Accounting for the Effect of Rising Interest Rates

Extract, IFRS Discussion Group Report on Meeting – December 2, 2013

Interest rates have been at historical lows for some period of time in Canada (and in many other jurisdictions around the world). Recently, there have been indications that interest rates in Canada are expected to rise over the short to medium term.

Under IFRSs, the initial or subsequent measurement of many balances requires interest rates as inputs either for recognition or disclosure purposes. Examples of such items include interest-bearing financial assets, non-financial assets for which an impairment trigger has been identified and an impairment assessment is required, defined benefit employee obligations, asset retirement obligations and long-term debt.

The Group discussed some of the potential accounting implications of an actual or expected increase in interest rates in respect of the following standards:

- IAS 36 *Impairment of Assets*;
- financial instruments standards (i.e., IAS 39 *Financial Instruments: Recognition and Measurement, IFRS 9 Financial Instruments*, and disclosure requirements under IFRS 7 *Financial Instrument Disclosures*); and
- other standards that require the use of interest-sensitive discount rates, such as IAS 19 Employee Benefits; IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, IAS 40 *Investment Property* and IAS 41 *Agriculture*.

The Group's Discussion

Group members observed that the effect of a change in interest rates can be quite pervasive. Group members noted that there is a direct effect for some IFRSs with explicit requirements, such as IAS 36 and IAS 39, while the effect is more indirect for other IFRSs, such as IAS 2 *Inventories* and IAS 17 *Leases*.

Group members observed that it is important to take a holistic view because interest rates are integrated with, and affect, many other assumptions. In addition to the risk-free rate, credit spreads and other necessary adjustments must be appropriately considered to achieve an appropriate discount rate.

Group members noted that entities need to consider how changes in interest rates might drive changes in other key variables, such as inflation, commodity prices and foreign exchange rates. This analysis is important not only for measurement but also if presenting any sensitivity analysis or other disclosures. Group members suggested that entities should strive to make sensitivity analyses more than just a mechanical calculation that ignores the interaction of key variables. Group members highlighted the importance of taking a step back to ensure that consistent assumptions about key variables have been used throughout the financial statements. Group members observed that, given there will be a time when interest rates will rise, entities that have not previously done this type of comprehensive analysis should do a holistic calculation, understand where the risks lie and determine if those risks need to be managed.

The Group did not recommend any further action be taken regarding this issue.