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In depth

New IFRSs for 2020

April 2020

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Introduction

Since March 2019, the IASB has issued the following:

- Amendments to IFRS 9, IAS 39, 'Financial instruments' and IFRS 7, 'Financial instruments disclosure', Interest rate benchmark reform
- Amendments to IAS 1,'Presentation of financial statements', Classification of liabilities. This guide summarises these amendments plus those standards, amendments and IFRICs issued previously that are effective from 1 January 2020.

It is designed to be used by preparers, users and auditors of IFRS financial statements. It includes a quick reference table of each standard/amendment/interpretation categorised by the effective date, whether early adoption is permitted and the EU endorsement status as of 1 February 2020. The publication gives an overview of the impact of the changes, which may be significant for some entities, helping companies understand if they will be affected and to begin their considerations. It will help entities plan more effectively by flagging up where new processes and systems or more guidance may be needed.

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Amended standards

Amendments to IFRS 3, ‘Business combinations’ – Definition of a business

Effective date	EU adoption status
• Annual periods beginning on or after 1 January 2020 • Early adoption is permitted	• Not adopted at time of publication

Issue

To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present (including for early stage companies that have not generated outputs). To be a business without outputs, there will now need to be an organised workforce.

The definition of the term 'outputs' is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets.

An entity can apply a 'concentration test' that, if met, eliminates the need for further assessment. Under this optional test, where substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets), the assets acquired would not represent a business.

Impact

The changes to the definition of a business will likely result in more acquisitions being accounted for as asset acquisitions across all industries, particularly real estate, pharmaceutical, and oil and gas. Application of the changes would also affect the accounting for disposal transactions.

Differences in accounting between business combinations and asset acquisitions include, among other things, the recognition of goodwill, recognition and measurement of contingent consideration, accounting for transaction costs, and deferred tax accounting.

Effective date

An entity shall apply these amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period. Earlier application of these amendments is permitted subject to EU endorsement. If an entity applies these amendments for an earlier period, it shall disclose that fact.

Amendments to IAS 1, Presentation of financial statements', and IAS 8, 'Accounting policies, changes in accounting estimates and errors' – Definition of material

Effective date	EU adoption status
• Annual periods beginning on or after 1 January 2020 • Early adoption is permitted	• Endorsed

Issue

The amendments to IAS 1, 'Presentation of financial statements', and IAS 8, 'Accounting policies, changes in accounting estimates and errors', and consequential amendments to other IFRSs:
i) use a consistent definition of materiality throughout IFRSs and the Conceptual Framework for Financial Reporting; ii) clarify the explanation of the definition of material; and iii) incorporate some of the guidance in IAS 1 about immaterial information.

The amended definition is:
'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.'

The amendment clarifies that the reference to obscuring information addresses situations in which the effect is similar to omitting or misstating that information. It also states that an entity assesses materiality in the context of the financial statements as a whole.

The amendment also clarifies the meaning of 'primary users of general purpose financial statements' to whom those financial statements are directed, by defining them as 'existing and potential investors, lenders and other creditors' that must rely on general purpose financial statements for much of the financial information they need.

Impact

The amendments clarify the definition of material and make IFRSs more consistent, but are not expected to have a significant impact on the preparation of financial statements.

Effective date

An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2020. Earlier application is permitted subject to EU endorsement. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Amendments to IFRS 9, 'Financial instruments', IAS 39, 'Financial instruments', and IFRS 7,'Financial instruments: disclosures' – Interest rate benchmark reform

Effective date	EU adoption status
• Annual periods beginning on or after 1 January 2020 • Early adoption is permitted	• Endorsed

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-phase project to consider what, if any, reliefs to give from the effects of IBOR reform. Phase 1, which considers reliefs to hedge accounting in the period before the reform, has led to these amendments.

Phase 2 of the IASB's project will address issues that arise once the existing interest rate is replaced with an alternative interest rate. In February 2020, the Board finished its deliberations on Phase 2 and an Exposure Draft is expected in April 2020.

Impact

As discussed in more detail below, the Phase 1 amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform. The reliefs have the effect that IBOR reform should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness should continue to be recorded in the income statement under both IAS 39 and IFRS 9. Furthermore, the amendments set out triggers for when the reliefs will end, which include the uncertainty arising from interest rate benchmark reform no longer being present.

'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 interest payments on a forecast issuance of a LIBOR-based debt hedged with an interest rate derivative), a question arises as to whether they can be considered 'highly probable' beyond the date at which the relevant IBOR might cease being published.

The relief provided by the amendments 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 hedged cash flows may change as a result of IBOR reform (for example, where the future interest payments on a hedged forecast debt issuance might be SONIA + X% rather than GBP LIBOR + Y%), this will not cause the 'highly probable' test to be failed.

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

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.

Cash flows under IBOR and IBOR replacement rates are currently expected to be broadly equivalent, which minimises any ineffectiveness. However, as the date of the reform gets closer, this might no longer be the case. This could give rise to hedge ineffectiveness in the prospective assessment, in particular where the replacement of the benchmark rate is expected to occur at different times in the hedged item and the hedging instrument.

Under the amendments, 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.

IAS 39 retrospective effectiveness test exception

The uncertainties described above in the context of prospective assessments could also affect IAS 39's retrospective effectiveness requirement. In particular, IBOR reform might cause a hedge to fall outside the required 80–125% range. IAS 39 has therefore been amended to provide 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. However, the other requirements for hedge accounting, including the prospective assessment, would still need to be met.

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 and reliably measurable. Under the amendments, 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.

Disclosures

The amendment requires disclosure of the nominal amount of hedging instruments to which the reliefs are applied, any significant assumptions or judgements made in applying the reliefs, and qualitative disclosures about how the entity is impacted by IBOR reform and is managing the transition process.

Effective date

These amendments should be applied for annual periods beginning on or after 1 January 2020. Earlier application is permitted.

Amendments to IAS 1, 'Presentation of financial statements' – Classification of liabilities as current or non-current

Effective date	EU adoption status
• Annual periods beginning on or after 1 January 2022 • Early adoption is permitted	• Not adopted at time of publication

Issue

On 23 January 2020, the IASB issued a narrow-scope amendment to IAS 1 to clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. The amendment requires the following:

- Liabilities are classified as non-current if the entity has a substantive right to defer settlement for at least 12 months at the end of the reporting period. The amendment no longer refers to unconditional rights, since loans are rarely unconditional (for example, because the loan might contain covenants).
- The assessment determines whether a right exists, but it does not consider whether the entity will exercise the right. So, management's expectations do not affect classification.
- The right to defer only exists if the entity complies with any relevant conditions at the reporting date. A liability is classified as current if a condition is breached at or before the reporting date and a waiver is obtained after the reporting date. A loan is classified as non-current if a covenant is breached after the reporting date.
- 'Settlement' is defined as the extinguishment of a liability with cash, other economic resources or an entity's own equity instruments. There is an exception for convertible instruments that might be converted into equity, but only for those instruments where the conversion option is classified as an equity instrument as a separate component of a compound financial instrument.

Impact

The amendment changes the guidance for the classification of liabilities as current or non-current. It could affect the classification of liabilities, particularly for entities that previously considered management's intentions to determine classification and for some liabilities that can be converted into equity. All entities should reconsider their existing classification in the light of the amendment and determine whether any changes are required.

Effective date

These amendments should be applied for annual periods beginning on or after 1 January 2022, retrospectively in accordance with IAS 8. Earlier application is permitted. If an entity applies those amendments for an earlier period, it should disclose that fact.

Amendments to the conceptual framework

Effective date	EU adoption status
Annual periods beginning on or after 1 January 2020 Early adoption is permitted	Endorsed

Issue

The IASB has revised its Conceptual Framework. This will not result in any immediate change to IFRS, but the Board and Interpretations Committee will use the revised Framework in setting future standards. It is therefore helpful for stakeholders to understand the concepts in the Framework and the potential ways in which they might impact future guidance.

Impact

Level in the IFRS hierarchy
The Framework is not an IFRS standard and does not override any standard, so nothing will change in the short term. The revised Framework will be used in future standard-setting decisions, but no changes will be made to current IFRS. Preparers might also use the Framework to assist them in developing accounting policies where an issue is not addressed by an IFRS.

Key changes

Key changes include:

- Increasing the prominence of stewardship in the objective of financial reporting, which is to provide information that is useful in making resource allocation decisions.
- Reinstating prudence, defined as the exercise of caution when making judgements under conditions of uncertainty, as a component of neutrality.
- Defining a reporting entity, which might be a legal entity or a portion of a legal entity.
- Revising the definition of an asset as a present economic resource controlled by the entity as a result of past events.
- Revising the definition of a liability as a present obligation of the entity to transfer an economic resource as a result of past events.
- Removing the probability threshold for recognition, and adding guidance on derecognition.
- Adding guidance on the information provided by different measurement bases, and explaining factors to consider when selecting a measurement basis.
- Stating that profit or loss is the primary performance indicator and that, in principle, income and expenses in other comprehensive income should be recycled where the relevance or faithful representation of the financial statements would be enhanced.

The Board did not make any changes that address challenges in classifying instruments with characteristics of both liability and equity. That will be addressed through the IASB's standard-setting project on that topic. Other amendments to the Framework might be needed at the conclusion of that project.

New standards

Insurance contracts – IFRS 17

Effective date	EU adoption status
Annual periods beginning on or after 1 January 2021. Early adoption is permitted	Not adopted at time of publication

Issue

On 18 May 2017, the IASB finished its long-standing project to develop an accounting standard on insurance contracts and published IFRS 17, 'Insurance contracts'. IFRS 17 replaces IFRS 4, which currently permits a wide variety of practices. IFRS 17 will fundamentally change the accounting by all entities that issue insurance contracts and investment contracts with discretionary participation features.

Impact

Scope
IFRS 17 applies to insurance contracts issued, to all reinsurance contracts and to investment contracts with discretionary participating features if an entity also issues insurance contracts. For fixed-fee service contracts whose primary purpose is the provision of services, entities have an accounting policy choice to account for them in accordance with either IFRS 17 or IFRS 15.Similar to the position under IFRS 4, financial guarantee contracts are allowed to be within the scope of IFRS 17 if the entity previously asserted explicitly that it regarded them as insurance contracts. Insurance contracts (other than reinsurance) where the entity is a policyholder are not within the scope of IFRS 17.

Embedded derivatives and distinct investment and service components should be 'unbundled' and accounted for separately in accordance with the related IFRSs. Voluntary unbundling of other components is prohibited.

The measurement model
IFRS 17 requires a current measurement model, where estimates are remeasured in each reporting period. The measurement is based on the building blocks of discounted, probability-weighted cash flows, a risk adjustment and a contractual service margin ('CSM') representing the unearned profit of the contract. A simplified premium allocation approach is permitted for the liability for the remaining coverage if it provides a measurement that is not materially different from the general model or if the coverage period is one year or less. However, claims incurred will need to be measured based on the building blocks of discounted, risk-adjusted, probability weighted cash flows.

For presentation and measurement, entities are required at initial recognition to disaggregate a portfolio (that is, contracts that are subject to similar risks and managed together as a single pool) into three groups of contracts: onerous; no significant risk of becoming onerous; and remaining contracts. Contracts that are issued more than one year apart should not be in the same group.

Changes in cash flows related to future services should be recognised against the CSM. The CSM cannot be negative, so changes in future cash flows that are greater than the remaining CSM are recognised in profit or loss. Interest is accreted on the CSM at rates locked in at initial recognition of a contract. To reflect the service provided, the CSM is released to profit or loss in each period on the basis of passage of time.

Under IFRS 17, entities have an accounting policy choice to recognise the impact of changes in discount rates and other assumptions that relate to financial risks either in profit or loss or in other comprehensive income (‘OCI’). The OCI option for insurance liabilities reduces some volatility in profit or loss for insurers where financial assets are measured at amortised cost or fair value through OCI under IFRS 9.

The variable-fee approach is required for insurance contracts that specify a link between payments to the policyholder and the returns on underlying items, such as some ‘participating’, ‘with profits’ and ‘unit linked’ contracts. The interest on the CSM for such contracts is accreted implicitly through adjusting the CSM for the change in the variable fee. The variable fee represents the entity’s share of the fair value of the underlying items less amounts payable to policyholders that do not vary based on the underlying items. The CSM is also adjusted for the time value of money and the effect of changes in financial risks not arising from underlying items such as options and guarantees.

Requirements in IFRS 17 align the presentation of revenue with other industries. Revenue is allocated to periods in proportion to the value of expected coverage and other services that the insurer provides in the period, and claims are presented when incurred. Investment components (that is, amounts repaid to policyholders even if the insured event does not occur) are excluded from revenue and claims.

Insurers are required to disclose information about amounts, judgements and risks arising from insurance contracts. The disclosure requirements are more detailed than currently required under IFRS 4.

On transition to IFRS 17, an entity applies IFRS 17 retrospectively to groups of insurance contracts, unless it is impracticable. In this case, the entity is permitted to choose between a modified retrospective approach and the fair value approach. In applying a modified retrospective approach, the entity achieves the closest outcome to retrospective application using reasonable and supportable information and choosing from a list of available simplifications. Alternatively, the CSM at transition can be based on fair value at transition. In practice, using different approaches to transition could result in significantly different outcomes that will drive profit recognised in future periods for contracts in force on transition.

Insights

IFRS 17 will impact businesses well beyond the finance, actuarial and systems development areas (for example, product design and distribution, development of revised incentive and wider remuneration policies and reconfigured budgeting and forecasting methodologies feeding into business planning). There could also be an impact on the cash tax position and dividends, both on transition and going forward. Gap analysis and impact assessments to develop an implementation roadmap will enable entities to begin the detailed implementation project. A fundamental shift might be required in the way in which data is collected, stored and analysed, changing the emphasis from a prospective to a retrospective basis of analysis and introducing a more granular level of measurement and additional disclosures. Before the effective date, insurers will need to carefully consider their ‘IFRS 17 story’ for investors and analysts, as well as the key metrics that they will apply in the new world.

For first time adopters of IFRS, IFRS 1 mirrors the transition guidance set out in Appendix C of IFRS 17.

Effective date

IFRS 17 applies to annual periods beginning on or after 1 January 2021, with earlier application permitted if IFRS 15 and IFRS 9 are also applied. The standard should be applied retrospectively unless impracticable.

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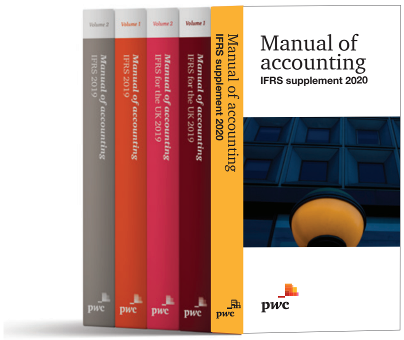

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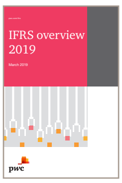

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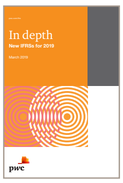

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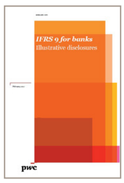

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