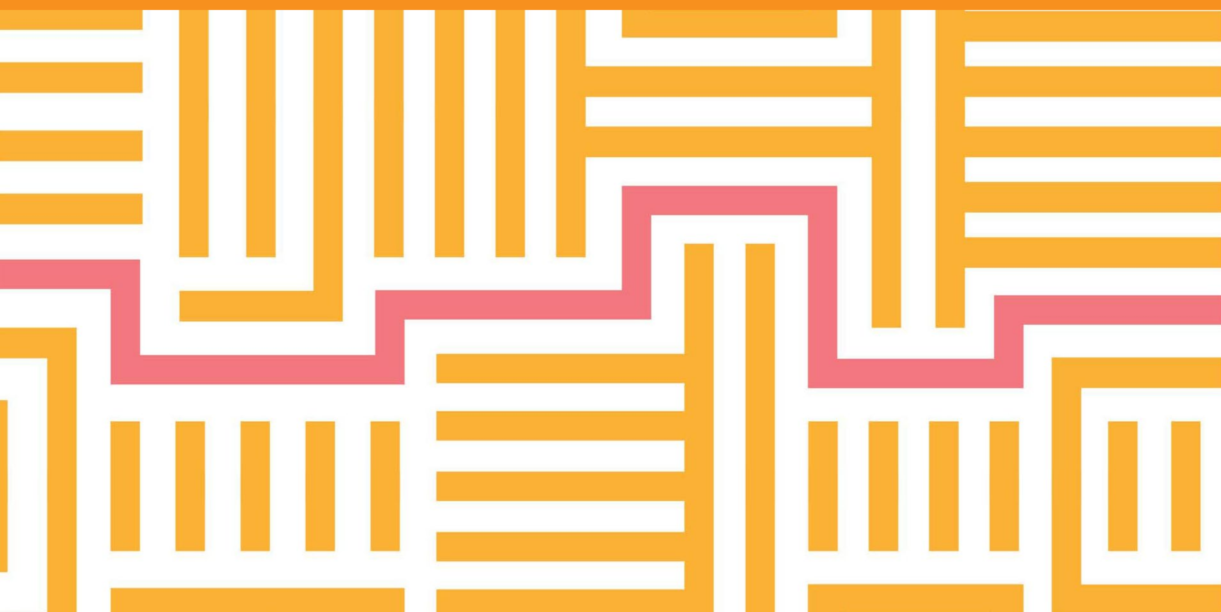
# IFRS news

**May 2019**



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# A look at current financial reporting issues

Release Date: 3 May 2019 | INT2019-07

## The effect on hedge accounting of the reform of LIBOR and other similar rates – PwC In brief

**Proposed amendments to IFRS 9 and IAS 39: relief from the effects of the reform of LIBOR and other similar rates on certain aspects of hedge accounting**

**At a glance**

The reform of LIBOR and other similar rates ('IBOR reform') will affect virtually all companies in all industries. Whilst the reforms are expected to happen over several years, there are potential impacts on financial reporting in the short term, in particular for hedge accounting.

The IASB has published an Exposure Draft 'Interest Rate Benchmark Reform: Proposed amendments to IFRS 9 and IAS 39'. These proposed amendments would enable hedge accounting to continue for certain hedges that might otherwise need to be discontinued due to uncertainties arising from IBOR reform. The comment period for the Exposure Draft ends on 17 June 2019, with the IASB aiming to finalise the amendments by the end of 2019.

### What is the issue?

Following the financial crisis, the replacement of benchmark interest rates such as LIBOR and other inter-bank offered rates ('IBORs') has become a priority for global regulators. Many uncertainties remain but the roadmap to replacement is becoming clearer. Given the pervasive nature of IBOR-based contracts among both financial institutions and corporates, there are significant potential impacts of these changes on financial reporting under IFRS.

The IASB has a two-stage project to consider what, if any, reliefs to give from the effects of IBOR reform. The first stage considers reliefs to hedge accounting in the period before the reforms are enacted, and has led to the Exposure Draft described in this In brief. In the second stage, the IASB will consider possible reliefs relevant at the time when the reforms occur.

The Exposure Draft proposes amendments to IFRS 9 and IAS 39, to enable hedge accounting to continue for certain hedges that might otherwise need to be discontinued due to uncertainties arising from IBOR reform. More specifically, the Exposure Draft proposes that:

- the 'highly probable' requirement should be amended such that, when assessing the likelihood that a forecast transaction will occur, an entity would assume that IBOR-based contractual terms are not altered as a result of IBOR reform;
- the prospective hedge effectiveness assessment should be amended such that an entity would assume that the IBOR-based contractual cash flows from the hedging instrument and the hedged item are not altered as a result of IBOR reform; and
- an entity would continue hedge accounting where a non-contractually specified IBOR risk component met the separately identifiable requirement at the inception of the hedging relationship, even if it does not meet that requirement at a later date.

It is proposed that the reliefs above would be mandatory, to address concerns around arbitrary discontinuation of hedge accounting ('cherry picking') and to be consistent with IFRS 9's prohibition on voluntary discontinuation of hedge accounting. They would apply to both existing and new hedges.

The Exposure Draft proposes that the reliefs should stop being applied at the earlier of when the uncertainty regarding the timing and amount of the resulting cash flows is no longer present, on the one hand, and the discontinuation of the hedge relationship on the other.

## What is the impact and for whom?

The proposed amendments will have an impact in all jurisdictions that have decided that there is a need for IBOR reform. They will affect companies in all industries that have applied hedge accounting for IBOR-related hedges, such as hedges of loans, bonds and borrowings with instruments such as interest rate swaps, interest rate options, FRAs and cross-currency swaps. More detail is given below.

### Highly probable requirement

Cash flow hedge accounting under both IFRS 9 and IAS 39 requires the future hedged cash flows to be 'highly probable'. Where these cash flows depend on an IBOR (for example, future LIBOR-based interest payments on issued debt hedged with an interest rate swap), the question arises as to whether they can be considered 'highly probable' beyond the date at which the relevant IBOR is expected to cease being published. Under the proposed amendments, an entity would assume that the current IBOR-based cash flows remain unchanged as a result of IBOR reform, and so the highly probable requirement would still be met.

### Prospective assessments (economic relationship and highly effective hedge)

Both IFRS 9 and IAS 39 require a forward-looking prospective assessment in order to apply hedge accounting. IFRS 9 requires there to be an economic relationship between the hedged item and the hedging instrument, whereas IAS 39 requires the hedge to be expected to be highly effective. Given the uncertainties arising from IBOR reform, including when IBORs will be replaced and with what rate(s), this might become difficult to demonstrate. Under the proposed relief, an entity would assume that the IBOR-based contractual cash flows of the hedging instrument and hedged item remain unchanged as a result of IBOR reform when making the prospective assessment. However, no relief is proposed from measuring and recognising all ineffectiveness (including that arising from IBOR reform) in the normal way; nor from discontinuing a hedge where, under IAS 39, it exceeds the 80–125% threshold in the retrospective effectiveness assessment.

### Risk components

In some hedges, the hedged item or hedged risk is a non-contractually specified IBOR risk component. An example is a fair value hedge of fixed-rate debt where the designated hedged risk is changes in the fair value of the debt attributable to changes in an IBOR. In order for hedge accounting to be applied, both IFRS 9 and IAS 39 require the designated risk component to be separately identifiable. Given the uncertainties arising from IBOR reform, this might cease to be the case. Under the proposed relief, entities would continue hedge accounting, provided that the component was separately identifiable when the hedge was designated. However, no relief is proposed for new hedges in which the risk component is not separately identifiable at the inception of the hedging relationship.

## When does it apply and what will happen next?

The IASB is aware that, without the reliefs, some hedges might fail to qualify for hedge accounting in the near future. It therefore aims to finalise the amendments in late 2019 and, to facilitate this, the Exposure Draft has a shorter than normal comment period, ending on 17 June 2019. The proposed effective date is accounting periods beginning on or after 1 January 2020, with earlier application permitted. It is also proposed that the amendments be applied retrospectively.

Release Date: April 2019

# Interim disclosures in the first year of applying IFRS 16 – PwC In brief

**At a glance**

After adopting IFRS 16, many companies will issue interim financial statements under IAS 34 before preparing the first annual financial statements. These interims will be the first financial statements applying IFRS 16, and so they will need additional disclosures to explain the changes. Investors, regulators and other stakeholders might focus on these disclosures.

## What is the issue?

**Interim financial statements need to disclose changes arising from IFRS 16**

For many companies, IFRS 16, the new accounting standard for leases, will materially affect the financial position and results. It is important to clearly explain the changes to regulators, investors and other key stakeholders.

IFRS 16 does not introduce disclosure requirements that are additional to IAS 34. However, paragraph 16A(a) of IAS 34 requires a description of the nature and effect of any changes to accounting policies and methods since the most recent annual financial statements. In the first year of applying IFRS 16, this means that additional disclosures are required in the interim financial statements.

## What is the impact and for whom?

**What disclosures are required in interim financial statements in the year in which IFRS 16 is adopted?**

The extent of the disclosures will depend on an entity's circumstances. Entities apply judgement to determine the extent of the disclosure, taking into consideration, for example:

- the requirements or expectations of local regulators: entities should consider any guidance issued by regulators that might require specific disclosures or information to be included in interim reports; some regulators might require all of the disclosures required in annual financial statements to be included in the interim report; and
- the significance of the changes: the extent of disclosures might vary depending on the effect on the financial statements of the initial adoption of IFRS 16; disclosures might be less extensive where the impact is not qualitatively or quantitatively material.

The disclosures might include:

- a description of the nature and effect of the change resulting from the new accounting policies (this disclosure is required by para 16A(a) of IAS 34);
- the key judgements made by management in applying IFRS 16 (for example, assessing whether an arrangement contains a lease, determining the lease term, calculating the discount rate, and whether any service/lease components of arrangements will be separated);
- details of the impact on the amounts presented in the interim financial statements, including earnings per share, the opening balance of retained earnings and alternative performance measures (where used), such as EBITDA and free cash flow;
- the transition method selected, together with any transitional practical expedients applied – entities that elect to apply the modified retrospective transition approach should consider whether the requirements of paragraphs C12-C13 of IFRS 16 for annual financial statements could be used to explain the nature and effect of the change in accounting policy; and
- disclosures specific to the entity – entities should consider whether the requirements in paragraph 28 of IAS 8, which will be applicable for the annual financial statements, could be used to explain the nature and effect of the change in accounting policy when IFRS 16 is first applied.

## When does it apply?

Interim reporting periods for years beginning on or after 1 January 2019 (that is, after IFRS 16 has been adopted).

Any interim financial statements prepared under IAS 34 before the first annual financial statements applying IFRS 16 will need to consider the above guidance (that is, for quarterly reporting, disclosure is required in all quarterly financial statements, because it will still be a change from the last annual financial statements).

## Where do I get more details?

The PwC Illustrative condensed interim financial statements provide illustrative disclosures. Alternatively, contact Jessica Taurae (jessica.taurae@pwc.com) for more information.

# The latest on IFRS 17 implementation

Release date: 5 April 2019 | No. 2019-04

## Transition Resource Group ('TRG') continues discussions on IFRS 17 implementation – PwC In transition

**In its latest meeting the TRG debated the definition, separation and measurement of an investment component in IFRS 17 and provided feedback on other submissions received**

**At a glance**

At its half day meeting on 4 April 2019, the TRG for IFRS 17 continued the discussion on implementation issues. The IASB has received 127 submissions in total, 46 of which were considered in this meeting.

The TRG meeting discussed one detailed agenda paper on investment components (covering 3 submissions). The IASB staff noted that they will propose an amendment to the definition of investment component as part of the proposed annual improvements, to be discussed at the April 2019 Board meeting. Many TRG members observed that the proposed revised definition of an investment component as an amount that the insurance contract requires the entity to repay to the policyholder in all circumstances was a helpful clarification. The staff noted that while investment components were in some cases obvious (e.g. explicit cash surrender values and account balances), in other cases, such as certain European whole life contracts and payout annuities, the amounts were implicit. In addition, for some contracts, the return of amounts to policyholders represented the refund of unearned premium rather than an investment component. The TRG observed that there might be challenges in distinguishing the amount that is a repayment of premium from an investment component, and the IASB staff will consider these concerns further.

There were 43 other submissions not meeting the submission criteria. The TRG members provided feedback on some of these, particularly the treatment of inflation assumptions, the eligibility test for the variable fee approach, and consideration of reinsurance contracts in the determination of the risk adjustment.

The IASB has not scheduled any further TRG meetings. The chair noted that he sees a continuation of the trend noted at the September 2018 TRG in that the submissions received are more narrow and relate to specific fact patterns thus not meeting the criteria for discussion. Therefore, to avoid further disruption in implementation of IFRS 17, no further TRG meetings are scheduled. However, the staff noted that submissions can continue to be made to the TRG mail box.

The views in this document are based on our observations from the meeting, and might differ in some respects from the official summary of the meeting to be published by the IASB at a later date.

## Background on the TRG

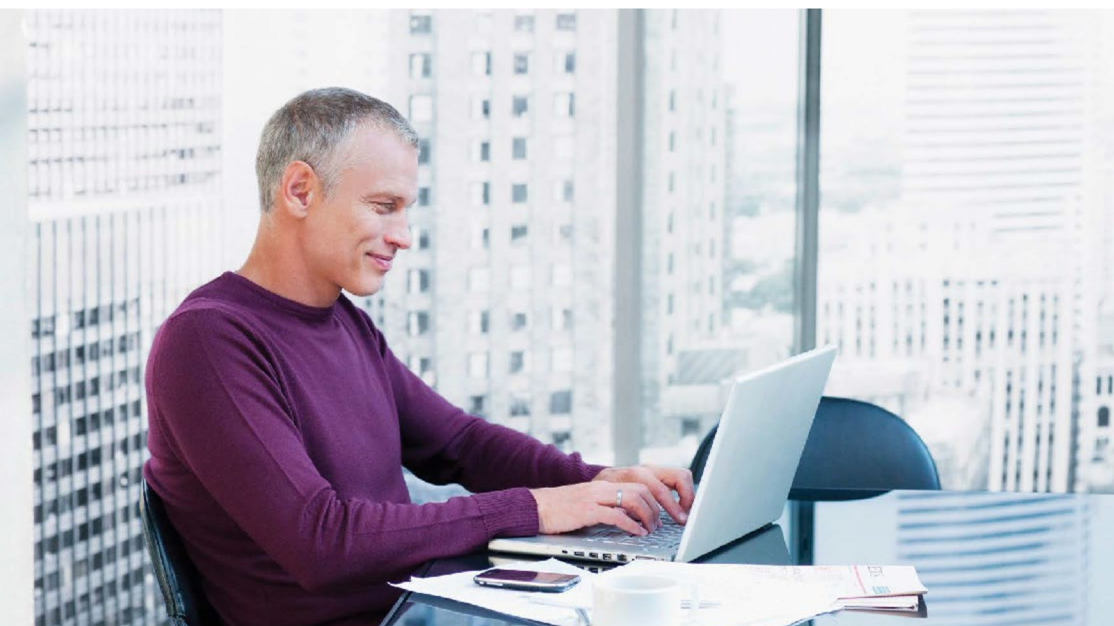
1. In connection with the issuance of IFRS 17, 'Insurance Contracts', the IASB established a working group, the TRG, to provide a public forum for stakeholders to follow the discussion of questions raised on implementation of the new standard. The TRG comprises financial statement preparers and auditors, and an additional three members with observer status representing international security regulators, insurance supervisors and actuarial organisations.
2. Overall, the purpose of the TRG is to facilitate a public discussion to provide support for stakeholders and information to the Board on implementation questions arising from the application of IFRS 17. During the meetings, the TRG members share their views on the issues. The TRG will not issue guidance. The IASB will determine what action, if any, will be taken on each issue. Possible actions include providing supporting implementation guidance, such as webinars and case studies, and/or referral to the Board for potential editorial corrections or referral to the Interpretations Committee.
3. Additional background on the issues discussed at the TRG meeting can be found on the IASB website.

## Highlights of the TRG discussions

**Summary of issues discussed**

4. The Chairman of the TRG noted that 46 submissions will be considered in the April 2019 TRG meeting, and 43 of these submissions did not meet the submission criteria requiring a detailed discussion. The trend for submissions to be more detailed and narrow in scope submissions that was noted at the September 2018 TRG meeting has continued. This may indicate both that the pace of ongoing implementation projects is increasing and that the TRG may be approaching its maturity.
5. Although there are no future scheduled TRG meetings at this time, the IASB has not precluded further TRG discussions should further issues arise. The Chairman noted that any implementation of new standards usually benefits from a quiet period to avoid any disruption to implementation.
6. There was only one detailed agenda paper (on investment components) discussed at the April 2019 meeting. In addition, the TRG members provided their views on agenda paper 2 covering 43 submissions which did not meet the submission criteria. A summary of the topics and anticipated next steps are provided in the table below, followed by a detailed description of the meeting.

| TRG Agenda ref | Topic discussed | Anticipated next steps |
|---|---|---|
| 1 Investment components within an insurance contract | The TRG provided comments on Investment components in IFRS 17, divided into 3 categories:<br>• identification of an investment component (including proposed annual improvement of definition),<br>• assessing if the investment component is distinct, and<br>• determining the amount of the investment component. | The IASB staff will report the discussions on the proposed annual improvement to the Board. |
| 2 Reporting on other questions submitted | The TRG provided feedback on some of the submissions received not meeting the submission criteria. | Some of the comments provided by TRG members will be reported back to the Board as part of the annual improvements project |



## Issues discussed at the TRG meeting

**Investment component**

7. The IASB staff noted that they have received a number of submissions about investment components, including how to determine whether an insurance contract includes an investment component, assessing whether an investment component is distinct and determining the amount of a non-distinct investment component.

### Determining whether an insurance contract includes an investment component

8. The staff noted that the current definition of an investment component in the standard is 'the amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur.' Based on requests for clarification of these words, the staff proposes to revise the definition to 'the amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances.' The Board members present and the staff indicated that the notion of amounts repayable 'in all circumstances' are words that appear in the basis for conclusions and have always been an anchoring point in the Board's principles around determining an investment component. Therefore, they view this change as a clarification rather than an amendment.

9. The staff noted that in some cases the current definition was sufficient to identify investment components, such as explicit cash surrender values and account balances in life insurance products. However, in other cases, such as certain European whole life contracts and payout annuities, the investment components may be implicit. In other cases, for example car insurance or other general insurance, the staff explained that the return of amounts to policyholders on cancellation of a contract represents the refund of unearned premium rather than an investment component.

10. Some TRG members noted that they found the proposed annual improvement helpful. However, other TRG members expressed concerns that the clarification could potentially cause confusion and disruption to the implementation process by implying a change in the scope of what preparers currently consider to be investment components. Board members noted that the new words 'in all circumstances' are already in the basis for conclusions to the standard and so do not represent an amendment.

11. A few TRG members found the distinction between a refund of premiums and definition of an investment component confusing, and some TRG members noted that a further description of a premium refund should be included in the amended standard. Some did not see the need for such a distinction given that the objective of the requirements would be the same, namely to exclude the amounts from premiums (and claims). However, the staff thought it would be a helpful clarification for some general insurance products (e.g. car insurance) to distinguish premium refunds from investment components. One Board member, emphasised that it would be important to clearly define an investment component rather than a repayment of premium, since the former would have an impact on the proposed amendment related to amortisation of the contractual service margin (CSM) for contracts under the general measurement model that include an investment return service.

12. In the staff paper it was noted that a repayment of an amount that is calibrated to reflect outstanding future coverage may represent a refund of premiums for unused coverage rather than an investment component. TRG members noted that in certain situations it would be challenging to identify whether the repaid amount is an investment component or a premium refund, as a payment could contain both. It was also suggested that the liability reconciliation required by IFRS 17 paragraph 103(c), which requires disclosure of 'investment components excluded from insurance revenue and insurance service expenses', be amended to include investment components and premium refunds, with no requirement to separate the two. One member noted that a non-distinct investment component has no effect on profit in the period, whereas a premium refund will change profit. The IASB staff agreed to consider the disclosure consideration further.

### Assessing if the investment component is distinct

13. The TRG agreed with the analysis prepared by the IASB staff on separation of distinct investment components. It was acknowledged that the hurdle for separating a distinct investment component is high, as the components usually lapse together, which is an indicator of them being non-distinct. The IASB staff noted that separation would normally only be met if clearly distinct components were combined in one contract, for example, for administrative purposes.

**Determining the amount of an investment component**

14. The TRG observed that assuming it has been determined that there is a non-distinct investment component, the determination of the amount of an investment component is performed only at the time when there is a repayment. The TRG acknowledged that there might be different methods of determining this amount. It was emphasised by several TRG members that in many cases, for example, where the contract provided for an explicit cash surrender value or explicit account balance, there was no need for an additional calculation. However, in some cases a present value calculation might be required, for example, in a non-cancellable whole life contract where a policyholder will receive a specified amount either upon death or upon maturity, which would require that the amount upon maturity be discounted back to the date of death.

15. TRG members expressed concern over the explanation provided in the staff paper where it is noted that an investment component may exist even where there is no repayment. In the staff paper it is noted that a net settlement could potentially occur because the investment component is used to pay a surrender charge. One TRG member noted that IFRS 17 only refers to a payment and contains no references to surrender charges and that the example in the staff paper is confusing. The IASB staff acknowledged the potential for confusion and will consider this further.

**Reporting on other issues submitted**

16. The TRG members welcomed many of the clarifications provided by the IASB staff for the submissions not meeting the criteria for discussions. For some of the submissions TRG members requested further clarifications or more guidance, and for some of the submissions TRG members expressed concerns over the guidance in the staff paper:
    - Several TRG members expressed concern over submission S122 on inflation assumptions based on an index. The staff response noted that changes in cash flows determined using inflation indices should be considered as relating to financial risk and therefore immediately recognised in income or loss rather than CSM. Some TRG members thought that changes in estimates of fulfilment cash flows caused by changes in inflation assumptions are changes relating to financial risk only where there is a contractual requirement to adjust payments for inflation. Conversely, when a specified inflation index is used to set an entity's own expectations of future nominal cash flows, those inflation assumptions represent 'assumptions about inflation based on an entity's expectation of specific price changes' as noted in B128(b) and therefore 'are not assumptions that relate to financial risk.' The entity chose to use an inflation index to estimate its future costs, but equally could have used some other estimation method (e.g. looking at historical trends in cost increases that implicitly included the impact of inflation).
    - TRG members noted that S115 focusing on paragraph B101(b) scope determination for the variable fee approach was a helpful clarification. However, it was noted that some further examples on the assessment of the requirements would be useful, including consideration of the application of paragraph B101(c). A few TRG members noted that in the example provided, the charge for the insurance cover is fixed and does not vary with the underlying items, whereas for many contracts the mortality fee may be stated as a percentage of the account balance which staff noted is a different fact pattern. Consequently, different fact patterns and charging structures might lead to different outcomes.
    - For submission S118 related to whether the effect of reinsurance should be considered in determining the risk adjustment for non-financial risk for contracts that have been reinsured, TRG members appreciated the response from staff. Some people have disagreed with the example in the staff paper. The staff emphasised that there were two key messages: (1)the cost of reinsurance (not just the benefits) should be considered in the analysis and (2) the risk adjustment for reinsurance contracts held represents the amount of risk being transferred by the holder to the reinsurer (in the example 50% of the risk adjustment of CU25). In submission S119 the IASB staff clarified that any risk of non-performance by the reinsurer is not transferred to the reinsurer, and thus this should not be considered in the risk adjustment for non-financial risks, but should instead be included in the estimates of fulfilment cash flows.
    - Staff noted TRG members' feedback on Submission S92, related to clarification of the treatment of changes in underlying items under the general model. These are required to be treated as changes in investments and therefore as changes in assumptions relating to financial risk. Some TRG members noted that the underlying items themselves are not necessarily related to changes in financial assumptions (e.g. where they relate to mortality experience). The staff will consider this feedback further
    - The staff noted a proposed annual improvement arising from the submissions (S101, S120 and S124) on the treatment of changes in the risk adjustment for non-financial risk due to the time value of money and financial risk. The proposed amendment will clarify that if an entity chooses to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and financial risk for presentation purposes, this will also apply for measurement purposes, i.e. only the change relating to future insurance service will adjust CSM.

## What’s next?

17. All of the 127 submissions have been considered by either a detailed TRG discussion or reported to the TRG. Of these submissions 49 have been discussed in detailed discussions and the remaining 78 submissions have been reported to the TRG classified by those that: (a) can be answered applying only the words in IFRS 17; (b) do not meet the submission criteria; or (c) are being considered through a process other than a TRG discussion (such as a proposed annual improvement).

18. In the April 2019 IASB Board meeting a summary of all the proposed amendments and annual improvements will be considered by the Board. If the Board decides to continue with the proposed amendments, the staff will request to start the balloting process for issuance of an exposure draft. The Staff will also request the Due Process Oversight Committee to approve a shorter than usual comment period for the exposure draft.

19. The IASB will prepare a report of the TRG meeting, expected to be made publicly available within two working weeks from the meeting date.

## Word on a Wharf

The board met on Tuesday 9 to Thursday 11 April2019 at the IFRS Foundation's Offices in London

The topics, in order of discussion, were:

- Amendments to IFRS 17 Insurance Contracts
- Business Combinations under Common Control
- Accounting Policies and Accounting Estimates (Amendments to IAS 8)
- Implementation matters
- Disclosure Initiative —Accounting Policies
- Research programme update
- Management Commentary
- Primary Financial Statements
- Goodwill and Impairment
- Dynamic Risk Management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