to previously IBOR-based hedging instruments and/or hedged items, the hedge documentation and designation will have to be updated for existing hedges, including a redefinition of the hedged risk from IBOR to RFR for interest risk hedges. Application of existing rules under either IFRS 9 or IAS 39 may result in hedge discontinuation. The ED proposes a relief by allowing hedge accounting to continue despite such changes to the hedge designation, arising from the IBOR reform.

Secondly, for hedges that still qualify to be designated under IAS 39 rules, retrospective quantitative effectiveness tests may fail the 80% to 125% thresholds as a result of market movements arising from the expected IBOR reform and associated uncertainty. The Phase 1 amendments have provided a temporary relief on this requirement, but that relief ends once the uncertainty surrounding IBOR reform has cleared. The Phase 2 ED attempts to resolve this issue, by requiring cumulative fair value changes to be reset to zero for purposes of retrospective effectiveness tests that are conducted on a cumulative basis. However, actual hedge ineffectiveness will still be fully recognised in profit and loss.

Thirdly, for interest rate instruments that are hedged as a group, the contractual transition date of each instrument from IBORs to RFRs may differ, which may result in the group failing the proportionality test under both IFRS 9 and IAS 39. The proportionality test needs to be satisfied in order for the items to be hedged as a group, and requires that the expected change in fair value attributable to the hedged risk



for each item in the group, to be approximately proportional to the overall change in fair value of the entire group. However, this may not be the case if different instruments in the group are based on different interest rate benchmarks. This situation will occur if some instruments in the group have contractually transitioned to RFRs but others have not. To resolve this, the ED allows the proportionality test to be performed separately for each sub-group referencing a different benchmark rate.

The final hedge accounting exemption that will be discussed in this article is in respect of the hedging of identifiable risk components. Certain risk strategies involve hedging risks against a risk component even though that risk component is not contractually specified in the hedged item. Where such a hedge is conducted, IFRS 9 requires an evaluation of the pricing within the relevant market structure, in order to ascertain whether the risk involved is separately identifiable within that market. For example, the fair value hedge of a fixed rate debt against a benchmark rate is permitted when the price of fixed-rate debt instruments is observed to vary directly in response to changes in the benchmark rate. This is the case even though the debt contract did not specify the benchmark rate.

However, such observation and evaluation requires sufficient volume and liquidity of market transactions against the benchmark rate. Upon initial transition to RFR, such volume and liquidity may not be available as time is needed to establish the impact of RFR on the market structure. In cases where IBOR was previously designated as a separately identifiable risk component, the absence of specific relief, may preclude hedge accounting from being applied to RFR as a separately identifiable risk component after the transition away from IBOR.

To resolve this, the ED proposes a relief that allows entities, upon designation of the hedge, to assume that the separately identifiable requirement is met, provided that there is a reasonable expectation that the RFR risk component is expected to become separately identifiable within the next twenty-four months.

CONCLUSION

This article has attempted to highlight the key proposals in the ED in relation to IBOR reform. The above discussions are not exhaustive and are only meant to provide a high-level overview. Although the ED aims to simplify financial reporting issues that arise from the IBOR reform, however, financial instruments accounting is, at the core, a complex topic, and care will be required in examining the interactions of the ED simplifications with existing complex requirements. Transition issues also needs to be examined. For example, the ED has required that hedging relationships that were discontinued due to the IBOR reform, before the ED takes effect, to be reinstated. This can be challenging, potentially requiring the maintenance of a separate set of hedging records, and needs to be planned for.

Finally, thought should be given to the changes that were not addressed by the ED. For example, if RFRs should prove to be a less liquid interest rate benchmark than IBORs, RFR-based instruments may have to be transferred to a lower fair value hierarchy within IFRS 13, with possible consequential risk capital implications for regulated financial reporters. As with all financial reporting changes, early preparation and planning is crucial.

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