Quick read - IBOR reform: Accounting and reporting considerations for corporates

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At a glance

Regulators have agreed on the new interest rate benchmarks to replace existing benchmark interest rates such as Singapore inter-bank offered rate (“SIBOR”) and other inter-bank offered rates (“IBOR”). These new alternative rates are likely to impact corporates in several ways, including but not limited to, the following:

Potential accounting issues		Available reliefs		Possible action(s)
1. Hedge accounting will need to be discontinued due to uncertainties brought about by IBOR reform.	+	The Phase 1 and Phase 2 SFRS(I) 9 amendments provide specific reliefs to prevent discontinuation of hedge accounting solely due to IBOR reform.	→	Adopt the reliefs for annual period beginning on or after 1 January 2020 (Note: The amendment does not provide relief from recognising hedge ineffectiveness).
2. Hedges using IBOR-based derivatives may no longer be effective or there may be elements of ineffectiveness brought about by IBOR reform.	+	None	→	While the Phase 1 amendments provide relief from discontinuing hedge accounting, it does not provide relief from recognising hedge ineffectiveness. Hedge ineffectiveness may arise due to expected timing difference in transiting the hedged items and the hedging derivatives to new benchmark reference rates.
3. Debt instruments (including lease liabilities and financing receivables) with IBOR-based terms will need to be re-measured when the new rates are negotiated with the lenders.	+	Phase 2 amendments provides practical expedients on amendments to debt instruments if certain criteria are met.	→	Apply the practical expedients for annual period beginning on or after 1 January 2021 to limit the re-measurement impact on profit and loss.
4. Effects of the changes in benchmark rates could impact valuation of IBOR-linked instruments as well as the inputs used in valuation models in other standards such as discount rates.	+	None	→	The liquidity for IBOR-linked instruments will decline in value over time. Use of IBOR as inputs to the valuation model may also become inappropriate when IBORs are no longer liquid. Entities will need to assess when the change will impact inputs to valuation models used for other areas.

Accounting and reporting considerations

What can corporates do now?

Given the replacement of IBOR affecting a significant number of financial arrangements across entities, it is imperative that entities should start to identify and inventorise their contracts with references to existing benchmark rate.

With the reduced liquidity for IBOR-linked instruments over time, the reduced trading volumes could lead to change in pricing of these products. Therefore, entities will need to quickly reduce their IBOR exposure and review their investment strategy which includes the evaluation on when to transition to the new reference rate-linked instruments.

Examples of items that could have IBOR references include:

- Revenue: Customer contracts with variable rate payment penalties
- Hedging: Interest rate derivatives used to hedge debt instruments
- Debt instruments: Loans receivable or payable, receivable or supplier factoring arrangements, inter-company loans
- Leases: Lease receivable, lease liabilities

What are the accounting implications?

(a) Reliefs and practical expedients available

The Phase 1 and Phase 2 amendments require additional disclosures to be made.
For the items identified, entities should assess if the changes to the items qualify for reliefs or practical expedients under the Phase 1 amendments to SFRS(I) 9 and the Phase 2 amendments to SFRS(I) 9 and SFRS(I) 16[2].

Scope of the amendments to the Standards	How do I apply these reliefs
To be within the scope of the Phase 1 amendments, the hedging relationship must be directly affected by IBOR reform and the reform gives rise to uncertainties about: • A contractually or non-contractually specified interest rate benchmark that has been designated as a hedged risk; and/or • The timing or amount of IBOR-based cash flows of the hedged item or of the hedged instrument	The Phase 1 amendments provide temporary reliefs[1] to allow entities to continue hedge accounting despite uncertainties over when the IBOR rates will be replaced. However, the amendment does not provide relief from recognising hedge ineffectiveness. The Phase 1 amendments are effective for annual period beginning on or after 1 January 2020.

When could hedge ineffectiveness arise?
Hedge ineffectiveness may arise due to a number of factors including expected timing difference in transitioning the hedged items and the hedging derivatives to new benchmark reference rates or a difference in rates after the transition.

For example, an entity could have IBOR-based loans hedged by longer-dated IBOR-based derivatives. When the loans mature, the new loans are contracted based on the new reference rates. If the management has no plans to re-negotiate the existing IBOR-based derivatives, there would be differences in the fair valuation of the forecast cash flows resulting in hedge ineffectiveness for the current reporting period end.

[1]Viewpoint is a digital platform providing you with compelling accounting and business insights, all personalised for you. For more information on Viewpoint, please refer to the following link.
Registration for Viewpoint is required to access the content. Registration is complimentary.
[2]On top of the amendments mentioned above, amendments were also made to SFRS(I) 1-39 and SFRS(I) 7 under the Phase 1 amendments and SFRS(I) 1-39, SFRS(I) 7 and SFRS(I) 4 under the Phase 2 amendments.

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Scope of the amendments to the Standards	How do I apply these reliefs
To be within the scope of the Phase 2 amendments, changes to the terms of debt instruments, lease liabilities and hedge item or hedge instrument must meet both of the following criteria: ● The change is necessary as a direct consequence of interest rate benchmark reform; and ● The new basis for is economically equivalent to the previous basis	The Phase 2 amendments[1] provides: ● Reliefs for hedge accounting ● Practical expedients - Modification of debt instruments ● Practical expedients - Modification of leases The Phase 2 amendments are effective for annual period beginning on or after 1 January 2021

What should corporates do when the reliefs for Phase 1 end?

For each of the reliefs under the Phase 1 amendments, there are specific criteria that must be met for the relief to end. Details can be found in the following link[1].

When the reliefs under the Phase 1 amendments end, the entity will need to adopt the reliefs under the Phase 2 amendments to continue hedge accounting. If the Phase 1 reliefs end before the effective date of the Phase 2 amendments, the entity should early adopt the Phase 2 amendments to avoid discontinuation of hedge accounting.

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Accounting and reporting considerations

(b) Other areas potentially impacted by IBOR reform

As IBORs may be used as inputs to valuation models for other areas, entities will need to assess when the change to new reference rates will impact areas such as:

- Revaluation of property, plant and equipment under SFRS (I) 1-16
- Post retirement benefits/pensions under SFRS(I) 1- 19
- Impairment of non-financial assets under SFRS(I) 1- 36
- Investment properties under SFRS(I) 1-40
- Valuation of biological assets under SFRS(I) 1-41
- Share-based payments under SFRS(I) 2
- Revenue with significant financing components under SFRS(I) 15

More details can be found in the following guides and publications:

- Practical guides from Viewpoint[1]
  - Phase 1 amendments
  - Phase 2 amendments
- Illustrative Annual Report 2020

Is there anything else that entities should be aware of?

The IBOR reform may require business and operational changes such as contract re-negotiations, system changes (e.g. treasury systems to manage interest rate risks), or create challenges in the disposal of IBOR-based assets closer to the transition date. Corporates will need to understand what the IBOR changes will have on its business to allow for earlier preparation to iron out potential issues and apply a cross-functional approach to evaluate the impact of this change which extends beyond accounting.

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Explore further

For other related information, you can refer to:

- Reference Rate Reform in Singapore - LIBOR transition
- Illustrative Annual Report 2020
- SORA - A Guide for Corporates and SMEs
- SOR Transition to SORA Masterclass: A Corporate and SME Guide to SORA Transition

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