Beyond the GAAP

MAZARS' NEWSLETTER ON ACCOUNTING STANDARDS

NEWSLETTER / No. 143
April 2020

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EDITORIAL

As the COVID-19 epidemic continues to disrupt business, with significant impacts expected on 2020 financial statements, various stakeholders (most especially standard-setters) are working hard to respond to this unprecedented crisis (cf. issue no. 2 of our COVID-19 supplement).

While the IASB is currently focusing on managing this crisis, it has not abandoned its regular, non-COVID-19 related work, as shown by the two features in this issue's 'A Closer Look' section.

In these features, we present the IASB's proposals for improving disclosures following a business combination, and for simplifying impairment testing of goodwill. This issue also covers the proposed amendments to IFRS 9 and IAS 39 from Phase 2 of IBOR reform, which will specify the appropriate accounting treatment for changes to interest rate benchmarks as a result of the reform.

Enjoy your reading!

Edouard Fossat **Carole Masson**

IFRS highlights

Impact of the COVID-19 pandemic on IASB work plan

In light of the COVID-19 pandemic, the IASB held a supplementary meeting on 17 April, at which it approved the following measures:

- to **defer** the publication date of various consultation documents: for example, the *Business Combinations under Common Control* Discussion Paper is now scheduled for the third quarter of 2020 (rather than the second quarter as previously planned);
- to **extend** the comment period for various consultations by **around three months**: for example, the *Primary Financial Statements* Exposure Draft is now open for comment until 30 September (rather than 30 June as previously planned), while the Discussion Paper on goodwill and impairment, published in March 2020, is now open for comment until 31 December 2020 (rather than 15 September, cf. this issue's 'A Closer Look' feature).

Moreover, the mandatory effective date for the amendments to IAS 1 (*Classification of Liabilities as Current or Non-current*) has been deferred to 1 January 2023 (cf. Beyond the GAAP no. 140, January 2020).

Some deadlines have not been changed, such as the publication of the amendments to IFRS 17 – *Insurance Contracts*, which is still scheduled for June 2020, or the comment deadline for the Exposure Draft on Phase 2 of IBOR reform, which is still set at 25 May (cf. our second 'A Closer Look' feature).

Due to the constantly-changing nature of the crisis, and the consequent uncertainty, the IASB may consider taking additional measures if necessary.

Aside from these changes, the IASB also notes that it is actively monitoring financial reporting issues resulting from COVID-19.

The IASB's work plan is updated regularly and a detailed schedule can be found here:
https://www.ifrs.org/projects/work-plan/

Narrow-scope amendments to IFRS 16 to take account of COVID-19

On 27 April, the IASB published an Exposure Draft on IFRS 16 – *Leases.*

The Exposure Draft aims to respond to the practical difficulties involved in accounting for rent concessions received or granted as a result of the COVID-19 crisis – an issue that affects many companies.

The IASB is proposing to amend IFRS 16 to permit lessees (but not lessors) to apply a practical expedient that would exempt them from assessing whether a COVID-19-related rent concession constitutes a lease liability. So that the amendments can be published as quickly as possible, the comment period is just 14 days. Comments had thus to be submitted by 8 May 2020.

For more details on the proposed amendments, see issue no. 2 of our COVID-19 supplement (April 2020).

Request for Information to be published for PIR of IFRS 10, 11 and 12

At its April meeting, the IASB decided to continue its work on the Post-implementation Review of IFRS 10 – *Consolidated Financial Statements*, IFRS 11 – *Joint Arrangements*, and IFRS 12 – *Disclosure of Interests in Other Entities*, by publishing a Request for Information in the fourth quarter of 2020.

The Request for Information will focus on the following topics:

- in relation to IFRS 10: power over an investee; the link between power and returns, with a focus on identifying agency relationships; accounting requirements, with a focus on changes in ownership interests; and the consolidation exception for investment entities;
- in relation to IFRS 11: collaboration arrangements outside the scope of the standard; the classification of joint arrangements as joint operations based on other facts and circumstances; and accounting requirements, with a focus on joint operations;
- in relation to IFRS 12: the quality of information provided by an entity, and whether and how well the objectives of the disclosure requirements are met.

The IASB will discuss the next steps of the due process at a future meeting.

Second compilation of IFRS IC agenda decisions published

On 7 April, the IFRS Foundation published the second compilation of IFRS IC agenda decisions. The compilation brings together the six most recently-published IFRS IC agenda decisions, from October 2019 to March 2020.

The document is available on the IASB's website via the following link:
https://www.ifrs.org/news-and-events/2020/04/compilation-of-agenda-decisions-volume-2-published/

EUROPEAN highlights

IFRS 3R: new definition of a "business" adopted by European Commission

Following the Post-implementation Review of IFRS 3, the IASB published amendments to the standard in October 2018 to clarify the definition of a business and to help entities to determine whether a given acquisition is a business or a group of assets. This distinction is key to determining the correct accounting treatment (for more details of the amendment, see Beyond the GAAP no. 126 – October 2018).

The amendment became mandatory for financial periods commencing on or after 1 January 2020, but had not yet been adopted by the European Union.

This has now been done. The amendment was published in the Official Journal of the European Union (OJEU) on 21 April 2020. The late adoption is not expected to have any significant impact.

For more details, the amendments published in the OJEU are available here:
https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2020.127.01.0013.01.ENG&toc=OJ:L:2020:127:TOC

ESMA publishes 2019 report on European enforcers' regulatory and enforcement activities

The European Securities and Markets Authority (ESMA) published its annual report on European enforcers' activities on 2 April 2020.

In this report, ESMA provides an overview of the activities and actions undertaken by enforcers in 2019 in order to promote good practice in IFRS financial reporting.

The report states that European enforcers examined the (interim or annual) published financial statements of 943 issuers (around 17% of the issuers listed on EU regulated markets), of which 900 were ex-post examinations of annual or interim financial statements. Actions were taken against 299 issuers (33% of the ex-post examinations), primarily due to infringements in the following areas: accounting for financial instruments, impairment of non-financial assets, and presentation of financial statements, followed by a significant number of infringements relating to revenue (as a result of the new IFRS 15 requirements).

The actions taken against issuers were generally to require a correction in future financial statements (241 issuers), a corrective note (54 entities) or, in very few cases (4 issuers), the reissuance of amended financial statements.

Still on the subject of IFRS enforcement, the financial statements of 196 issuers were examined to assess their compliance with ESMA's 2018 enforcement priorities (for more details of these, see Beyond the GAAP no. 126 – October 2018).

As a result, enforcers took actions against 39 of these issuers, primarily relating to revenue recognition (IFRS 15) and, to a lesser extent, the application of IFRS 9 by credit institutions.

In this annual report, ESMA also gives details of other enforcement activities, relating to the following areas:

- Alternative Performance Measures (APMs): Enforcers examined the financial statements of 712 issuers (or 13% of European issuers) to assess compliance with the principles set out in ESMA's Guidelines on Alternative Performance Measures. Actions were taken against 109 issuers (or 15% of the issuers examined);
- non-financial information: 937 issuers (or around 35% of the companies required to publish this information) were examined, and actions were taken against 95 of these issuers.

In the report, ESMA also reminds issuers of the European Common Enforcement Priorities for 2019, namely:

- application of IFRS 16 – *Leases*;
- follow-up of specific issues relating to IFRS 9 and IFRS 15;
- issues relating to the application of IAS 12, including IFRIC 23. For more details on the ECEP, see Beyond the GAAP no. 137 – October 2019.

ESMA's 2019 report on enforcers' activities is available via the following link:
https://www.esma.europa.eu/sites/default/files/library/esma32-63-846_2019_activity_report.pdf

ESMA publishes 24th extract from IFRS enforcement decisions database

On 2 April 2020, ESMA published the 24th extract from its confidential database of IFRS enforcement decisions taken by enforcers in the European Economic Area (EEA).

This regular publication has the twin aims of:

- **strengthening supervisory convergence** between the 38 national enforcers and supervisory authorities in the EEA that participate in the European Enforcers Coordination Sessions;
- **providing** issuers and users of financial statements with **relevant information on the appropriate application of IFRSs** from the perspective of the EECS. However, ESMA emphasises that these decisions are not interpretations of IFRSs, as this remains the prerogative of the IFRS Interpretations Committee.

The extract comprises eight decisions made by national enforcers in their monitoring of issuers' financial reporting between May 2018 and October 2019.

The decisions relate to the following topics:

- identification of performance obligation (IFRS 15);

- financial disclosures on the liquidity risk of notes with an early redemption option (IFRS 7);
- deferred tax assets related to a change of accounting policy due to first application of IFRS 9 – changes in tax legislation (IAS 12 and IFRS 9);
- assessment of de-facto control (IFRS 10);
- disaggregation of revenue (IFRS 15);
- presentation of a condensed interim income statement (IAS 34);
- accounting for a framework agreement – identification of performance obligations (IFRS 15);
- identification of lease and non-lease components in a real estate lease contract and agent/principal distinction (IFRS 15 and IFRS 16).

The 24th database extract is available here:
https://www.esma.europa.eu/sites/default/files/library/esma32-63-845_24th_extract_from_the_eecss_database_of_enforcement.pdf

A list of all the decisions published by ESMA, together with previous extracts from its database, are available on the ESMA website here:
https://www.esma.europa.eu/databases-library/esma-library?f%5B0%5D=im_esma_sections%3A366

ESMA publishes updated Q&A on its Guidelines on APMs in light of COVID-19 pandemic

ESMA has just published an update to its Q&A on Alternative Performance Measures (APMs), adding question 18, which relates specifically to the application of ESMA's Guidelines in the context of the COVID-19 epidemic.

For more details on this, see issue no. 2 of our COVID-19 supplement (April 2020).

The Q&A on ESMA's Guidelines on APMs is available here:
https://www.esma.europa.eu/sites/default/files/library/esma32-51-370_qas_on_esma_guidelines_on_apms.pdf

A Closer Look

IASB publishes a Discussion Paper on business combinations and impairment testing

On 19 March 2020, the IASB published a Discussion Paper entitled *Business Combinations – Disclosures, Goodwill and Impairment*. Comments should be sent to the IASB by 31 December 2020 at the latest. The Discussion Paper is available on the IASB's website via the following link: https://www.ifrs.org/news-and-events/2020/03/forthcoming-goodwill/

First of all, it is important to remember that the published document is "only" a discussion paper, or in other words part of the research process. Thus, in practice, no changes will be made to standards in the near future. We will not really know what modifications could be made to currently applicable standards, or the extent of any changes in practice required as a result of such modifications, until such time as an exposure draft is published.

At this stage, and based on the published document, the Board did not change its mind about the "impairment only" approach. In short, the IASB is not planning to return to amortisation of goodwill. The Board believes that neither approach is perfect (either systematic impairment testing, or amortisation coupled with impairment testing where there is an indication that goodwill may be impaired). It was also pointed out that it would be better not to change approach unless new arguments arise in favour of amortisation. Ultimately, the Board voted by a narrow majority to stick with the current approach.

It is proposing new disclosure requirements, notably on whether the acquisition has been a "success". It is true that many stakeholders feel there is a lack of information on the subsequent performance of the acquired business after the acquirer has obtained control, and on the synergies resulting from the acquisition.

After considering whether it would be possible to reduce the "shielding" effect that arises when the acquired operations are combined with the operations already owned by the acquirer, the IASB concluded that it is not possible to make impairment testing significantly more efficient without incurring excessive costs for companies. However, the Board is considering simplifying some aspects, in response to criticism from some preparers of financial statements.

1. New disclosure requirements

The main change here would be the requirement to disclose information on the success of the acquisition, or in other words on the performance of the acquired business and how this compares with management's objectives.

In practice, at the acquisition date an issuer would need to disclose information on the strategic rationale and general objectives for the acquisition, as well as the metrics to be used in the future to assess whether the acquisition has been a success.

The Board plans to require entities to disclose the information that is used by the chief operating decision maker, as this will ensure it is both more relevant and easier for entities to prepare.

The term "chief operating decision maker" is defined in IFRS 8 as the individual or body (e.g. the board of directors or executive committee) in charge of allocating resources to and assessing the performance of the operating segments of an entity.

In other words, rather than requiring entities to disclose specific metrics, which would have allowed for greater comparability with other companies, the Board is planning to require the disclosure of information that is relevant to the entity itself, as it is actually used internally to assess whether the business combination has been a success.

Entities would be implicitly required to disclose information on the extent to which objectives are being met for two years after the acquisition. If the CODM is not monitoring an acquisition, the entity would need to explain why in the notes. Similarly, if an entity stops monitoring an acquisition before the end of the second year after it obtains control, or if the entity changes the metrics used to monitor the performance of the acquired business, it would need to disclose and justify this in the notes.

In addition to information on the performance of acquired businesses, the IASB is planning to require more disclosures on expected synergies (a description of the synergies, when they are expected to be realised, the amount or range of the synergies, and any costs to achieve them) as well as on certain types of liabilities (financing and defined benefit pension liabilities, as requested by some stakeholders).

Similarly, regarding the contribution of the acquired business, IFRS 3 already requires the following disclosures:

- the amounts of the business's revenue and profit or loss from the acquisition date onwards, as presented in the consolidated financial statements for the period in which the acquisition took place. This allows users of financial statements to compare this period with the previous one, without the impact of the acquired business to confuse matters;
- pro forma information on the revenue and profit or loss of the combined entity, as if the acquisition date had been at the start of the financial period. This helps users of financial statements to meaningfully compare the financial statements for the following year with those for the period in which the acquisition took place.

The IASB is planning to replace the term "profit or loss" with "operating profit before deducting acquisition-related costs and integration costs". It believes this will be both more useful, as it focuses on operating performance, and easier for companies to prepare, as they will not need to make subjective allocations of finance costs and tax expenses.

Similarly, the IASB is planning to require entities to additionally disclose information on the cash flows from operating activities of the acquired business since the acquisition date, and cash flows from operating activities of the combined business as if the acquisition date had been at the start of the financial period.

Finally, the IASB is planning to require disclosure of the amount of equity after deduction of goodwill.

2. Simpler requirements for impairment testing of goodwill

A key element of the IASB's plans is to remove the requirement for annual impairment testing of goodwill. In other words, whereas the current IAS 36 requires regular impairment testing on an annual basis, as well as when there is an indication that the asset may have become impaired, in future a test would only be required if there is an indication of impairment (i.e. no mandatory annual testing).

The Board believes that this change would not make impairment testing any less robust, particularly given that, if there is no indication of impairment, it is unlikely that a quantitative test would identify significant levels of impairment.

Having said that, if annual testing were to be removed, the IASB may revise its list of potential indicators of impairment, e.g. by adding "failure to meet the objectives of an acquisition" to the list.

In addition to removing the regular testing requirement, the IASB is also proposing further simplifications to the impairment testing process. Thus, it would be possible in future to use post-tax interest rates, and it would no longer be necessary to adjust cash flow forecasts from business plans or budgets relating to future restructurings or asset enhancements (e.g. expansionary investments). These simplifications would not be restricted to impairment testing involving goodwill.

In order to take account of many criticisms from stakeholders that impairment is often recognised too late, particularly due to the shielding effect that occurs when the acquired operations are combined with the operations already owned by the acquirer, the IASB has continued to work on the issue of "headroom", or the amount by which the recoverable amount exceeds the carrying amount of the assets tested, including goodwill. Headroom primarily arises from the fact that not all of a company's value is recognised in the balance sheet.

The IASB considered the possibility of an impairment test that would take account of the headroom that existed at the previous testing date, along with the other assets and goodwill recognised.

However, as the IASB believes it is not possible to completely eliminate the shielding effect, it has concluded that it is not necessary to consider how one might recognise an impairment loss by allocating it between goodwill and headroom. The impairment test itself will thus remain largely unchanged.

As regards the other identified weakness of the current impairment test – namely the impact of potentially over-optimistic management forecasts – the Board believes that this falls within the remit of auditors and regulators, and does not require a modification to the standard.

Despite the current challenges posed by the impact of the public health crisis on the financial statements for 2019 and 2020, it is to be hoped that stakeholders will nonetheless make the most of this opportunity to express their views to the IASB, particularly since the comment period has been extended to 31 December 2020.

Key points to remember

- The IASB has published a Discussion Paper entitled *Business Combinations: Disclosure, Goodwill and Impairment*, and the comment period is open until 31 December 2020. The document may eventually result in amendments (via an exposure draft).
- At this stage of the due process, there are no plans to change the current IAS 36 impairment model; the IASB is not planning to return to amortisation of goodwill. However, as this decision was only passed by a narrow majority, the IASB is particularly interested in stakeholders' views on the subject.
- Additional disclosures would be required on the performance of the acquired business after the acquisition date, and how this compares with management's objectives.
- The information disclosed should be the same as that used by the chief operating decision maker (as defined in IFRS 8), as the IASB has chosen to focus on ensuring the relevance of the information (rather than comparability of metrics between different companies).
- The disclosures currently required under IFRS 3 would be slightly altered, with additional disclosures required on cash flows from operating activities, and clarification on the issue of profit (henceforth, entities should disclose operating profit before deducting acquisition-related costs and integration costs).
- The IASB plans to remove the requirement for regular annual impairment testing (an impairment test would only be carried out when there is an indication that an asset may be impaired).
- The IASB is also proposing some simplifications to the process:
  - permitting entities to use a post-tax discount rate;
  - removing the requirement to adjust business plans where they include items relating to future restructurings or asset enhancements.

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A Closer Look

IASB publishes Exposure Draft on Phase 2 of IBOR reform

Since October 2019, the IASB has been discussing issues identified as key to Phase 2 of IBOR reform (see our February issue for a summary), and in April it published an Exposure Draft proposing amendments to IFRS 9, IAS 39 and IFRS 7, and to a lesser extent IFRS 4 and IFRS 16.

The amendments are intended to specify the appropriate accounting treatment for financial instruments affected when interest rate benchmarks are replaced by alternative benchmark rates (e.g. EONIA by €STER or LIBOR USD by SOFR). They focus on the following topics:

- the accounting impacts of a modification to the cash flows of a financial instrument resulting from a contractually-required change of index;
- the consequences of a change of index for hedge accounting;
- disclosures required in the notes;
- the impacts of IBOR reform on standards other than those relating to financial instruments.

While Phase 1 focused on the pre-replacement consequences of IBOR reform for hedge accounting, Phase 2 looks specifically at the consequences of contractual changes resulting from the reform. The scope of this phase is broader: in addition to hedge accounting, it looks at the impact in terms of modified financial assets or liabilities, whether or not they are designated in a hedging relationship.

We will address each of these topics in its own section below.

1. Accounting for contractual modifications to cash flows as a result of IBOR reform

Financial instruments within the scope of IFRS 9 must be assessed if their contractual terms change, to determine whether:

- the existing instrument should be derecognised and a new one recognised to take account of the new contractual terms; or
- the change in contractual terms should be accounted for as a "modification".

The Exposure Draft proposes that if the changes:

- are a direct result of interest rate reform; and
- generate cash flows that are economically equivalent to those expected immediately prior to the changes resulting from the reform

then the financial instrument shall not be derecognised. In practice, its effective interest rate will be modified to take account of these changes, without requiring any impact to be immediately recognised in profit or loss (cf. IFRS 9.B5.4.5).

If the changes resulting from interest rate reform are accompanied by other changes to the financial instrument, the entity shall follow a two-stage process:

i) account for the changes resulting from the reform in accordance with the principles set out above; then

ii) account for the other changes in accordance with the general principles of IFRS 9.

As regards changes resulting from interest rate reform, the IASB has identified two types of situation:

a) situations in which the reform leads to a change in contractual terms; and

b) situations in which the reform leads to a modification of cash flows without requiring a change in contractual terms (e.g. the existence of a fallback provision, reform of a benchmark rate with no change to its denomination, etc.).

At one point, the IASB considered stating that each of these situations would constitute a "modification" in the IFRS 9 sense. Many stakeholders then pointed out that in practice situations as described in b) could crop up regularly (e.g. reform of an inflation index by changing the calculation method used). They also pointed out that in practice, these situations were not always accounted for as a "modification" to a financial instrument as in IFRS 9.

In response, the IASB has suggested that its proposals should be restricted to the context of the current IBOR reform and not be generalised to other situations. Thus, changes resulting from the reform that meet both the previously-mentioned conditions shall be accounted for in the same way irrespective of whether they fall into category a) or category b). However, the IASB has, for now, shelved the issue of whether a "modification" should always be the appropriate accounting treatment for situations in which the basis for determining the contractual cash flows is changed, but the contractual terms are not.

2. Further exceptions to hedge accounting requirements proposed

Following the exceptions to hedge accounting requirements proposed in Phase 1, in Phase 2 the Board is proposing further reliefs to ensure that hedging relationships affected by IBOR reform need not be discontinued at the time of replacement.

The table below summarises the various exceptions from the requirements of IAS 39 and IFRS 9 proposed in the Exposure Draft

Current accounting treatment (IAS 39/IFRS 9) and issue raised by the reform	Exception proposed in Exposure Draft
1) Documentation of hedging relationships	
A hedging relationship must be formally designated and documented from inception. The hedge documentation shall be amended when uncertainty arising from IBOR reform is no longer present, i.e. no further changes are expected to the hedged risk (or item) and/or the hedging instrument as a result of the reform. Normally, this would involve discontinuing the hedging relationship and designating a new hedging relationship.	A hedging relationship shall not be discontinued if the amendment to the documentation: i. is a direct result of the reform; and ii. is limited to one or more of the following changes: a. designating an alternative benchmark rate (whether contractually specified or not) as a hedged risk; b. amending the description of the hedged item or the hedging instrument so that it refers to an alternative benchmark rate; c. updating the description of the method used to measure hedge effectiveness (IAS 39 only). Amendments may be made to the documentation several times, e.g. if the hedging instrument and the hedged item are modified at different times. If changes are made to an instrument designated as part of a hedging relationship that go beyond the changes required by the reform, the entity must first apply the requirements of IAS 39 or IFRS 9 to determine whether the hedging relationship should be discontinued. If the hedging relationship can be maintained, the documentation is amended in accordance with the relief described above.
2) Assessing retrospective hedge effectiveness (IAS 39 only)	
Under IAS 39, when assessing retrospective effectiveness, the relationship between changes in the fair value of the hedging instrument and changes in the fair value of the hedged item must fall within a range of 80%-125%. If this requirement is not met, the hedging relationship is discontinued. When effectiveness is calculated on a cumulative basis, some hedging relationships could end up being immediately discontinued when the Phase 1 exceptions cease to apply, due to the ineffectiveness accumulated during Phase 1.	As soon as the Phase 1 exceptions cease to apply, the cumulative change in fair value of the hedging instrument and the hedged item shall be reset to zero for the purposes of the retrospective effectiveness assessment.
3) Fair value hedges	
Given that, under normal circumstances, a change in the hedging relationship results in the relationship being discontinued, preparers need to know what accounting treatment to use when this exception is applied (modification + hedging relationship maintained).	When the hedge documentation is amended, the entity should: - remeasure the hedging instrument based on the alternative benchmark rate and recognise the corresponding gain or loss in profit or loss; - remeasure the carrying amount of the hedged item based on the alternative benchmark rate and recognise the corresponding gain or loss in profit or loss.

4) Cash flow hedges

Cash flow hedges involve recognising the cumulative change in fair value of the hedging instrument, measured based on the old benchmark rate, as a cash flow hedge reserve in other comprehensive income (OCI).

When the hedging relationship is modified to take account of the alternative benchmark rate, entities need to know what to do with this reserve.

When the hedge documentation is amended, the CFH reserve is measured at the lower of:

- the cumulative gain or loss on the hedging instrument calculated based on the alternative benchmark rate; or
- the cumulative change in fair value of the hedged item calculated based on the alternative benchmark rate.

In practice, this means that the CFH reserve is remeasured to what it would have been if the alternative benchmark rate had been used since the inception of the hedging relationship.

If an amount is retained in a CFH reserve for a hedging relationship that has been discontinued but for which the hedged transaction is still expected to occur, the amount in the reserve shall be deemed to be based on the alternative benchmark rate.

5) Groups of hedged items

Where items have been hedged on a portfolio basis, an entity may encounter a situation where some items are still referenced to the old benchmark rate and others to the alternative benchmark rate. This may mean that the entity has two hedging relationships, one for each benchmark rate.

It is thus necessary to specify the accounting treatment for this situation.

Furthermore, IAS 39 states that a group of items may only be hedged on a portfolio basis if the change in fair value attributable to the hedged risk for each individual item is approximately proportional to that for the portfolio as a whole. This criterion is no longer met if there are two benchmark rates for a single portfolio.

When the hedge documentation is amended, the group of items in question shall be split into two sub-groups, one for each benchmark rate. In practice, this will involve managing two hedging relationships, and the hedged items will migrate from one to the other as they are modified to reference the alternative benchmark rate.

The proportionality criterion from IAS 39 shall be applied separately to each sub-group.

6) Designation of non-contractually specified risk components as hedged items

IAS 39 and IFRS 9 both permit entities to hedge a specific risk component of an item, rather than the item in its entirety, provided that the risk component is separately identifiable and reliably measurable at inception and throughout the hedging relationship. This is particularly important when the hedged risk component is “non-contractually specified” (e.g. the €STER component of a fixed-rate debt instrument).

However, as markets based on the alternative benchmark rate will develop gradually, and the timing may differ for different instruments (derivatives vs. cash instruments) and their markets, it may be difficult to demonstrate that the “separately identifiable” criterion is met at the point when the alternative benchmark rate is designated as the hedged risk.

An alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable at the date it is designated, shall be deemed to have met this condition if the entity reasonably expects that the alternative benchmark rate will become a separately identifiable component within 24 months of its designation as a hedged risk component.

If subsequently the entity reasonably expects that the alternative benchmark rate will not in fact become separately identifiable within 24 months from the date it was designated as a risk component, hedge accounting shall be discontinued prospectively.

However, the Exposure Draft specifies that the component must be “reliably measurable” throughout. No exception is permitted here.

3. Qualitative and quantitative disclosures required in the notes

The proposals presented in our February issue have been retained and partially extended by the Board in the Exposure Draft: thus, IFRS 7 shall be amended to help users of financial statements to understand the nature and extent of risks arising from IBOR reform, and the entity's progress in completing the transition to alternative benchmark rates. To meet these objectives, the following disclosures are required:

- a description of how the entity is managing the IBOR transition for the various rates involved and the risks arising from this transition;
- the carrying amount of non-derivative financial assets and liabilities and the nominal amount of derivatives that continue to reference interest rate benchmarks subject to reform. These amounts shall be disaggregated by significant interest rate benchmark and presented separately;
- for each significant interest rate benchmark, an explanation of how the entity determined the base rate and relevant adjustments to assess whether the modifications fell within the scope of the Phase 2 amendments. This explanation must also enable users to understand any significant judgements the entity made when assessing which modifications were eligible for the practical expedients;
- the impacts of IBOR reform on the entity's risk management strategy.

4. Accounting impacts of IBOR reform on other standards (IFRS 16, IFRS 4)

As IBOR reform also potentially affects financial instruments outside the scope of IFRS 9, the Board is also proposing amendments to IFRS 16 and IFRS 4.

As regards IFRS 4, insurers that are still applying IAS 39 shall apply the same accounting treatment for financial instruments modified as a result of the reform as would have been applied under IFRS 9 (i.e. the practical expedient presented in section 1 above).

As regards IFRS 16, some leases include lease payments indexed to benchmark rates that fall within the scope of IBOR reform. In a lessee's financial statements, a change in the basis for calculating variable lease payments would normally meet the definition of a lease modification as defined in IFRS 16. The lease liability would then need to be remeasured by discounting the revised lease payments using a revised discount rate.

To address the specific circumstances resulting from the reform, the Board is proposing that, as a practical expedient, changes in variable lease payments as a result of IBOR reform shall be accounted for as remeasurements of the lease liability rather than as lease modifications. This exception is strictly limited to changes that are a direct result of IBOR reform and that are economically equivalent to the previous basis (i.e. the old interest rate benchmark).

The Board has not amended other standards that could be affected by the reform due to the use of discount rates (e.g. employee benefits under IAS 19, impairment testing of assets under IAS 36) as it felt that this was covered by the provisions of IAS 8 on accounting for changes in estimates.

5. Effective date and transition

In line with the most recent proposals prior to publication of the Exposure Draft, all the amendments would be mandatory for financial reporting periods commencing on or after 1 January 2021, with early application permitted. If an entity opts for early application, it should disclose this in the notes to the financial statements.

The amendments would be applicable retrospectively, in accordance with IAS 8. However, entities would not be required to restate prior periods to reflect the application of these amendments. An entity may restate the figures for prior periods if it wishes, provided that this is possible without the use of hindsight.

If it does not restate prior periods, any difference in carrying amount resulting from the application of these amendments shall be recognised in opening retained earnings for the period in which the amendments are first applied.

In practice, retrospective application would permit entities to reinstate hedging relationships that were discontinued as a result of IBOR reform during a prior period before publication of the amendments.

The Exposure Draft is available on the IASB's website via the following link:
https://www.ifrs.org/news-and-events/2020/04/exposure-draft-ibor-2/

Given the time constraints, the comment period for this Exposure Draft is short, closing on 25 May 2020.

Events and FAQ

Frequently asked questions

IFRSs

- Revenue recognition: distinguishing between an agent and a principal
- Measuring losses at completion in the context of the COVID-19 crisis
- Accounting treatment of dismantling costs for a commercial lease
- Presenting disclosures on sensitivity analyses of impairment tests
- Impact of the COVID-19 crisis on recognition of lease payments
- Accounting for mutually binding promises to buy and sell securities

UPCOMING MEETINGS OF THE IASB, IFRS INTERPRETATIONS COMMITTEE AND EFRAG

IFRS		EFRAG	
IASB	**Committee**	**Board**	**TEG**
18-22 May	16-17 June	26 May	6 May
22-26 June	15-16 September	16 June	3-4 June
20-24 July	1-2 December	16 July	3 July

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The drafting of the present issue was completed on 13 May 2020
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