In depth

A look at current financial reporting issues

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Practical guide to Phase 2 amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 for interest rate benchmark (IBOR) reform

At a glance

The IASB has issued amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 that address issues arising during the reform of benchmark interest rates including the replacement of one benchmark rate with an alternative one. Given the pervasive nature of IBOR-based contracts, the amendments could affect companies in all industries. The amendments are effective from 1 January 2021. This publication provides guidance on how to apply the Phase 2 amendments to various contracts and hedge accounting relationships, including the interaction with the Phase 1 reliefs for hedge accounting.

Refer here for frequently asked questions relating to the Phase 2 amendments.

What's inside?

1. Key highlights

Benchmark interest rates are a core component of global financial markets. Retail and commercial loans, corporate debt, derivatives and securitisation transactions all rely on these benchmark interest rates for pricing contracts and for hedging interest rates.

The London Interbank Offered Rate ('LIBOR') is one of the most common series of benchmark interest rates, referenced by contracts measured in trillions of dollars across global currencies. Following the financial crisis, calls grew to reform the process used to generate LIBOR (including USD LIBOR, JPY LIBOR, CHF LIBOR and GBP LIBOR) and other benchmark interest rates.

As a result, the replacement of benchmark interest rates such as LIBOR and other interbank offered rates ('IBORs') has become a priority for global regulators. The Financial Stability Board's July 2014 report 'Reforming Major Interest Rate Benchmarks' set out recommendations for the reform of certain benchmarks. As a result, many jurisdictions are in the process of transitioning to alternative benchmark rates.

The reforms aim to achieve a shift away from individual quotes to observed transaction rates, and to increase the population on which those rates are based. Since the changes are market driven, there remains some uncertainty around their timing and precise nature. However, a summary of the position, at the time of writing (October 2020), for some of the most used benchmark rates is as follows:

Benchmark Rate	USD LIBOR	GBP LIBOR	EONIA	CHF LIBOR	JPY LIBOR
Selected Alternative Rate	SOFR Secured Overnight Financing Rate	SONIA Reformed Sterling Overnight Index Average	€STR* Euro Short-Term Rate	SARON Swiss Average Rate Overnight	TONA Tokyo Overnight Average rate
Working Group	Alternative Reference Rates Committee (ARRC)	Working Group on Sterling Risk-Free Rates	Working Group on Euro RFR	National Working Group on Swiss Franc reference rates (NWG)	Cross-Industry Committee on JPY Interest Rate Benchmarks
Nature	Secured	Unsecured	Unsecured	Secured	Unsecured
Methodology	Fully transaction-based	Fully transaction-based	Fully transaction-based	Transaction- and binding quotes-based	Fully transaction-based
Overnight versus Term	Overnight rate	Overnight rate	Overnight rate	Overnight rate	Overnight rate
Term Rate Availability	Targeted for H1 2021, moved up from original target date of end of 2021	Forward term rate planned by end of 2020	WG recommended OIS quotes-based methodology for forward term rate	Use of compounded SARON recommended – robust term rate seen as unlikely	Planned: a vendor to calculate term rates has been selected and publication is expected by mid-2021

** €STR is expected to co-exist with local IBOR in a multi-rate environment. The phase-in of all EURIBOR banks to the hybrid methodology for EURIBOR was completed in November 2019 and, at the time of writing (October 2020), the final recommendations on EURIBOR provisions and fallback benchmarks for cash and derivatives are expected in Q1 2021.*

Who might IBOR replacement affect and how?

Financial institutions are likely to be most heavily affected by IBOR replacement, given the significant extent of their direct exposure to IBOR-linked financial instruments. However, IBOR reform might also be a significant issue for corporates with IBOR-based debt funding, or with fixed-rate funding that is hedged using IBOR-based derivatives, and for lessees with lease payments that are indexed to an IBOR rate.

Even if an entity does not have any contracts referencing an IBOR, it might still use an IBOR in constructing certain discount rates used in financial reporting, such as in calculating an asset's 'value in use' when assessing it for impairment or fair values in accordance with IFRS 13, and so it might still be affected by these changes.

The impacts of IBOR replacement are potentially wide-ranging, and they are likely to include all of risk management, legal, IT and financial reporting. This publication focuses on only one aspect of the reforms, namely the implications for financial reporting under IFRS. For publications on the latest developments in IBOR replacement, and for further reading on other aspects of IBOR replacement, visit our LIBOR reference rate and reform insights page.

What is the impact of the Phase 2 amendments?

The IASB has undertaken a two-phase project to consider what, if any, reliefs to give from the effects of IBOR reform. The Phase 1 amendments, issued in September 2019, provided temporary reliefs from applying specific hedge accounting requirements to relationships affected by IBOR reform. The Phase 2 amendments that were issued in August 2020 address issues that arise during the reform of an interest rate benchmark rate, including the replacement of one benchmark rate with an alternative one.

The key reliefs provided by the Phase 2 amendments are as follows:

- **Changes to contractual cash flows**. When changing the basis for determining contractual cash flows for financial assets and liabilities (including lease liabilities), the reliefs have the effect that the changes that are required by an interest rate benchmark reform (that is, are necessary as a direct consequence of IBOR reform and are economically equivalent) will not result in an immediate gain or loss in the income statement.

- **Hedge accounting**. The hedge accounting reliefs will allow most IAS 39 or IFRS 9 hedge relationships that are directly affected by IBOR reform to continue. However, additional ineffectiveness might need to be recorded.

This publication provides a detailed explanation of each of these reliefs – see Sections 2 to 6.

2. Phase 2 amendments – Changes in the basis for determining contractual cash flows of financial assets and financial liabilities as a result of IBOR reform

The basis for determining the contractual cash flows of financial assets or financial liabilities to which the amortised cost measurement applies can change as a result of IBOR reform.

Such changes can be due to:

- an amendment to the contractual terms specified at initial recognition (for example, if the contract is amended to replace the benchmark rate with an alternative one);
- a change that was not considered or contemplated in the contractual terms at initial recognition (for example, if the method of calculating the benchmark rate is changed, even though the contractual terms are not); or

- the activation of an existing contractual term (for example, triggering of an existing fallback clause in a contract).
  [IFRS 9 para 5.4.5]. [IFRS 9 para 5.4.6].

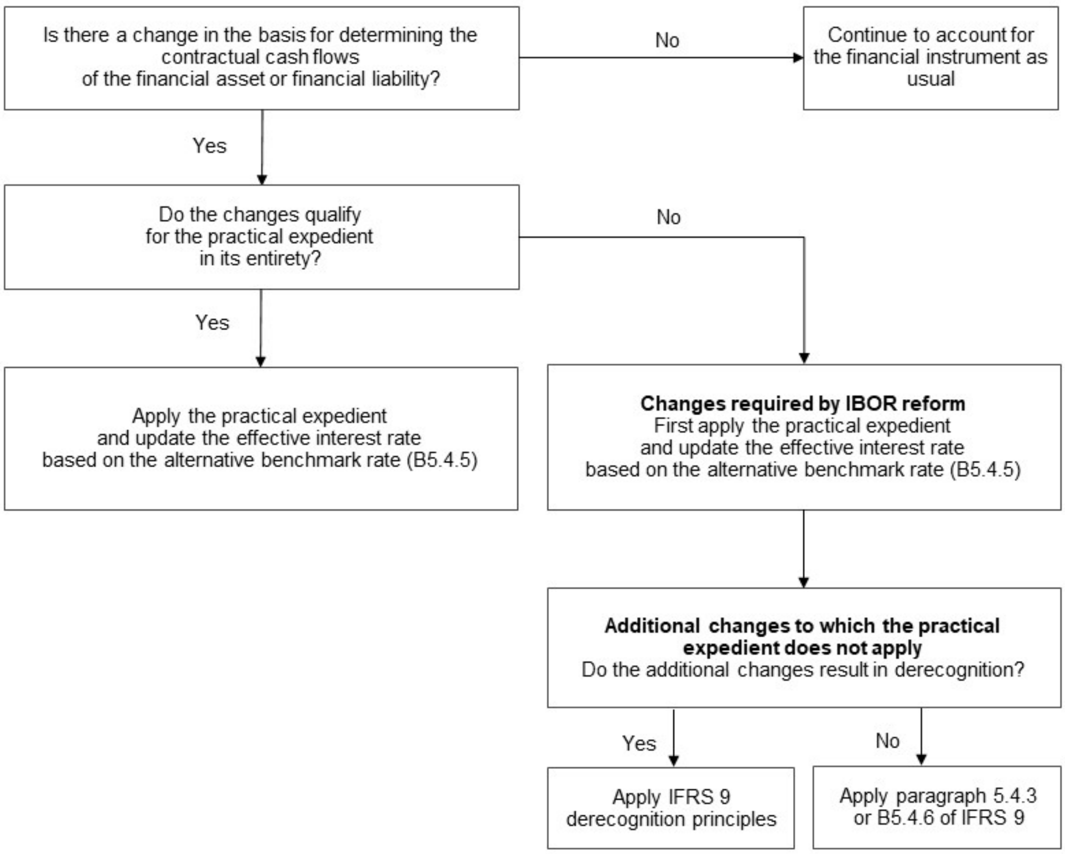
The Phase 2 amendments provide a practical expedient to account for these changes in the basis for determining contractual cash flows as a result of interest rate benchmark reform.

Under the practical expedient, entities will account for these changes by updating the effective interest rate using the guidance in paragraph B5.4.5 of IFRS 9 without the recognition of an immediate gain or loss. This practical expedient applies only to such a change and only to the extent that it is necessary as a direct consequence of interest rate benchmark reform, and the new basis is economically equivalent to the previous basis. [IFRS 9 para 5.4.7]. The Phase 2 amendments provide a number of examples of what is considered to be ‘economically equivalent’. [IFRS 9 para 5.4.8].

Without the practical expedient, an entity would need to consider whether these changes result in the derecognition of the financial asset or financial liability. If the changes did not result in derecognition, an entity would have had to apply either paragraph 5.4.3 or B5.4.6 of IFRS 9 to the changes. This would mean recalculating the carrying amounts and recognising a gain or loss immediately in the income statement, while continuing to recognise interest income or expense using the original effective interest rate. [IFRS 9 paras BC5.302–BC5.305].

If there are changes in addition to those required by IBOR reform, an entity will first apply the practical expedient and then apply the other applicable requirements in IFRS 9 to the additional changes to which the practical expedient does not apply. [IFRS 9 para 5.4.9].

The following flowchart illustrates the typical steps that an entity will follow when applying the practical expedient:



As part of the Phase 2 amendments, the IASB considered other IFRS 9 classification and measurement issues in the context of IBOR reform and concluded that the standard provides an adequate basis to determine the required accounting. These matters include:

- *Derecognition:* Derecognition of financial assets and financial liabilities and the recognition of the resulting gain or loss following a substantial modification because of IBOR reform.
- *Business model:* Whether changes in the basis for determining contractual cash flows resulting from the reform affects an entity's business model for managing financial assets following the derecognition of a financial asset.
- *SPPI:* Whether the interest component of the contractual cash flows of a financial asset referenced to an alternative benchmark rate meets the criteria for solely payments of principal and interest (SPPI).
- *Expected credit losses:* The recognition of the expected credit losses for a new financial asset following a substantial modification as a result of the reform.
- *Embedded derivatives:* Whether an entity must reassess whether an embedded derivative is required to be separated from a financial liability host contract, and whether the practical expedient applies to hybrid financial liabilities that have been separated into a host contract and an embedded derivative.

[IFRS 9 paras BC5.319–BC5.320].

3. Phase 2 amendments to IFRS 4 for insurers

IFRS 4 permits insurers to continue to apply IAS 39, instead of adopting IFRS 9, if their activities are 'predominantly connected with insurance' and IFRS 9 has not previously been applied. This temporary exemption to apply IAS 39 will cease to be applicable when IFRS 17 becomes effective on 1 January 2023.

The Phase 2 amendments will require insurers that are applying the temporary exemption from IFRS 9 (that is, they are still applying IAS 39) to also apply the same practical expedient as under IFRS 9 for changes in the basis for determining contractual cash flows of financial assets and financial liabilities as a result of IBOR reform. [IFRS 4 paras 20R, 20S].

The practical expedient is discussed further in 'Section 2. Phase 2 amendments - Changes in the basis for determining contractual cash flows of financial assets and financial liabilities as a result of IBOR reform'.

4. Phase 2 amendments to IFRS 16, 'Leases'

Some leases might include variable lease payments that are referenced to a benchmark interest rate subject to IBOR reform. IFRS 16 requires lessees to include these variable lease payments in the measurement of their lease liabilities. [IFRS 16 para BC267C].

IFRS 16 has been amended to include a practical expedient, for all leases that are modified, to change the basis for determining future lease payments as a result of IBOR reform. As a practical expedient, a lessee will remeasure the lease liability by discounting the revised lease payments using a discount rate that reflects the change in the interest rate. This practical expedient applies only if the lease modification is necessary as a direct consequence of IBOR reform, and the new basis for determining the lease payments is economically equivalent to the previous basis. [IFRS 16 para 105].

If lease modifications are made in addition to those required by IBOR reform, an entity will be required to apply applicable IFRS 16 requirements to account for all lease modifications made at the same time, including those required by IBOR reform. [IFRS 16 para 106].

The IASB decided not to amend requirements for lease modifications from a lessor's perspective. For finance lease modifications, the Board noted that a lessor would be required to apply IFRS 9 to those modifications. As a result, a finance lessor would be required to apply the practical expedient relief for modifications required by the reform (see 'Section 2. Phase 2 Amendments - Changes in the basis for determining contractual cash flows of financial assets and financial liabilities as a result of IBOR reform'). In addition, the Board noted that, for operating leases, lessors should follow the modification guidance in IFRS 16. [IFRS 16 para BC267J].

5. Phase 2 amendments to IAS 39 and IFRS 9 hedge accounting

The Phase 2 amendments address replacement issues (that is, where changes are made to hedging relationships as a result of the transition to alternative benchmark rates). The Phase 2 amendments require an entity to amend the hedging relationship, to reflect the changes required by IBOR reform, where the uncertainty arising from the reform is no longer present with respect to the hedged risk or the timing and the amount of IBOR-based cash flows of the hedging item or of the hedging instrument. As a result, hedge relationships within the scope of the Phase 1 reliefs will also be within the scope of the Phase 2 amendments, with the exception of the separately identifiable requirement which will also apply to new hedge designations. [IFRS 9 para BC6.604]. [IAS 39 para BC296].

5.1 Summary of the Phase 1 reliefs

The Phase 1 amendments provided temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform.

The following table summarises the key Phase 1 reliefs, including when each of the reliefs prospectively ceases to apply:

Key relief		**End of relief**
'Highly probable' requirement	Cash flow hedge accounting under both IFRS 9 and IAS 39 requires the future hedged cash flows to be 'highly probable'. The relief requires an entity to assume that the interest rate on which the hedged cash flows are based does not change as a result of the reform. Hence, where the cash flows might change as a result of benchmark reform, the reliefs allow the hedge relationship not to fail because of the reform.	Ceases to apply to a hedged item at the earlier of (a) when there is no longer uncertainty arising from IBOR reform over the timing and amount of IBOR-based cash flows of hedged item, and (b) when the hedging relationship is discontinued.
Prospective assessments	Both IAS 39 and IFRS 9 require a forward-looking prospective assessment in order to apply hedge accounting. IAS 39 requires the hedge to be expected to be highly effective, whereas IFRS 9 requires there to be an economic relationship between the hedged item and the hedging instrument. Under the relief, an entity assumes that the interest rate benchmark on which the cash flows of the hedged item, hedging instrument or hedged risk are based is not altered by IBOR reform.	Ceases to apply to: • a hedged item at the earlier of (a) when there is no longer uncertainty arising from IBOR reform with respect to the hedged risk or over the timing and amount of IBOR-based cash flows, and (b) when the hedging relationship is discontinued. • a hedging instrument at the earlier of (a) when there is no longer uncertainty arising from IBOR reform over the timing and amount of IBOR-based cash flows, and (b) when the hedging relationship is discontinued.

Key relief		End of relief
IAS 39 retrospective effectiveness test exception	IBOR reform might cause a hedge to fall outside the required 80–125% range. The relief provides an exception to the retrospective effectiveness test, such that a hedge is not discontinued during the period of IBOR-related uncertainty solely because the retrospective effectiveness falls outside this required 80–125% range.	Ceases to apply at the earlier of (a) when there is no longer uncertainty arising from IBOR reform with respect to the hedged risk and the timing and amount of IBOR-based cash flows of the hedged item or of the hedging instrument, and (b) when the hedging relationship is discontinued. See updated end of relief date as part of the Phase 2 amendments in 'Section 5.2 End of Phase 1 reliefs provided by the Phase 2 amendments'.
Recycling of the cash flow hedging reserve	Under IAS 39 and IFRS 9, entities are required to recycle a cash flow hedge reserve if the hedged cash flows are no longer expected to occur. The relief requires an entity to assume that the interest rate on which the hedged cash flows are based does not change as a result of the reform.	Cease to apply at the earlier of (a) when there is no longer uncertainty arising from IBOR reform over the timing and amount of IBOR-based future cash flows of the hedged item, and (b) when the entire amount in the cash flow reserve for the discontinued hedge has been recycled to profit or loss.
Risk components	In some hedges, the hedged item or hedged risk is a non-contractually specified IBOR risk component. In order for hedge accounting to be applied, both IAS 39 and IFRS 9 require the designated risk component to be separately identifiable and reliably measurable. Under the relief, the risk component only needs to be separately identifiable at initial hedge designation, and not on an ongoing basis. In the context of a macro hedge, where an entity frequently resets a hedging relationship, the relief applies from when a hedged item was initially designated within that hedging relationship.	The Phase 1 amendments did not provide an end date for the risk components relief. See end of relief date as part of the Phase 2 amendments in 'Section 5.2 End of Phase 1 reliefs provided by the Phase 2 amendments'.

[IFRS 9 paras 6.8.4–6.8.12]. [IAS 39 paras 102D–102N].

5.2 End of Phase 1 reliefs provided by the Phase 2 amendments

Non-contractually specified risk components in hedging relationships

The Phase 2 amendments provide an end date for the Phase 1 relief for non-contractually specified risk components (IFRS 9) and non-contractually specified risk portions (IAS 39) relief. These are referred to as 'non-contractually specified risk components' in this publication. The relief will prospectively cease to apply at the earlier of (a) when changes required by the reform are made to the non-contractually specified risk component, or (b) when the hedging relationship is discontinued. [IFRS 9 para 6.8.13]. [IAS 39 para 102O].

Retrospective effectiveness assessment (IAS 39 only)

The reliefs from the retrospective effectiveness assessment, for IAS 39 only, end under the Phase 1 amendments at the earlier of (a) when the uncertainty arising from IBOR reform is no longer present with respect to the hedged risk and the timing and amount of the cash flows of the hedged item **or** the hedging instrument, and (b) when the hedging relationship is discontinued.

The Phase 2 amendments extend the end of the relief to the earlier of (a) when the uncertainty arising from IBOR reform is no longer present with respect to the hedged risk and the timing and amount of the cash flows of the hedged item **and** the hedging instrument, and (b) when the hedging relationship is discontinued. [IAS 39 para 102M].

5.3 Amendments to the formal designation of hedge relationships

Temporary exception for changes made to the hedge designation and hedge documentation

When an entity ceases to apply the Phase 1 reliefs (see summary of the reliefs in Section 5.1 above), the Phase 2 amendments require an entity to make changes to the formal designation of the hedge relationship, to reflect the changes that are required by IBOR reform. Similar to the practical expedient for changes in the basis of contractual cash flows of financial assets and financial liabilities, the change needs to be required by interest rate benchmark reform, which means the following two conditions need to be met: the change is necessary as a direct consequence of interest rate benchmark reform, and the new basis is economically equivalent to the previous basis. The hedge designation shall, in this context, be amended only to make one or more of the following changes:

- designating an alternative benchmark rate as a hedged risk;
- amending the description of the hedged item (including the description of the designated portion of the cash flows or fair value being hedged);
- amending the description of the hedging instrument; or
- amending the description of how the entity will assess hedge effectiveness (IAS 39 only).

[IFRS 9 para 6.9.1]. [IAS 39 para 102P].

The hedge designation will be required to be amended by the end of the reporting period during which a change required by IBOR reform is made to the hedged risk, hedged item or hedging instrument. Amending the formal designation of a hedging relationship, as required by this temporary exception, is not the discontinuation of the hedge relationship nor the designation of a new hedging relationship. [IFRS 9 para 6.9.4]. [IAS 39 para 102S].

Amending the description of the hedging instrument

An entity should also amend the hedge designation relating to the hedging instrument if the following three conditions are met:

- the entity makes a change required by IBOR reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument;
- the original hedging instrument (for example, the derivative) is not derecognised; and
- the approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument.

[IFRS 9 para 6.9.2]. [IAS 39 para 102Q].

Additional changes other than those required by IBOR reform

If additional changes other than those required by IBOR reform are made, an entity will first apply the applicable IAS 39 or IFRS 9 hedge accounting requirements to determine if the changes result in the discontinuance of hedge accounting. If the changes do not result in the discontinuance of hedge accounting, the entity will amend the designation of the hedge relationship using the temporary exception. [IFRS 9 para 6.9.5]. [IAS 39 para 102T].

Amendments to the formal designation of hedge relationships at different times

The Phase 1 reliefs (see a summary of the reliefs in Section 5.1 above) might cease to apply at different times. When applying the temporary exception to amend the formal designation, an entity might be required to:

- amend the formal designation of different hedging relationships at different times, or
- amend the formal designation of a specific hedging relationship more than once (for example, due to changes to the hedging instrument or the hedged item).

[IFRS 9 para 6.9.3]. [IAS 39 para 102R].

An entity amending the hedge designation should apply the accounting reliefs related to cash flow hedging, group of items and risk components, as applicable. [IFRS 9 para 6.9.3]. [IAS 39 para 102R]. These accounting reliefs are discussed in Sections 5.4 to 5.6 below.

5.4 Accounting for qualifying hedge relationships

No exception for the measurement of hedged items or hedging instruments

An entity will apply the existing requirements in IAS 39 or IFRS 9 for qualifying fair value and cash flow hedging relationships to account for any changes in the fair value of the hedged item or hedging instrument. [IFRS 9 paras 6.5.8, 6.5.11, 6.9.3]. [IAS 39 paras 89, 96, 102R].

The IASB has not provided any exception to the measurement of hedged items or hedging instruments. This is because such an exception would be inconsistent with the decision not to change the requirements to measure and recognise hedge ineffectiveness.

Due to the economically equivalent requirement, the IASB also does not expect that there will be a significant change in fair value arising from the remeasurement of the hedged item or hedging instrument.

No exception for the recognition and measurement of ineffectiveness

There is no exception for the recognition and measurement of hedge ineffectiveness. The IAS 39 and IFRS 9 hedge accounting requirements will need to be applied, and any resulting ineffectiveness recognised in the income statement. [IFRS 9 paras BC6.626–BC6.627]. [IAS 39 paras BC319–BC320]. In the IASB's view, this reflects the economic effects of the amendments to the formal designation of a hedging relationship. The Board further noted that the temporary exception to amend the description of the hedged item enables an entity to change the hedging relationship in a way that minimises the change in fair value on the remeasurement of the hedged item or hedging instrument. [IFRS 9 para BC6.624]. [IAS 39 para BC317].

Temporary exception for amounts accumulated in the cash flow hedge reserve

At the point when an entity amends the description of a hedged item under the temporary exception to amend the hedge designation and documentation (see 'Section 5.3 Amendments to the formal designation of hedge relationships' above), the amounts accumulated in the cash flow hedge reserve are deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined. [IFRS 9 para 6.9.7]. [IAS 39 para 102W].

The Phase 2 amendments also provide for a similar temporary exception for discontinued cash flow hedges when the benchmark interest rate on which the hedged future cash flows were based has changed, as required by IBOR reform, where the amount accumulated in the cash flow hedge reserve for that hedging relationship shall be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based. [IFRS 9 para 6.9.8]. [IAS 39 para 102X].

Temporary exception for the retrospective effectiveness test (IAS 39 only)

For the purposes of assessing retrospective effectiveness of a hedge relationship on a cumulative basis, an entity may elect, on an individual hedging relationship basis, to reset to zero the cumulative fair value changes of the hedged item and hedging instrument when ceasing to apply the retrospective effectiveness assessment relief provided by the Phase 1 amendments (see summary of the Phase 1 reliefs in Section 5.1 above). [IAS 39 para 102V].

PwC Observation

The Phase 1 IAS 39 retrospective effectiveness test relief provides an exception to the retrospective effectiveness test such that a hedge is not discontinued during the period of IBOR-related uncertainty solely because the retrospective effectiveness falls outside this required 80–125% range. When this Phase 1 relief ceases to apply, an entity will be required to assess the retrospective effectiveness of the hedge relationship. If this assessment is done on a cumulative basis, the hedging relationship might fail the retrospective test. The IASB noted that this would be inconsistent with the objective of Phase 1. The Phase 2 amendments therefore allow entities that carry out the assessment on a cumulative basis to elect either to reset or to not reset the cumulative fair value hedged item and hedging instrument to zero.

The IASB allowed a choice to reset because, in some cases, if an entity were to reset to zero, it might cause the hedging relationship to fail the retrospective test. For example, a hedging relationship might fall outside the 80–125% range if there is market volatility during the initial period after the transition to the alternative benchmark rate, and the entity were to reset to zero. [IAS 39 paras BC322–BC324].

5.5 Accounting for hedges of groups of items

When applying the ‘changes to hedge designations and hedge documentation’ temporary exception (see ‘Section 5.3 Amendments to the formal designation of hedge relationships’ above) to groups of items, hedged items are allocated to sub-groups based on the benchmark rate being hedged, and the benchmark rate for each sub-group is designated as the hedged risk. As a result, some items in the group could be changed at different times. [IFRS 9 para 6.9.9]. [IAS 39 para 102Y].

Each sub-group will be required to be assessed separately, to determine whether it meets the requirements for an eligible hedged item. [IFRS 9 para 6.6.1]. [IAS 39 paras 78, 83]. Hedge accounting will be discontinued prospectively, for the hedging relationship in its entirety, if any sub-group fails to meet the eligible hedged item requirements. An entity should also account for the ineffectiveness related to the hedging relationship in its entirety. [IFRS 9 para 6.9.10]. [IAS 39 para 102Z].

5.6 Designation of risk components and portions

An alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable, at the date when it is designated, will be deemed to have met the requirements at that date if the entity reasonably expects that it will meet the requirements within a period of 24 months. The 24-month period will:

- apply to each alternative benchmark rate separately (on a rate-by-rate basis); and
- begin from the date when the entity designates the alternative benchmark rate as a non-contractually specified risk component for the first time.

[IFRS 9 para 6.9.11]. [IAS 39 para 102Z1].

The non-contractually specified risk component will, however, be required to be reliably measurable.

If, at a later date, the entity reasonably expects that the alternative benchmark rate will not be separately identifiable within the 24-month period, it will cease to apply the temporary exception and prospectively discontinue hedge accounting from the date of that reassessment. [IFRS 9 para 6.9.12]. [IAS 39 para 102Z2].

This relief will similarly apply to new hedging relationships where the alternative benchmark rate is not separately identifiable at the date when the non-contractually specified risk component is designated. [IFRS 9 para 6.9.13]. [IAS 39 para 102Z3].

6. Disclosures

The objective of the disclosures required by the Phase 2 amendments is to enable users of financial statements to understand the effect of IBOR reform on an entity's financial instruments and risk management strategy. An entity needs to disclose information about the nature and extent of risks arising from IBOR reform to which the entity is exposed, how the entity manages those risks, and the entity's progress in completing the transition to alternative benchmark rates and how it is managing that transition. [IFRS 7 para 24I].

To meet these objectives, the Phase 2 amendments require disclosure of:

- how the entity is managing the transition to alternative benchmark rates, its progress and the risks to which it is exposed arising from financial instruments because of the transition;
- disaggregated by significant interest rate benchmark subject to IBOR reform, quantitative information about financial instruments that have yet to transition to an alternative benchmark rate at the end of the reporting period, showing separately non-derivative financial assets and liabilities, and derivatives; and
- if the risks identified have resulted in any changes to an entity's risk management strategy, a description of these changes.

[IFRS 7 para 24J].

7. Effective date and transition

Effective date

The amendments should be applied for annual periods beginning on or after 1 January 2021. Earlier application is permitted. [IFRS 9 para 7.1.9]. [IAS 39 para 108H]. [IFRS 7 para 44GG]. [IFRS 4 para 50]. [IFRS 16 App C para C1B].

Transitional requirements for the amendments to IFRS 9, IAS 39, IFRS 4 and IFRS 16

The amendments to IFRS 9, IAS 39, IFRS 4 and IFRS 16 are to be applied retrospectively. However, the amendments provide relief from restating comparative information. An entity may restate prior periods if, and only if, it is possible to do so without the use of hindsight.

If an entity does not restate prior periods, it recognises any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of the Phase 2 amendments in the opening retained earnings (or other component of equity, as appropriate) of the reporting period that includes the date of initial application of the amendments. [IFRS 9 para 7.2.46]. [IAS 39 para 108K]. [IFRS 4 para 51]. [IFRS 16 App C paras C20C, C20D].

Transitional requirements for the amendments to IFRS 7

The amendments to IFRS 7 apply when an entity applies the Phase 2 amendments to IFRS 9, IAS 39, IFRS 4 and IFRS 16. In the reporting period when an entity first applies the Phase 2 amendments, it is not required to present that quantitative information required by paragraph 28(f) of IAS 8. [IFRS 7 paras 44GG, 44HH].

Reinstating discontinued hedges

An entity is prohibited from designating a new hedge accounting relationship in prior periods. However, discontinued hedging relationships are required to be reinstated if, and only if, the following two conditions are met:

- the hedge relationship was discontinued solely due to changes required by IBOR reform (and would not have been discontinued if the Phase 2 reliefs had been available); and
- at the date of initial application, the discontinued hedging relationship continues to meet all qualifying criteria for hedge accounting (after taking the Phase 2 reliefs into account).

[IFRS 9 para 7.2.44]. [IAS 39 para 108I].

If an entity reinstates a discontinued hedging relationship, the 24-month period for a non-contractually specified risk component begins from the date of initial application of the Phase 2 amendments (see 'Section 5.6 Designation of risk components and portions'). [IFRS 9 para 7.2.45]. [IAS 39 para 108J].

PwC Observation

We expect that entities planning on making IBOR-related amendments to contracts in 2020 will choose to early adopt the Phase 2 amendments as soon as possible (subject to any local endorsement requirements).

If an entity adopts the amendments in 2021 and adoption has a measurement impact, either due to the reinstatement of hedges previously discontinued due to uncertainty arising from IBOR reform, or due to reversal of previous modification gains / losses for changes in the basis of determining contractual cash flows to the extent that it was required by IBOR reform, then in 2020 the entity will already have had to:

1. identify those hedges affected and compute the accounting entries to discontinue the hedge accounting for 2020, prior to reinstatement in the following year;
2. identify those financial instruments that have been modified and compute the modification gain / loss; and
3. disclose, under paragraph 30(b) of IAS 8, the possible impact of adopting these amendments in 2021, which would generally be expected to be reasonably estimable by continuing to apply the previous hedge accounting (for 1 above) or using the new cash settlements to compute the paragraph B5.4.5 accounting (for 2 above).

This would result in a significant amount of work being performed in 2020, solely to be undone on adoption in 2021. Early adoption would therefore result in less disruption from an accounting perspective.

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