IBOR reform – Broad discussions including new disclosures

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"The Board's Phase 2 discussions are reaching their conclusion and highlight that the impact of reforms could extend beyond hedging relationships and financial instruments. Preparers of financial statements will need to ensure they are completely and accurately reflecting all IBOR-related issues."

Chris Spall,
KPMG's global IFRS financial instruments leader

Tentative decisions, potential amendments and new disclosures

Highlights

- Effectiveness assessment could reset to zero when Phase 1 exceptions cease to apply
- Potential amendments to other IFRS® Standards – For insurers and lease contracts
- Additional disclosures for Phase 2 of IBOR reform
- Next steps – Potentially one last Phase 2 discussion before exposure draft in Q2 2020

January discussion shows the scope of Phase 2 is broader than previous phase.

At its January 2020 meeting, the International Accounting Standards Board (the Board) discussed the interaction between its tentative Phase 2 decisions and the end of application requirements for the Phase 1 amendments to IFRS®9 *Financial Instruments* and IAS®39 *Financial Instruments: Recognition and Measurement*. The Board also discussed the potential impact of IBOR reform on other IFRS Standards and disclosure requirements for Phase 2.

End of application for Phase 1 exceptions

Under IAS 39, when the retrospective assessment[1] of a hedging relationship is based on cumulative fair value changes, the hedge could fail when the Phase 1 exception for retrospective assessment ceases to apply. This is because the Phase 1 exception allows a hedge to continue even if the actual result of the hedge is not within a range of 80 to 125 percent.

As a result, the Board tentatively decided to amend IAS 39 to require that, for the purposes of assessing retrospective effectiveness only, the effectiveness reassessment would reset to zero at the date the exceptions cease to apply. The Board also tentatively decided that no additional guidance or amendments would be made to the other Phase 1 end-of-application requirements.

1. Retrospective assessment – whether the actual result of the hedge (i.e. the extent to which offsetting changes in fair value or cash flows attributable to the hedged risk is achieved) is within a range of 80 to 125 percent.

Potential amendments to other IFRS Standards

The Board tentatively decided to provide a practical expedient in IFRS 16 *Leases* for a lessee to account for lease modifications directly required by IBOR reform using the existing guidance[2] that applies to changes in lease payments due to changes in floating interest rates.

The Board also proposed to amend IFRS 4 *Insurance Contracts* so that insurers applying IAS 39 can also apply the amendments and practical expedient in accounting for modifications directly required by IBOR reform.

However, the Board noted that the existing guidance in IFRS 13 *Fair Value Measurement* and IFRS 17 *Insurance Contracts* are adequate for addressing issues related to IBOR reform. It also noted that the current IFRS Standards already provide adequate guidance to account for the potential impacts of IBOR replacement on discount rates and their valuations.

Additional disclosures for Phase 2 of IBOR reform

The transition from IBORs to alternative benchmark rates is likely to have broader implications on a company's business, its financial statements, the risks it is exposed to and how it manages those risks. Therefore, the Board tentatively decided to amend IFRS 7 *Financial Instruments: Disclosures* to require companies to provide the following information.

To enable users to understand…	Companies need to disclose…
the nature and extent of risks arising from IBOR reform to which the company is exposed, and how the company manages those risks	– the carrying amount of financial instruments, including the nominal amount of derivatives, that continue to reference IBOR subject to reform (disaggregated by significant IBOR exposures) – when assessing modifications, how the company determined the base rate and relevant adjustments for each significant alternative benchmark rate that it is exposed to – the extent to which IBOR reform has resulted in changes to the company's risk management strategy, and how the company is managing those risks
the company's progress in transitioning from IBORs to alternative benchmark rates, and how the company is managing this transition	– how it is managing the transition from IBORs to alternative benchmark rates, and the status/progress made at the reporting date

Next steps

The Board is expecting to have its final Phase 2 discussion at its next meeting. The Board will discuss the proposed amendments set out above, voluntary versus mandatory application, the effective date and transition, and due process steps. An exposure draft for IBOR Phase 2 is expected in Q2 2020.

Look out for **further updates** and speak to your usual KPMG contact to find out more about the Board's tentative decisions.

2. IFRS 16.42(b) and 43

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