Hong Kong Institute of
Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK

Update No. 264

(Issued 29 July 2021)

This Update relates to the following:

(i) Consequential amendments arising from the following Standards that were previously set out in the Appendices to the respective Standards but are now incorporated into the text of the relevant Standards and Basis for Conclusions.

Effective from annual periods beginning on or after:	**Amendments**
1 January 2021	*Interest Rate Benchmark Reform — Phase 2* (Amendments to HKAS 39 *Financial Instruments: Recognition and Measurement*, HKFRS 4 *Insurance Contracts*, HKFRS 7 *Financial Instruments: Disclosures*, HKFRS 9 *Financial Instruments* and HKFRS 16 *Leases*)
1 April 2021	*Covid-19-related rent concessions beyond 30 June 2021* (Amendment to HKFRS 16 *Leases*)

(ii) *Preface to Hong Kong Financial Reporting Standards* is updated for the issuance of invitations to comment on IFRS Interpretations Committee tentative agenda decisions.

(iii) HKAS 36 *Impairment of Assets* is updated for editorial corrections.

Document Reference and Title	***Instructions***
VOLUME II	
Contents of Volume II	Discard existing pages i-ii & replace with revised pages i-ii.
PREFACE AND FRAMEWORK	
Preface to Hong Kong Financial Reporting Standards	Replace the cover page and pages 8 and 9 with revised cover page and revised pages 8 and 9.

(Continued next page)

Document Reference and Title	*Instructions*
HONG KONG ACCOUNTING STANDARDS (HKAS)	
HKAS 36 *Impairment of Assets*	Replace the cover page and pages 2 and 3 with revised cover page and revised pages 2 and 3.
HKAS 39 *Financial Instruments: Recognition and Measurement*	Replace the cover page and pages 2, 4, 18 and 21 with revised cover page and revised pages 2, 4, 18 and 21. Insert pages 18A – 18C after page 18, and page 21A after page 21. Discard pages 37 – 41.
HKAS 39 *Financial Instruments: Recognition and Measurement* (Basis for Conclusions)	Replace the cover page and pages 3 and 51 with revised cover page and revised pages 3 and 51. Insert pages 51A – 51Q after page 51. Discard pages 52A – 52S.
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)	
HKFRS 4 *Insurance Contracts*	Replace the cover page and pages 2, 4, 15, 16 and 29 with revised cover page and revised pages 2, 4, 15, 16 and 29. Insert page 15A after page 15. Discard page 41.
HKFRS 4 *Insurance Contracts* (Basis for Conclusions)	Replace the cover page and pages 2, 4 and 73A with revised cover page and revised pages 2, 4 and 73A. Insert page 73B after page 73A. Discard page 86.
HKFRS 7 *Financial Instruments: Disclosures*	Replace the cover page and pages 2, 4, 21, 21A and 36A with revised cover page and revised pages 2, 4, 21, 21A and 36A. Insert page 21B after page 21A. Discard page 55.
HKFRS 7 *Financial Instruments: Disclosures* (Basis for Conclusions)	Replace the cover page, pages 3 and 24B with revised cover page, revised pages 3 and 24B. Insert pages 24C – 24E after page 24B. Discard pages 49 – 51.
HKFRS 9 (2014) *Financial Instruments*	Replace the cover page and pages 2, 3, 20, 36B, 36C, 38 and 41A with revised cover page and revised pages 2, 3, 20, 36B, 36C, 38 and 41A. Insert page 20A after page 20, pages 36D and 36E after page 36C, and page 41B after page 41A. Discard pages 125 – 129.
HKFRS 9 (2014) *Financial Instruments* (Basis for Conclusions)	Replace the cover page and pages 2, 3, 128, 207K and 229 with revised cover page and revised pages 2, 3, 128, 207K and 229. Insert pages 128A – 128G after page 128, pages 207L – 207X after page 207K, and pages 229A – 229C after page 229. Discard pages 288 – 308.

(Continued next page)

Document Reference and Title	***Instructions***
HKFRS 16 *Leases*	Replace the cover page and pages 4, 5, 13A, 21, 37, 37A and 40 with revised cover page and revised pages 4, 5, 13A, 21, 37, 37A and 40. Insert page 40A after page 40. Discard pages 42 – 45.
HKFRS 16 *Leases* (Basis for Conclusions)	Replace the cover page and pages 6, 7, 47A, 47B and 59 with revised cover page and revised pages 6, 7, 47A, 47B and 59. Insert page 47C after page 47B, pages 59A – 59B after page 59, and page 68A after page 68. Discard pages 70 – 74.

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to July 2021)

Effective upon issue

Preface to Hong Kong Financial Reporting Standards

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

breach of section 380(4)(b) unless the statutory financial statements of that company contain an explicit and unreserved statement of compliance with HKFRSs as issued by the HKICPA. If a company has not previously included an explicit and unreserved statement of compliance with HKFRSs as issued by the HKICPA in its financial statements then it is required to comply with the requirements of HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (or Section 35 of the HKFRS for Private Entities, if opting to adopt that HKFRS) in order to comply with the requirements of section 380(4)(b) of the CO. This statement may be in addition to a statement of compliance with a basis or standard of accounting other than HKFRSs provided that the financial statements satisfy the requirements of both accounting frameworks.[2]

25C In all other cases, where a member of the HKICPA assumes responsibilities in respect of financial statements prepared under a basis or standard of accounting other than HKFRSs, the member should observe that other basis or standard of accounting. Accordingly, paragraphs 22 to 24 of this Preface shall apply, as if the references to HKFRSs in those paragraphs are to the other basis or standard of accounting, to members of the HKICPA who assume responsibilities in respect of financial statements prepared under a basis or standard of accounting other than HKFRSs, as they apply to members of the HKICPA who assume responsibility in respect of financial statements prepared under HKFRSs.

Coordination with international due process

26 Council understands that close co-ordination between the HKICPA's and IASB's due processes is important to the success of achieving convergence of HKFRSs with IFRSs. Council has aligned the HKICPA's due process, including the timing of issuing consultation documents[3], standards and interpretations, as closely as possible with the IASB's due process as a result of its convergence policy. Council has published in June 2006 *Information Paper: Setting HKFRSs*[4] which outlines the step Council plans in supporting the development of IFRSs and the implementation of HKFRSs in Hong Kong. This Information Paper makes reference to the *Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard Setters* issued by the IASB in February 2006 which identifies a range of activities that the IASB and other accounting standard-setters, including the HKICPA, believe should be undertaken by them in the interests of facilitating the ongoing convergence with IFRSs. A copy of the Information Paper and a copy of the IASB Statement of Best Practice are attached as Appendix 1 and Appendix 2, respectively, to this Preface for reference.

2 For example, if an existing IFRS reporter wishes to assert dual compliance with HKFRSs and IFRSs, it would be necessary that no material changes to accounting policies or reported amounts were made as a result of applying the requirements of HKFRS 1 on transition to HKFRSs.

Similarly, if a company has not previously included an explicit and unreserved statement of compliance with IFRSs as issued by the IASB in its financial statements and wishes to do so in addition to continuing to comply with HKFRSs, it would be necessary that no material changes to accounting policies or reported amounts were made as a result of applying the requirements of IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

3 Consultation documents include, for example, research papers, requests for information, discussion papers~~, and~~ exposure drafts and IFRS Interpretations Committee tentative agenda decisions.

4 This Information Paper was published prior to the issue of this revised Preface to HKFRSs and, accordingly, its content does not take into account the changes made in this revised Preface to HKFRSs.

Due process

27 HKFRSs are developed through a due process that involves members and member practices of the HKICPA, listed companies in Hong Kong, the stock exchange, regulatory and legal authorities, academics and other interested individuals and organisations.

28 The FRSC decides on major projects and work priorities. The FRSC identifies potential agenda items for which timely guidance can be provided. Due process for projects may involve any or all of the following steps which are conducted by the FRSC except for noted otherwise:

(a) identifying and reviewing all the issues associated with an exposure draft or a draft interpretation issued by the IASB for possible adoption in Hong Kong or any other topics and considering the application of the *Conceptual Framework* to the issues, if needed;

(b) studying pronouncements of the IASB and other standard setting bodies and accepted industry practices about the issues;

(c) [not used];

(d) forming an advisory group to give advice to the FRSC on the project;

(e) publishing for public comment a consultation document or a draft interpretation and, in the case of the IASB issuing a consultation document or a draft IFRIC Interpretation, issuing an invitation to comment in Hong Kong on that IASB consultation document or draft IFRIC Interpretation with a request for comment before the comment deadline imposed by the IASB so as to allow the FRSC a reasonable time to consider the comments before making a submission to the IASB;~~[5]~~

(f) [not used];

(g) publishing within an exposure draft a basis for conclusions;

(h) considering all comments received within the comment period on the consultation documents and draft interpretations and those received in response to the Hong Kong invitation to comment on the IASB documents and, when appropriate, preparing a comment letter to the IASB;

(i) following publication of the finalised IFRS or IFRIC Interpretation, considering the changes made, if any, by the IASB and adopting the finalised IFRS or IFRIC Interpretation in Hong Kong with the same effective date;

(j) approving a standard or an Interpretation, including that converged with the equivalent IFRS or IFRIC Interpretation, by Council; and

~~[5] No invitation to comment is issued by the HKICPA on the IFRS Interpretations Committee's tentative agenda decisions.~~

HKAS 36
Revised ~~September 2018~~July 2021

Hong Kong Accounting Standard 36

Impairment of Assets

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

COPYRIGHT

CONTENTS

HKAS 39
Revised ~~October 2020~~July 2021

Hong Kong Accounting Standard 39

Financial Instruments:

Recognition and Measurement

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

COPYRIGHT

Hong Kong Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (HKAS 39) is set out in paragraphs 2-109 and Appendices A ~~–C~~and B. All the paragraphs have equal authority. HKAS 39 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting.* HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

102M An entity shall prospectively cease applying paragraph 102G to a hedging relationship at the earlier of:

(a) when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and the timing and the amount of the interest rate benchmark-based cash flows of the hedged item ~~or~~and of the hedging instrument; and

(b) when the hedging relationship to which the exception is applied is discontinued.

102N When designating a group of items as the hedged item, or a combination of financial instruments as the hedging instrument, an entity shall prospectively cease applying paragraphs 102D–102G to an individual item or financial instrument in accordance with paragraphs 102J, 102K, 102L, or 102M, as relevant, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of the interest rate benchmark-based cash flows of that item or financial instrument.

102O An entity shall prospectively cease applying paragraphs 102H and 102I at the earlier of:

(a) when changes required by interest rate benchmark reform are made to the non-contractually specified risk portion applying paragraph 102P; or

(b) when the hedging relationship in which the non-contractually specified risk portion is designated is discontinued.

Additional temporary exceptions arising from interest rate benchmark reform

Hedge accounting

102P As and when the requirements in paragraphs 102D–102I cease to apply to a hedging relationship (see paragraphs 102J–102O), an entity shall amend the formal designation of that hedging relationship as previously documented to reflect the changes required by interest rate benchmark reform, ie the changes are consistent with the requirements in paragraphs 5.4.6–5.4.8 of HKFRS 9. In this context, the hedge designation shall be amended only to make one or more of these changes:

(a) designating an alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;

(b) amending the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged;

(c) amending the description of the hedging instrument; or

(d) amending the description of how the entity will assess hedge effectiveness.

102Q An entity also shall apply the requirement in paragraph 102P(c) if these three conditions are met:

(a) the entity makes a change required by interest rate benchmark reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 5.4.6 of HKFRS 9);

(b) the original hedging instrument is not derecognised; and

(c) the chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 5.4.7 and 5.4.8 of HKFRS 9).

102R The requirements in paragraphs 102D–102I may cease to apply at different times. Therefore, applying paragraph 102P, an entity may be required to amend the formal designation of its hedging relationships at different times, or may be required to amend the formal designation of a hedging relationship more than once. When, and only when, such a change is made to the hedge designation, an entity shall apply paragraphs 102V–102Z2 as applicable. An entity also shall apply paragraph 89 (for a fair value hedge) or paragraph 96 (for a cash flow hedge) to account for any changes in the fair value of the hedged item or the hedging instrument.

102S An entity shall amend a hedging relationship as required in paragraph 102P by the end of the reporting period during which a change required by interest rate benchmark reform is made to the hedged risk, hedged item or hedging instrument. For the avoidance of doubt, such an amendment to the formal designation of a hedging relationship constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship.

102T If changes are made in addition to those changes required by interest rate benchmark reform to the financial asset or financial liability designated in a hedging relationship (as described in paragraphs 5.4.6–5.4.8 of HKFRS 9) or to the designation of the hedging relationship (as required by paragraph 102P), an entity shall first apply the applicable requirements in this Standard to determine if those additional changes result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, an entity shall amend the formal designation of the hedging relationship as specified in paragraph 102P.

102U Paragraphs 102V–102Z3 provide exceptions to the requirements specified in those paragraphs only. An entity shall apply all other hedge accounting requirements in this Standard, including the qualifying criteria in paragraph 88, to hedging relationships that were directly affected by interest rate benchmark reform.

Accounting for qualifying hedging relationships

Retrospective effectiveness assessment

102V For the purpose of assessing the retrospective effectiveness of a hedging relationship on a cumulative basis applying paragraph 88(e) and only for this purpose, an entity may elect to reset to zero the cumulative fair value changes of the hedged item and hedging instrument when ceasing to apply paragraph 102G as required by paragraph 102M. This election is made separately for each hedging relationship (ie on an individual hedging relationship basis).

Cash flow hedges

102W For the purpose of applying paragraph 97, at the point when an entity amends the description of a hedged item as required in paragraph 102P(b), the cumulative gain or loss in other comprehensive income shall be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.

102X For a discontinued hedging relationship, when the interest rate benchmark on which the hedged future cash flows had been based is changed as required by interest rate benchmark reform, for the purpose of applying paragraph 101(c) in order to determine whether the hedged future cash flows are expected to occur, the amount accumulated in other comprehensive income 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.

Groups of items

102Y When an entity applies paragraph 102P to groups of items designated as hedged items in a fair value or cash flow hedge, the entity shall allocate the hedged items to subgroups based on the benchmark rate being hedged and designate the benchmark rate as the hedged risk for each subgroup. For example, in a hedging relationship in which a group of items is hedged for changes in an interest rate benchmark subject to interest rate benchmark reform, the hedged cash flows or fair value of some items in the group could be changed to reference an alternative benchmark rate before other items in the group are changed. In this example, in applying paragraph 102P, the entity would designate the alternative benchmark rate as the hedged risk for that relevant subgroup of hedged items. The entity would continue to designate the existing interest rate benchmark as the hedged risk for the other subgroup of hedged items until the hedged cash flows or fair value of those items are changed to reference the alternative benchmark rate or the items expire and are replaced with hedged items that reference the alternative benchmark rate.

102Z An entity shall assess separately whether each subgroup meets the requirements in paragraphs 78 and 83 to be an eligible hedged item. If any subgroup fails to meet the requirements in paragraphs 78 and 83, the entity shall discontinue hedge accounting prospectively for the hedging relationship in its entirety. An entity also shall apply the requirements in paragraphs 89 or 96 to account for ineffectiveness related to the hedging relationship in its entirety.

Designating financial items as hedged items

102Z1 An alternative benchmark rate designated as a non-contractually specified risk portion that is not separately identifiable (see paragraphs 81 and AG99F) at the date it is designated shall be deemed to have met that requirement at that date, if, and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within 24 months. The 24-month period applies to each alternative benchmark rate separately and starts from the date the entity designates the alternative benchmark rate as a non-contractually specified risk portion for the first time (ie the 24-month period applies on a rate-by-rate basis).

102Z2 If subsequently an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designated it as a non-contractually specified risk portion for the first time, the entity shall cease applying the requirement in paragraph 102Z1 to that alternative benchmark rate and discontinue hedge accounting prospectively from the date of that reassessment for all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk portion.

102Z3 In addition to those hedging relationships specified in paragraph 102P, an entity shall apply the requirements in paragraphs 102Z1 and 102Z2 to new hedging relationships in which an alternative benchmark rate is designated as a non-contractually specified risk portion (see paragraphs 81 and AG99F) when, because of interest rate benchmark reform, that risk portion is not separately identifiable at the date it is designated.

Effective date and transitional provisions

103 **An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 32. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact. Except as provided for in paragraph 104 below, retrospective application is not permitted.**

103A [Deleted]

103B [Deleted]

103C HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 95(a), 97, 98, 100, 102, 108 and AG99B. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

103D [Deleted]

103E HKAS 27 (as amended in 2008) amended paragraph 102. An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendment shall be applied for that earlier period.

103F [Deleted]

103G An entity shall apply paragraphs AG99BA, AG99E, AG99F, AG110A and AG110B retrospectively for annual periods beginning on or after 1 July 2009, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies *Eligible Hedged Items* (Amendment to HKAS 39) for periods beginning before 1 July 2009, it shall disclose that fact.

103H-103J [Deleted]

108D *Novation of Derivatives and Continuation of Hedge Accounting* (Amendments to HKAS 39), issued in July 2013, amended paragraphs 91 and 101 and added paragraph AG113A. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2014. An entity shall apply those amendments retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

108E-108F [Deleted]

108G *Interest Rate Benchmark Reform*, which amended HKFRS 9, HKAS 39 and HKFRS 7, issued in November 2019, added paragraphs 102A–102N. An entity shall apply these amendments for annual periods beginning on or after 1 January 2020. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively to those hedging relationships that existed at the beginning of the reporting period in which an entity first applies these amendments or were designated thereafter, and to the gain or loss recognised in other comprehensive income that existed at the beginning of the reporting period in which an entity first applies these amendments.

108H *Interest Rate Benchmark Reform—Phase 2*, which amended HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16, issued in October 2020, added paragraphs 102O–102Z3 and 108I–108K, and amended paragraph 102M. An entity shall apply these amendments for annual periods beginning on or after 1 January 2021. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively in accordance with HKAS 8, except as specified in paragraphs 108I–108K.

108I An entity shall designate a new hedging relationship (for example, as described in paragraph 102Z3) only prospectively (ie an entity is prohibited from designating a new hedge accounting relationship in prior periods). However, an entity shall reinstate a discontinued hedging relationship if, and only if, these conditions are met:

(a) the entity had discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and the entity would not have been required to discontinue that hedging relationship if these amendments had been applied at that time; and

(b) at the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments), that discontinued hedging relationship meets the qualifying criteria for hedge accounting (after taking into account these amendments).

108J If, in applying paragraph 108I, an entity reinstates a discontinued hedging relationship, the entity shall read references in paragraphs 102Z1 and 102Z2 to the date the alternative benchmark rate is designated as a non-contractually specified risk portion for the first time as referring to the date of initial application of these amendments (ie the 24-month period for that alternative benchmark rate designated as a non-contractually specified risk portion begins from the date of initial application of these amendments).

108K An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise 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 these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

Withdrawal of other pronouncements

109 This Standard supersedes SSAP 24 *Accounting for Investments in Securities*.

Basis for Conclusions
Hong Kong Accounting Standard 39

Financial Instruments: Recognition and Measurement

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

BC288 Many respondents to the 2019 Exposure Draft commented on the clarity of the proposed retrospective application and suggested that further explanation be provided in the Standard. Consequently, the Board amended the transition paragraph to specify that retrospective application applies only to those hedging relationships that existed at the beginning of the reporting period in which an entity first applies these amendments or were designated thereafter, and to the gain or loss recognised in other comprehensive income that existed at the beginning of the reporting period in which an entity first applies these amendments. The Board used this wording to permit an entity to apply the amendments from the beginning of the reporting period in which an entity first applies these amendments even if the reporting period is not an annual period.

Amendments for *Interest Rate Benchmark Reform—Phase 2* (August 2020)

Background

BC289 In 2014, the Financial Stability Board recommended the reform of specified major interest rate benchmarks such as interbank offered rates (IBORs). Since then, public authorities in many jurisdictions have taken steps to implement interest rate benchmark reform and have increasingly encouraged market participants to ensure timely progress towards the reform of interest rate benchmarks, including the replacement of interest rate benchmarks with alternative, nearly risk-free interest rates that are based, to a greater extent, on transaction data (alternative benchmark rates). The progress towards interest rate benchmark reform follows the general expectation that some major interest rate benchmarks will cease to be published by the end of 2021. The term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 102B of IAS 39 (the reform).

BC290 In September 2019, the Board amended IFRS 9, IAS 39 and IFRS 7, to address as a priority issues affecting financial reporting in the period before the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (Phase 1 amendments). The Phase 1 amendments provide temporary exceptions to specific hedge accounting requirements due to the uncertainty arising from the reform. Paragraphs BC223–BC288 discuss the background to the Phase 1 amendments.

BC291 After the issuance of the Phase 1 amendments, the Board commenced its Phase 2 deliberations. In Phase 2 of its project on the reform, the Board addressed issues that might affect financial reporting during the reform of an interest rate benchmark, including changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate (replacement issues).

BC292 The objective of Phase 2 is to assist entities in providing useful information to users of financial statements and to support preparers in applying IFRS Standards when changes are made to contractual cash flows or hedging relationships because of the transition to alternative benchmark rates. The Board observed that for information about the effects of the transition to alternative benchmark rates to be useful, the information has to be relevant to users of financial statements and faithfully represent the economic effects of that transition on the entity. This objective assisted the Board in assessing whether it should amend IFRS Standards or whether the requirements in IFRS Standards already provided an adequate basis to account for such effects.

BC293 In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2* (2020 Exposure Draft), which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 *Insurance Contracts* and IFRS 16 *Leases* to address replacement issues.

BC294 Almost all respondents to the 2020 Exposure Draft welcomed the Board's decision to address replacement issues and agreed that the proposed amendments would achieve the objective of Phase 2. Many respondents highlighted the urgency of these amendments, especially in some jurisdictions that have progressed towards the reform or the replacement of interest rate benchmarks with alternative benchmark rates.

BC295 In August 2020 the Board amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 by issuing *Interest Rate Benchmark Reform***—***Phase 2* (Phase 2 amendments). The Phase 2 amendments, which confirmed with modifications the proposals in the 2020 Exposure Draft added paragraphs 102O–102Z3 and 108H–108K of IAS 39. Paragraph 102M was amended.

Amendments to hedging relationships

BC296 The Phase 2 amendments relating to the hedge accounting requirements in IAS 39 apply to hedging relationships directly affected by the reform as and when the requirements in paragraphs 102D–102I of IAS 39 cease to apply to a hedging relationship (see paragraphs 102J–102O of IAS 39). Therefore, an entity is required to amend the hedging relationship to reflect the changes required by the reform as and when the uncertainty arising from the reform is no longer present with respect to the hedged risk or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument. The scope of the hedging relationships to which the Phase 2 amendments apply is therefore the same as the scope to which the Phase 1 amendments apply, except for the amendment to the separately identifiable requirement, which also applies to the designation of new hedging relationships (see paragraph 102Z3 of IAS 39).

BC297 As part of the Phase 1 amendments, the Board acknowledged that, in most cases, for uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows arising from the reform to be resolved, the underlying financial instruments designated in the hedging relationship would have to be changed to specify the timing and the amount of alternative benchmark rate-based cash flows.

BC298 The Board noted that, applying the hedge accounting requirements in IAS 39, changes to the basis for determining the contractual cash flows of a financial asset or a financial liability (see paragraphs 5.4.6–5.4.9 of IFRS 9) that are designated in a hedging relationship would affect the designation of such a hedging relationship in which an interest rate benchmark was designated as a hedged risk.

BC299 The Board observed that amending the formal designation of a hedging relationship to reflect the changes required by the reform would result in the discontinuation of the hedging relationship. This is because, as part of the qualifying criteria for hedge accounting to be applied, IAS 39 requires the formal designation of a hedging relationship to be documented at inception. The hedge documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess hedge effectiveness.

BC300 The Board therefore concluded that, in general, the hedge accounting requirements in IAS 39 are sufficiently clear about how to account for hedging relationships directly affected by the reform after the Phase 1 exceptions set out in paragraphs 102D–102I of IAS 39 cease to apply. However, consistent with the Board's objective for Phase 2 (see paragraph BC292) and its objective for Phase 1 (see paragraph BC227), the Board considered that discontinuing hedge accounting solely due to the effects of the reform would not always reflect the economic effects of the changes required by the reform on a hedging relationship and therefore would not always provide useful information to users of financial statements.

BC301 Accordingly, the Board decided that if the reform requires a change to a financial asset or a financial liability designated in a hedging relationship (see paragraphs 5.4.6–5.4.8 of IFRS 9), it would be consistent with the Board's objective for Phase 2 to require the hedging relationship to be amended to reflect such a change without requiring discontinuation of that hedging relationship. For these reasons, in the 2020 Exposure Draft, the Board proposed that an entity would be required to amend the formal designation of the hedging relationship as previously documented to make one or more of these changes:

(a) designating the alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;

(b) amending the description of the hedged item so it refers to the alternative benchmark rate;

(c) amending the description of the hedging instrument so it refers to the alternative benchmark rate; or

(d) amending the description of how the entity will assess hedge effectiveness.

BC302 Respondents to the 2020 Exposure Draft agreed with the proposed amendments because those proposals would generally result in an entity continuing to apply hedge accounting to hedging relationships directly affected by the reform. Respondents also said that changes to the hedge designation necessary to reflect changes required by the reform are not expected to represent a change in an entity's risk management strategy or risk management objective for hedging their exposure to interest rate risk. Therefore, the Board concluded that continuing to apply hedge accounting to the affected hedging relationships when making changes required by the reform would correspond with the Board's objective for issuing the Phase 1 amendments in September 2019.

BC303 However, notwithstanding their general agreement with the proposed amendments, some respondents asked the Board to clarify the scope and timing of the required changes to the affected hedging relationships.

BC304 Regarding the scope of the required changes to the affected hedging relationships, the Board acknowledged it may be necessary to amend the designated hedged portion of the cash flows or fair value being hedged when the hedging relationship is amended to reflect the changes required by the reform. The Board also noted that the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 were implicit in the required amendments to the hedging relationships as proposed in the 2020 Exposure Draft. In considering the timing of when entities are required to amend an affected hedging relationship, the Board sought to balance the operational effort needed to amend the hedging relationships with maintaining the required discipline in the amendments to hedging relationships. Specifically, it sought to address the challenges associated with specifying the timing of when entities have to amend hedging relationships as required in paragraph 102P of IAS 39—particularly in the context of the large volume of changes that entities may need to make in a relatively short time—while also ensuring that the amendments to hedging relationships are accounted for in the applicable reporting period.

BC305 In response to respondents' requests, the Board revised the proposed wording in paragraph 102P of IAS 39 so that:

(a) amending the description of the hedged item includes amending the description of the designated portion of the cash flows or fair value being hedged;

(b) the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 are relevant when amending the formal designation of a hedging relationship; and

(c) amendments to hedging relationships are required to be made by the end of the reporting period during which the respective changes to the hedged item, hedged risk or hedging instrument are made.

BC306 The Board noted that the Phase 1 amendments may cease to apply at different times to directly affected hedging relationships and to the different elements within a hedging relationship. Therefore, an entity may be required to apply the applicable Phase 2 exceptions in paragraphs 102P–102Z2 of IAS 39 at different times, which may result in the designation of a particular hedging relationship being amended more than once. The Phase 2 amendments to the hedge accounting requirements in IAS 39 apply only to the requirements specified in these paragraphs. All other hedge accounting requirements in IAS 39, including the qualifying criteria in paragraph 88 of IAS 39, apply to hedging relationships directly affected by the reform. In addition, consistent with the Board's decision for the Phase 1 amendments (see paragraph BC254), the Phase 2 amendments also do not provide an exception from the measurement requirements for a hedging relationship. Therefore, entities apply the requirements in paragraphs 89 or 96 of IAS 39 to account for any changes in the fair value of the hedged items or hedging instruments (also see paragraphs BC315–BC320).

BC307 As set out in paragraph BC5.318 of the Basis for Conclusions on IFRS 9, the Board considered that changes might be made to a financial asset or a financial liability, or to the formal designation of a hedging relationship, in addition to those changes required by the reform. The effect of such additional changes to the formal hedge designation on the application of the hedge accounting requirements would depend on whether those changes result in the derecognition of the underlying financial instrument (see paragraph 5.4.9 of IFRS 9).

BC308 The Board therefore required an entity first to apply the applicable requirements in IAS 39 to determine if those additional changes result in discontinuation of hedge accounting, for example, if the financial asset or financial liability designated as a hedged item no longer meets the qualifying criteria to be an eligible hedged item as a result of changes in addition to those required by the reform. Similarly, if an entity amends the hedge designation to make a change other than the changes described in paragraph 102P of IAS 39 (for example, if it extends the term of the hedging relationship), the entity would first determine if those additional changes to the hedge designation result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, the designation of the hedging relationship would be amended as required by paragraph 102P of IAS 39.

BC309 Some respondents to the 2020 Exposure Draft said that entities may change a hedging relationship as a result of the reform, but such a change is not necessary as a direct consequence of the reform. This could include, for example, designating a basis swap as a new hedging instrument to mitigate ineffectiveness arising from the difference between the compounding of the alternative benchmark rates used for cash products and derivatives. These respondents asked the Board to permit such changes to be in the scope of the required changes to the hedging relationship set out in paragraph 102P of IAS 39. The Board however decided not to extend the scope of paragraph 102P of IAS 39 to other changes an entity makes as a result of the reform. The Board considered that its objective for the Phase 2 amendments is not only to support entities in applying the IFRS requirements during the transition to alternative benchmark rates, but also to provide users of financial statements with useful information about the effect of the reform on an entity's financial statements. To balance achieving this objective with maintaining the discipline that exists in the hedge accounting requirements in IAS 39, the Board limited the scope of the changes required to the designation of hedging relationships to only those changes that are necessary to reflect the changes required by the reform (as described in paragraphs 5.4.6–5.4.8 of IFRS 9).

Replacement of hedging instruments in hedging relationships

BC310 Respondents to the 2020 Exposure Draft said that, instead of changing the contractual terms of a derivative designated as a hedging instrument, counterparties may facilitate the transition to alternative benchmark rates using approaches that result in outcomes that are equivalent to changing the contractual terms of the derivative. These respondents asked whether using such an approach would be within the scope of the Phase 2 amendments—ie whether paragraph 102P(c) of IAS 39 would apply—if the approach results in an economic outcome that is similar to changing the basis for determining the contractual cash flows of the derivative.

BC311 The Board confirmed that, consistent with the rationale in paragraph BC5.298 of the Basis for Conclusions on IFRS 9, it is the substance of an arrangement, rather than its form, that determines the appropriate accounting treatment. The Board considered that the conditions in paragraph 5.4.7 of IFRS 9—ie the change is necessary as a direct consequence of the reform and is done on economically equivalent basis—are helpful in analysing the amendments to the contractual terms of derivatives described in paragraph BC310. In this context, the Board noted that if these other approaches result in derivatives with substantially different terms from those of the original derivative, the change may not have been made on an economically equivalent basis. The Board also noted that if a hedging instrument is derecognised, hedge accounting is required to be discontinued. Therefore, the Board decided that for hedge accounting to continue it is also necessary that the original hedging instrument would not be derecognised.

BC312 The Board considered these approaches described by respondents:

(a) *close-out and replace on the same terms (ie off-market terms)*—An entity applying this approach would enter into two new derivatives with the same counterparty. These two would be, a new derivative that is equal and offsetting to the original derivative (so both contracts are based on the interest rate benchmark to be replaced), and a new alternative benchmark-based derivative with the same terms as the original derivative so its fair value at initial recognition is equivalent to the fair value—on that date—of the original derivative (ie the new derivative is off-market). Under this approach the counterparty to the new derivatives is the same as to the original derivative, the original derivative has not been derecognised and the terms of the alternative benchmark rate derivative are not substantially different from that of the original derivative. The Board therefore concluded that such an approach could be regarded as consistent with the changes required by the reform as required in paragraph 102P of IAS 39.

(b) *close-out and replace on substantially different terms (eg on-market terms)*—An entity applying this approach would terminate (close-out) the existing interest rate benchmark-based derivative with a cash settlement. The entity then enters into a new on-market alternative benchmark rate derivative with substantially different terms, so that the new derivative has a fair value of zero at initial recognition. Some respondents to the 2020 Exposure Draft were of the view that since this approach does not result in any gain or loss recognised in profit or loss, it suggests the exchange was done on an economically equivalent basis. The Board disagreed with this view because the original derivative is extinguished and replaced with an alternative benchmark rate derivative with substantially different contractual terms. Therefore, this approach is not considered consistent with the changes required by the reform as required in paragraph 102P of IAS 39.

(c) *add a new basis swap*—An entity applying this approach would retain the original interest rate benchmark-based derivative but enter into a basis swap that swaps the existing interest rate benchmark for the alternative benchmark rate. The combination of the two derivatives is equivalent to modifying the contractual terms of the original derivative to replace the interest rate benchmark with an alternative benchmark rate. The Board noted that, in principle, the combination of an interest rate benchmark-based derivative and an interest rate benchmark-alternative benchmark rate swap could achieve an outcome economically equivalent to amending the original interest rate benchmark-based derivative. However, the Board observed that, in practice, basis swaps are generally entered into on an aggregated basis to economically hedge an entity's net exposure to basis risk, rather than on an individual derivative basis. The Board therefore noted that for this approach to be consistent with the changes required by the reform as described in paragraph 102P of IAS 39, the basis swap must be coupled or linked with the original derivative, ie done on an individual derivative basis. This is because a change to the basis for determining the contractual cash flows of a hedging instrument is made to an individual instrument and, to achieve the same outcome, the basis swap would need to be coupled with an individual derivative.

(d) *novating to a new counterparty*—An entity applying this approach would novate the original interest rate benchmark-based derivative to a new counterparty and subsequently change the contractual cash flows on the novated derivative to replace the interest rate benchmark with an alternative benchmark rate. The Board noted that novation of a derivative would result in the derecognition of the original derivative and thus would require hedge accounting to be discontinued in accordance with paragraph 101 of IAS 39 (see further paragraphs BC220E–BC220G). Therefore, this approach is not consistent with the changes required by the reform as set out in paragraph 102P of IAS 39.

BC313 The Board therefore added paragraph 102Q of IAS 39 so that, an entity also applies paragraph 102P(c) of IAS 39 if these three conditions are met:

(a) the entity makes a change required by the reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 5.4.6 of IFRS 9);

(b) the original hedging instrument is not derecognised; and

(c) the chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 5.4.7 and 5.4.8 of IFRS 9).

BC314 The Board decided not to add further amendments or provide application guidance because IAS 39 as amended provides an adequate basis for analysing the accounting requirements in context of the approaches described in paragraph BC312.

Remeasurement of the hedged item and hedging instrument

BC315 In paragraph BC254, the Board explained that no exceptions were made in Phase 1 to the measurement requirements for hedged items or hedging instruments. The Board concluded that the most useful information would be provided to users of financial statements if requirements for recognition and measurement of hedge ineffectiveness remain unchanged (see paragraph BC253). This is because recognising ineffectiveness in the financial statements based on the actual results of a hedging relationship faithfully represents the economic effects of the reform, thereby providing useful information to users of financial statements.

BC316 Applying the hedge accounting requirements in IAS 39, a gain or loss arising from the remeasurement of the hedged item attributable to the hedged risk or from remeasuring the hedging instrument is reflected in profit or loss when measuring and recognising hedge ineffectiveness.

BC317 When deliberating the Phase 2 amendments, the Board considered that changes in the fair value of the hedged item or hedging instrument could arise when the formal designation of a hedging relationship is amended.

BC318 The Board considered whether to provide an exception from the requirement to include in hedge ineffectiveness such fair value changes when they arise. The Board considered, but rejected, these approaches:

(a) *recognising the measurement adjustment in profit or loss over time*—An entity applying this approach would recognise the measurement adjustment in profit or loss over time (ie amortised) as the hedged item affects profit or loss. The Board rejected this approach because it would require an offsetting entry to be recognised either in the statement of financial position or as an adjustment to the carrying amount of the hedged item or hedging instrument. Such an offsetting entry would fail to meet the definition of an asset or a liability in the *Conceptual Framework*. Adjusting the carrying amount of the hedged item or hedging instrument would result in the recognition of a net measurement adjustment of zero and would be inconsistent with the Board's decision that no exceptions would be made to the measurement of hedged items or hedging instruments. The Board also noted that such an approach would likely result in increased operational complexity because an entity would need to track adjustments that occur at different times for the purpose of amortising the adjustments in the period(s) in which the hedged item affects profit or loss.

(b) *recognising the measurement adjustment as an adjustment to retained earnings*—An entity applying this approach would recognise the measurement adjustment as an adjustment to retained earnings during the period in which the measurement difference arises. However, the Board rejected this approach because the changes to the hedged risk might be driven by amendments to hedging relationships that may occur in different reporting periods. Therefore, recognising adjustments to retained earnings over time would be inconsistent with the Board's previous decisions (throughout IFRS Standards) that an adjustment to retained earnings only applies on transition to new requirements in IFRS Standards. Furthermore, the Board noted that the measurement adjustment would meet the definition of income or expense in the *Conceptual Framework* and therefore should be recognised in the statement of profit or loss. The Board also noted that recognising measurement adjustments directly in retained earnings would be inconsistent with the decision that no exceptions should be made to the measurement of hedged items or hedging instruments.

BC319 Some respondents to the 2020 Exposure Draft said they would not expect any significant changes in fair value to arise from the remeasurement of a hedged item or hedging instrument based on the alternative benchmark rate. That is because these amendments would apply only when the conditions in paragraph 5.4.7 of IFRS 9 are met, which require that changes are made on an economically equivalent basis. The Board acknowledged these comments noting that, applying paragraph 102P of IAS 39, a significant change in fair value arising from the remeasurement of the hedged item or the hedging instrument indicates that the changes were not made on an economically equivalent basis. Furthermore, the Board observed that the requirement in paragraph 102P(b) of IAS 39 which requires the description of the designated portion for the cash flows or fair value being hedged enables entities to amend a hedging relationship to minimise fair value changes on the remeasurement of the hedged item or the hedging instrument.

BC320 The Board therefore confirmed its previous decision not to provide an exception from the requirements in IAS 39 regarding the measurement and recognition of hedge ineffectiveness. Therefore, an entity would apply the requirements in paragraphs 89 (for a fair value hedge) and 96 (for a cash flow hedge) of IAS 39 for the measurement and recognition of hedge ineffectiveness. The Board considered that accounting for such fair value changes in any other way would be inconsistent with the decision to continue applying hedge accounting for such amended hedging relationships (see paragraph 102P of IAS 39). In the Board's view, applying the requirements in IAS 39 for the recognition and measurement of ineffectiveness reflects the economic effects of the amendments to the formal designation of a hedging relationship and therefore, provides useful information to users of financial statements.

Accounting for qualifying hedging relationships

Retrospective effectiveness assessment

BC321 Applying the Phase 1 exception in paragraph 102G of IAS 39, an entity is not required to discontinue a hedge accounting relationship because the actual results of the hedge do not meet the requirements in paragraph AG105(b) of IAS 39. Applying paragraph 102M of IAS 39, an entity is required to cease applying this exception when the uncertainty is no longer present with respect to the hedged risk and the timing and the amount of the interest rate benchmark-based cash flows of the hedged item and hedging instrument, unless the hedging relationship is discontinued before that date. As with the other Phase 1 amendments, at the date the exception in paragraph 102G of IAS 39 ceases to apply, an entity must apply the requirements in IAS 39 (as amended by the Phase 2 amendments). Therefore, at that time, an entity would apply paragraph AG105(b) of IAS 39 to assess whether the actual results of the hedge are within a range of 80–125 per cent and, if the results are outside that range, discontinue hedge accounting.

BC322 The Board considered that when paragraph 102G of IAS 39 ceases to apply and an entity first applies the requirement in paragraph AG105(b) of IAS 39 to assess the retrospective effectiveness of a hedging relationship, the hedging relationship could fail the retrospective assessment if the entity assesses hedge effectiveness on a cumulative basis. In the Board's view, this outcome would be inconsistent with the Board's objective for Phase 1. Specifically, it would be inconsistent with the objective of the exception to prevent the discontinuation of hedge accounting solely due to the effects of the uncertainties arising from the reform on the actual results of a hedge while recognising all ineffectiveness in the financial statements.

BC323 To address the issue described in paragraph BC322, the 2020 Exposure Draft proposed an amendment to IAS 39 that would require an entity, only for the purpose of applying the retrospective assessment, to reset to zero the cumulative fair value changes of the hedged item and the hedging instrument when the exception from the retrospective assessment ceases to apply. This proposed amendment would apply only when an entity assesses retrospective effectiveness on a cumulative basis (ie using the dollar offset method on a cumulative basis). As required by IAS 39, the entity would continue to measure and recognise hedge ineffectiveness by comparing the actual gains or losses on the hedged item to those on the hedging instrument.

BC324 Respondents to the 2020 Exposure Draft agreed with the objective of this proposed amendment but identified particular circumstances in which it could unintentionally cause some hedging relationships to fail the retrospective effectiveness assessment. For example, this could be the case when there is market volatility during the initial period following the transition to an alternative benchmark rate. Such volatility could cause the retrospective effectiveness assessment to breach the 80-125 per cent threshold because an entity would be precluded from assessing effectiveness based on data prior to the reset date even if that data would show that the hedging relationship actually is effective over a longer time horizon. The Board agreed with these comments and therefore, amended paragraph 102V of IAS 39 so that it permits, rather than requires, entities (ie entities may elect) to reset to zero the cumulative fair value changes for the purpose of assessing the retrospective effectiveness of a hedging relationship on a cumulative basis. Considering the nature of this amendment, the Board decided this election is made on an individual hedging relationship basis.

Prospective assessments

BC325 The Phase 1 exception in paragraph 102F of IAS 39 requires an entity to assume that, for the purpose of the prospective effectiveness assessment as required by paragraphs 88(b) and AG105(a) of IAS 39, the interest rate benchmark on which the hedged cash flows and/or the hedged risk (contractually or non-contractually specified) are based, is not altered as a result of the reform. As noted in paragraph 102L of IAS 39, this exception ceases to apply to the hedged item and the hedging instrument, respectively, at the earlier of, when there is no longer uncertainty about the hedged risk or the timing and the amount of the interest rate benchmark-based cash flows; and when the hedging relationship that the hedged item and the hedging instrument are a part of is discontinued.

BC326 Consistent with the Board's considerations on the highly probable requirement (see paragraphs BC327–BC328), the Board considered that, when the formal designation of a hedging relationship has been amended (see paragraph 102P of IAS 39), the prospective assessment should be performed based on the alternative benchmark rate on which the hedged cash flows and/or the hedged risk will be based. The Board therefore provided no exceptions from the prospective assessment for the period after the Phase 1 exception in paragraph 102F of IAS 39 ceases to apply.

Amounts accumulated in the cash flow hedge reserve

BC327 During the period in which a hedging relationship is affected by uncertainty arising from the reform, paragraph 102D of IAS 39 requires an entity to assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered for the purpose of determining whether a forecast transaction (or a component thereof) is highly probable. An entity is required to cease applying this exception at the earlier of the date the uncertainty arising from the reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and the date the hedging relationship of which the hedged item is a part of is discontinued.

BC328 The Board considered that uncertainty about the timing and the amount of the hedged cash flows would no longer be present when the interest rate benchmark on which the hedged cash flows are based is altered as required by the reform. In other words, uncertainty would no longer be present when an entity amends the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged, applying paragraph 102P(b) of IAS 39. Thereafter, applying the requirement in paragraph 88(c) of IAS 39, the assessment of whether the hedged cash flows are still highly probable to occur would be based on the contractual cash flows determined by reference to the alternative benchmark rate.

BC329 The Board noted that the amendment in paragraph 102P(b) of IAS 39 for amending the formal designation of a hedging relationship could lead to changes in the hedged item. Therefore, if an entity uses a hypothetical derivative—that is, a derivative that would have terms matching the critical terms of the designated cash flows and the hedged risk, commonly used in cash flow hedges to represent the forecast transaction—the entity may need to change the hypothetical derivative to calculate the change in the value of the hedged item to measure hedge ineffectiveness.

BC330 Consequently, as hedge accounting would not be discontinued when a hedging relationship is amended for changes required by the reform (see paragraph 102P of IAS 39), the Board decided that an entity would deem the amount accumulated in the cash flow hedge reserve at that point to be based on the alternative benchmark rate on which the hedged future cash flows are determined. Therefore, in applying paragraph 97 of IAS 39, the amount accumulated in the cash flow hedge reserve would be reclassified to profit or loss in the same period(s) during which the hedged cash flows based on the alternative benchmark rate affect profit or loss.

BC331 The approach described in paragraph BC330 is consistent with the Board's view that, when a hedging relationship is amended for changes required by the reform, more useful information is provided to users of financial statements if hedge accounting is not discontinued and amounts are not reclassified to profit or loss solely due to the changes required by the reform. This is because such an approach will more faithfully reflect the economic effects of changes required by the reform.

BC332 Consistent with the requirements in paragraphs 102E and 102K of IAS 39, the Board considered whether to provide similar relief for any discontinued hedging relationships in which the previously designated hedged item is subject to the reform. The Board observed that although a hedging relationship may have been discontinued, the amount accumulated in the cash flow hedge reserve arising from that hedging relationship remains in the reserve if the hedged future cash flows are still expected to occur. The Board noted that if the hedged future cash flows are still expected to occur, the previously designated hedged item will be subject to a change required by the reform, even if the hedging relationship has been discontinued.

BC333 The Board therefore decided that, for the purpose of applying paragraph 101(c) of IAS 39, an entity deems the cumulative gain or loss recognised in the other comprehensive income for a discontinued hedging relationship, to be based on the alternative benchmark rate on which the contractual cash flows will be based, which is similar to the amendment in paragraph 102W of IAS 39. That amount is reclassified to profit or loss in the same period(s) in which the hedged future cash flows based on the alternative benchmark rate affect profit or loss.

BC334 Some respondents to the 2020 Exposure Draft asked the Board to clarify whether the requirements in paragraphs 102W–102X of IAS 39 require the retrospective measurement of the hedged item based on the alternative benchmark rate-based cash flows—in other words, whether an entity would be required to recalculate what the cumulative gain or loss recognised in other comprehensive income would have been if the hedged item was based on the alternative benchmark rate since inception.

BC335 The Board considered that the cumulative gain or loss recognised in other comprehensive income is adjusted as required by paragraph 96 of IAS 39 (ie the cumulative gain or loss recognised in other comprehensive income is not subject to separate measurement requirements, but instead is derived from the cumulative changes in the fair value of the hedged item (present value) and hedging instrument). The Phase 2 amendments do not include an exception from the measurement requirements in IFRS 9. Accordingly, the fair value of the hedging instrument or of the hedged item (ie the present value of the cumulative changes in the hedged expected future cash flows) is determined at the measurement date based on the expected future cash flows and assumptions that market participants would use. In other words, the fair values are not determined retrospectively. The Board therefore considered that the cumulative gain or loss recognised in other comprehensive income is not remeasured as if it had been based on the alternative benchmark rate since inception of the hedging relationship.

BC336 The Board confirmed that the amendments in paragraphs 102W–102X of IAS 39 extend to cash flow hedges, regardless of whether the cash flow hedge is for an open or closed hedged portfolio. The general reference to cash flow hedges in these paragraphs reflects such scope, therefore, the Board considered that explicitly addressing open or closed hedged portfolios was unnecessary.

Groups of items

BC337 The Board considered that for groups of items designated as hedged items in a fair value or cash flow hedge, the hedged items could consist of items still referenced to the interest rate benchmark as well as items already referenced to the alternative benchmark rate. Therefore, an entity could not amend the description of the hedged risk or the hedged item, including the designated portion of the cash flows or fair value being hedged with reference only to an alternative benchmark rate for the whole group. The Board also considered that it would be inconsistent with the objectives of the Phase 2 amendments to require the discontinuation of such a hedging relationship solely because of the effects of the reform. In the Board's view, the same requirements and relief that apply to other hedging relationships should apply to groups of items designated as hedged items, including dynamic hedging relationships.

BC338 Paragraphs 102Y–102Z of IAS 39 therefore require an entity to allocate the individual hedged items to subgroups based on the benchmark rate designated as the hedged risk for each subgroup and to apply the requirements in paragraphs 78 and 83 of IAS 39 to each subgroup separately. The Board acknowledged that this approach is an exception to the hedge accounting requirements in IAS 39 because other hedge accounting requirements, including the requirements in paragraphs 89 and 96 of IAS 39, are applied to the hedging relationship in its entirety. However, in the Board's view, the robustness of the hedge accounting requirements is maintained because if any subgroup fails to meet the requirements in paragraphs 78 and 83 of IAS 39, the entity is required to discontinue hedge accounting for that entire hedging relationship. The Board concluded this accounting outcome is appropriate because the basis for designating the hedged item on a group basis is that the entity is managing the designated hedge for the group as a whole.

BC339 The Board acknowledged that preparers may incur additional costs to assess each subgroup in a hedging relationship separately, and to track items moving from one subgroup to another. However, the Board concluded that an entity is likely to have such information available because IAS 39 already requires it to identify and document hedged items designated within a hedging relationship with sufficient specificity. Therefore, the Board concluded that the benefits of avoiding the discontinuation of hedge accounting and the resulting accounting impacts outweigh the associated costs of this exception.

BC340 Respondents to the 2020 Exposure Draft asked the Board whether the requirement for groups of items applies to dynamic hedges of interest rate benchmark-based items when the items mature and are replaced with alternative benchmark rate-based items. The Board considered that although the objective of the Phase 2 amendments is to provide relief when individual items transition to an alternative benchmark rate, the replacement of items that have expired with items that reference the alternative benchmark rate is a natural consequence of a dynamic hedging relationship. Therefore, the Board observed that new items designated as part of the group to replace interest rate benchmark-based items that have matured would be allocated to the relevant subgroup based on the benchmark rate being hedged.

BC341 Respondents also asked the Board to clarify how the requirements in paragraphs 102Y–102Z of IAS 39 apply to the hypothetical derivative in a cash flow hedge, specifically, whether the hypothetical derivative could be amended (and therefore measured) based on the alternative benchmark rate if the actual hedged item (such as a floating rate loan) has not yet transitioned to the alternative benchmark rate. The Board considered that IAS 39 does not include specific requirements for the hypothetical derivative because it is one possible way of calculating the change in the value of the hedged item to measure ineffectiveness. Therefore, the terms on which the hypothetical derivative is constructed replicate the hedged risk and the hedged cash flows of the hedged item an entity is hedging. The hypothetical derivative cannot include features in the value of the hedged item that exist only in the hedging instrument (but not in the hedged item). The Board therefore decided that the identification of an appropriate hypothetical derivative is based on the requirements to measure hedge ineffectiveness and it would not be appropriate to include specific amendments for applying the requirements in paragraphs 102Y–102Z to the hypothetical derivative.

Designating financial items as hedged items

End of application of the Phase 1 exception

BC342 An entity may designate an item in its entirety or a portion of an item as the hedged item in a hedging relationship. Paragraphs 81 and AG99F of IAS 39 allow entities to designate only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk portion).

BC343 When developing the Phase 1 amendments, the Board decided not to set an end date for applying the exception for the separately identifiable requirement (see paragraphs 102H–102I of IAS 39). The Board considered that including an end date for that exception could require an entity to immediately discontinue hedge accounting at a point in time because, as the reform progresses, a risk portion based on the interest rate benchmark may no longer be separately identifiable (for example, as the market for the alternative benchmark rate is established). As noted in paragraph BC283, in the Board's view, such an immediate discontinuation of hedge accounting would be inconsistent with the objective of this exception in Phase 1. Therefore, when issuing the Phase 1 amendments, the Board decided that an entity should cease applying the Phase 1 exception from the separately identifiable requirement to a hedging relationship only when that hedging relationship is discontinued applying the requirements in IAS 39.

BC344 Having considered the interaction between the Phase 1 exception from the separately identifiable requirement and the Phase 2 amendments to the hedge accounting requirements in IAS 39, the Board decided it is necessary to specify that an entity is required to cease applying the Phase 1 exception from the separately identifiable requirement when the uncertainty arising from the reform, which led to that exception, is no longer present.

BC345 The Board considered that continuing to apply the Phase 1 amendments after the uncertainty arising from the reform is no longer present would not faithfully represent the actual characteristics of the elements of the hedging relationship in which the uncertainty has been eliminated nor the economic effects of the reform. The Board therefore added paragraph 102O to IAS 39 so the Phase 1 exception from the separately identifiable requirement ceases to apply at the earlier of:

(a) when changes required by the reform are made to the non-contractually specified risk portion as set out in paragraph 102P of IAS 39; or

(b) when the hedging relationship in which the non-contractually specified risk portion was designated is discontinued.

Application of the 'separately identifiable' requirement to an alternative benchmark rate

BC346 In developing the Phase 2 amendments, the Board was aware that considerations similar to those discussed in paragraphs BC342–BC345 apply to designating an alternative benchmark rate as a non-contractually specified risk portion in either a cash flow hedge or a fair value hedge. This is because an entity's ability to conclude that the alternative benchmark rate meets the requirements in paragraphs 81 and AG99F of IAS 39 that a risk portion must be separately identifiable and reliably measurable could be affected in the early stages of the reform.

BC347 Specific requirements on the separately identifiable requirement are already set out in paragraph 81 of IAS 39. However, the Board considered that an entity might expect an alternative benchmark rate to meet the separately identifiable requirement in IAS 39 within a reasonable period of time even though the alternative benchmark rate does not meet the requirement when it is designated as a risk portion.

BC348 The amendment in paragraph 102Z1 of IAS 39 applies to different set of instruments from the Phase 1 exception. For items within the scope of paragraph 102Z1 of IAS 39, the separately identifiable requirement has never been satisfied. In contrast, the population of hedging relationships to which the Phase 1 relief applied had already satisfied the qualifying criteria for hedge accounting to be applied. The Board therefore considered that any relief from the separately identifiable requirement in Phase 2 should be temporary.

BC349 Consequently, in the 2020 Exposure Draft, the Board proposed that an alternative benchmark rate that does not meet the requirement to be separately identifiable at the date it is designated as a non-contractually specified risk portion would be deemed to have met the requirement at that date if, and only if, an entity reasonably expects that the alternative benchmark rate will be separately identifiable within 24 months from the date it is designated as a risk portion.

BC350 Respondents to the 2020 Exposure Draft agreed with this proposed amendment but asked the Board to clarify the date from which the 24-month period applies. The Board acknowledged respondents' concerns, and considered whether the 24-month period applies:

(a) on a hedge-by-hedge basis—that is, to each hedging relationship individually, beginning from the date an alternative benchmark rate is designated as a risk portion in that relationship; or

(b) on a rate-by-rate basis—that is to, each alternative benchmark rate separately, beginning from the date when an entity first designates an alternative benchmark rate as a hedged risk for the first time.

BC351 The Board acknowledged that applying the 24-month period to each hedging relationship individually (as proposed in the 2020 Exposure Draft)—that is, on a hedge-by-hedge basis—is consistent with the basis on which hedging relationships are designated. For each new hedge designation, an entity is required to assess whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, have been met. However, the Board also considered that applying the 24-month period to different hedging relationships (with the same alternative benchmark rate designated as a risk portion) at different times, could add an unnecessary operational burden as the period would end at different times and thus would need to be monitored over different periods, for different hedging relationships. For example, if an entity designates the alternative benchmark rate as the risk portion in two hedging relationships—the first designated on 31 March 20X1 and the second on 30 June 20X1—the 24-month period for each hedge would begin and end at different dates, although the designated risk is the same in both hedging relationships.

BC352 Therefore, the Board decided that the requirement in paragraph 102Z1 would apply on a rate-by-rate basis so the 24-month period applies to each alternative benchmark rate separately and hence, starts from the date that an entity designates an alternative benchmark rate as a non-contractually specified risk portion for the first time (but see also paragraph 108J of IAS 39). The Board considered that if an entity concludes for one hedging relationship that it no longer has a reasonable expectation that the alternative benchmark rate would meet the requirements within the 24-month period, it is likely that the entity would reach the same conclusion for all other hedging relationships in which that particular alternative benchmark rate has been designated. Applying this requirement to the example in paragraph BC351, the 24-month period will begin on 31 March 20X1 for that alternative benchmark rate.

BC353 Despite the requirement to apply the 24-month period to each alternative benchmark rate separately, the requirement to assess whether an alternative benchmark rate is separately identifiable continues to separately apply to each hedging relationship. In other words, an entity is required to assess, for each hedge designation, whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, are met for the remainder of the 24-month period (ie until 31 March 20X3 following from the example in paragraph BC351).

BC354 Consistent with the requirement in IAS 39 to continuously assess the separately identifiable requirement, an entity's ability to conclude that an alternative benchmark rate is a separately identifiable component requires assessment over the life of the hedging relationship including during the 24-month period discussed in paragraph BC352. However, the Board decided that to avoid the complexity of detailed judgements during the 24-month period, an entity is required to cease applying the requirement during the 24-month period if, and only if, the entity reasonably expects that the alternative benchmark rate will not meet the separately identifiable requirement within that period. If an entity reasonably expects that an alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designates it as a non-contractually specified risk portion for the first time, the entity is required to cease applying the requirement in paragraph 102Z1 of IAS 39 to that alternative benchmark rate and discontinue applying hedge accounting prospectively from the date of that reassessment to all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk portion.

BC355 The Board acknowledged that 24 months is an arbitrary period. However, in the Board's view, a clearly defined end point is necessary because of the temporary nature of the amendment. The exception described in paragraphs 102Z1–102Z3 of IAS 39 is a significant relief from one of the requirements that is a basis for the robustness of the hedge accounting requirements, therefore the relief is intentionally short-lived. The Board considered that a period of 24 months will assist entities in applying the hedge accounting requirements in IAS 39 particularly during the early stages of the transition to alternative benchmark rates. Therefore, the Board decided that a period of 24 months from the date an entity first designates an alternative benchmark rate as a non-contractually specified risk portion, is a reasonable period and would enable entities to implement the reform and comply with any regulatory requirements, while avoiding potential short-term disruption as the market for an alternative benchmark rate develops.

BC356 While developing the proposals in the 2020 Exposure Draft, the Board considered proposing alternative periods for the requirement in paragraph 102Z1 of IAS 39, including a period of 12 months or a period longer than 24 months. However, the Board acknowledged the diversity in the approaches to the reform or replacement of interest rate benchmarks and the timing of the expected completion across various jurisdictions. The Board was concerned that 12 months would not provide sufficient time across all jurisdictions. At the same time, the Board considered that entities may not be able to have a reasonable expectation that an alternative benchmark rate would satisfy the separately identifiable requirement over a period longer than 24 months.

BC357 The Board emphasised that the amendments apply only for the separately identifiable requirement and not the reliably measurable requirement. Therefore, if the risk portion is not reliably measurable, either when it is designated or thereafter, the alternative benchmark rate would not meet the qualifying criteria to be designated as a risk portion in a hedging relationship. Similarly, if the hedging relationship fails to meet any other qualifying criteria set out in IAS 39 to apply hedge accounting, either at the date the alternative benchmark rate is designated or during the 24-month period, the entity is required to discontinue hedge accounting prospectively from that date. The Board decided that providing relief only for the separately identifiable requirement would achieve the objective described in paragraph BC292.

Mandatory application

BC358 The Board decided to require application of the Phase 2 amendments. The Board considered that allowing voluntary application of these amendments (ie except for the amendment in paragraph 102V of IAS 39 which is permitted, but not required) could lead to selective application to achieve specific accounting results. The Board also noted that the amendments are, to a large extent, interlinked and need to be applied consistently. Voluntary application, even if only possible by area or type of financial instruments, would reduce comparability of information provided in the financial statements between entities. The Board also does not expect that mandatory application of these amendments would result in significant additional costs for preparers and other affected parties because these amendments are designed to ease the operational burden on preparers, while providing useful information to users of financial statements, and would not require significantly more effort by preparers in addition to what is already required to implement the changes required by the reform.

End of application

BC359 The Board did not add specific end of application requirements for the Phase 2 amendments because the application of these amendments is associated with the point at which changes to financial instruments or hedging relationships occur as a result of the reform. Therefore, by design, the application of these amendments has a natural end.

BC360 The Board noted that, in a simple scenario, the Phase 2 amendments will be applied only once to each financial instrument or element of a hedging relationship. However, the Board acknowledged that because of differences in the approach to the reform applied in different jurisdictions and differences in timing, implementing the reform could require more than one change to the basis for determining the contractual cash flows of a financial asset or a financial liability.

BC361 As noted in paragraph 102R of IAS 39, the Board considered that an entity may be required to amend the formal designation of its hedging relationships at different times, or to amend the formal designation of a hedging relationship more than once. For example, an entity may first make changes required by the reform to a derivative designated as a hedging instrument, while only making changes required by the reform to the financial instrument designated as the hedged item later. In applying the amendments, the entity would be required to amend the hedge documentation to amend the description of the hedging instrument. The hedge documentation of the hedging relationship would then have to be amended again to change the description of the hedged item and/or hedged risk as required in paragraph 102P of IAS 39.

BC362 The amendment for hedges of risk portions in paragraph 102Z1 of IAS 39 applies only at the date an entity first designates a particular alternative benchmark rate as a non-contractually specified risk portion for the first time if an entity's ability to conclude that an alternative benchmark rate is separately identifiable is directly affected by the reform. Thus, an entity could not apply this amendment in other circumstances in which the entity is not able to conclude that an alternative benchmark rate is a separately identifiable risk portion.

BC363 The Board developed the amendment in paragraph 102V of IAS 39 to address the potential effect in hedge accounting at the date the Phase 1 exception from the retrospective assessment in paragraph 102G of IAS 39 ceases to apply. Therefore, the amendment in paragraph 102V of IAS 39 only applies at that date ie the date that the exception from the retrospective assessment in paragraph 102G of IAS 39 ceases to apply.

Effective date and transition

BC364 Acknowledging the urgency of the amendments, the Board decided that entities must apply the Phase 2 amendments for annual periods beginning on or after 1 January 2021, with earlier application permitted.

BC365 The Board decided that the amendments apply retrospectively in accordance with IAS 8 (except as discussed in paragraphs BC367–BC370) because prospective application would have resulted in entities applying the amendments only if the transition to alternative benchmark rates occurred after the effective date of the amendments.

BC366 The Board acknowledged that there could be situations in which an entity amended a hedging relationship as specified in paragraph 102P of IAS 39 in the period before the entity first applied the Phase 2 amendments; and in the absence of the Phase 2 amendments, IAS 39 would require the entity to discontinue hedge accounting. The Board noted that the reasons for the amendment in paragraph 102P of IAS 39 (see paragraphs BC300–BC301), apply equally in such situations. The Board therefore considered that discontinuation of hedge accounting solely because of amendments an entity made in hedge documentation to reflect appropriately the changes required by the reform, regardless of when those changes occurred, would not provide useful information to users of financial statements.

BC367 The Board acknowledged that the reinstatement of discontinued hedging relationships is inconsistent with the Board's previous decisions about hedge accounting in IAS 39. This is because hedge accounting is applied prospectively and applying it retrospectively to discontinued hedging relationships usually requires the use of hindsight. However, the Board considered that in the specific circumstances of the reform, an entity would typically be able to reinstate a discontinued hedging relationship without the use of hindsight. The +Board noted that this reinstatement of discontinued hedging relationships would apply to a very targeted population for a short period—that is, for hedging relationships which would not have been discontinued if the Phase 2 amendments relating to hedge accounting had been applied at the point of discontinuation. The Board therefore proposed in the 2020 Exposure Draft that an entity would be required to reinstate hedging relationships that were discontinued solely due to changes required by the reform before an entity first applies the proposed amendments.

BC368 Respondents to the 2020 Exposure Draft generally supported and welcomed the transition proposals but asked the Board to reconsider a specific aspect of the proposal that would require entities to reinstate particular discontinued hedging relationships. Specifically, these respondents highlighted circumstances in which reinstating discontinued hedging relationships would be challenging or have limited benefit—for example, when:

(a) the hedging instruments or the hedged items in the discontinued hedging relationships have been subsequently designated into new hedging relationships;

(b) the hedging instruments in the discontinued hedging relationships no longer exist at the date of initial application of the amendments—eg they have been terminated or sold; or

(c) the hedging instruments in the discontinued hedging relationships are now being managed within a trading mandate with other trading positions and reported as trading instruments.

BC369 The Board noted that the transition requirements as proposed in the 2020 Exposure Draft to apply the amendments retrospectively in accordance with IAS 8—including the requirement to reinstate particular discontinued hedging relationships—would be subject to impracticability applying IAS 8. However, the Board agreed with respondents' concerns that there could be other circumstances in which it would not be impracticable to reinstate the hedging relationship, but such reinstatement would be challenging or would have limited benefit. For example, if the hedging instrument or hedged item has been designated in a new hedging relationship, it appears inappropriate to require entities to reinstate the 'old' (original) hedging relationship and discontinue or unwind the 'new' (valid) hedging relationship. Consequently, the Board added paragraph 108I(b) to IAS 39 to address these concerns.

BC370 In addition, the Board concluded that if an entity reinstates a discontinued hedging relationship applying paragraph 108I(b) of IAS 39, for the purpose of applying paragraphs 102Z1–102Z2 of IAS 39, the 24-month period for the alternative benchmark rate designated as a non-contractually specified risk portion begins from the date of initial application of the Phase 2 amendments (ie it does not begin from the date the entity designated the alternative benchmark rate as a non-contractually specified risk portion for the first time in the original hedging relationship).

BC371 Consistent with the transition requirements for Phase 1, the Board decided that an entity is not required to restate comparative information. However, an entity may choose to restate prior periods if, and only if, it is possible without the use of hindsight.

Hong Kong Financial Reporting Standard 4

Insurance Contracts

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Hong Kong Financial Reporting Standard 4 *Insurance Contracts* (HKFRS 4) is set out in paragraphs 1-49 and Appendices A-B~~ and D~~. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 4 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting.* HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

20Q An entity may apply paragraphs 20O and 20P(b) separately for each associate or joint venture.

Changes in the basis for determining the contractual cash flows as a result of interest rate benchmark reform

20R An insurer applying the temporary exemption from HKFRS 9 shall apply the requirements in paragraphs 5.4.6–5.4.9 of HKFRS 9 to a financial asset or financial liability if, and only if, the basis for determining the contractual cash flows of that financial asset or financial liability changes as a result of interest rate benchmark reform. For this purpose, the term ‘interest rate benchmark reform’ refers to the market-wide reform of an interest rate benchmark as described in paragraph 102B of HKAS 39.

20S For the purpose of applying paragraphs 5.4.6–5.4.9 of the amendments to HKFRS 9, the references to paragraph B5.4.5 of HKFRS 9 shall be read as referring to paragraph AG7 of HKAS 39. References to paragraphs 5.4.3 and B5.4.6 of HKFRS 9 shall be read as referring to paragraph AG8 of HKAS 39.

Changes in accounting policies

21 Paragraphs 22-30 apply both to changes made by an insurer that already applies HKFRSs and to changes made by an insurer adopting HKFRSs for the first time.

22 An insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An insurer shall judge relevance and reliability by the criteria in HKAS 8.

23 To justify changing its accounting policies for insurance contracts, an insurer shall show that the change brings its financial statements closer to meeting the criteria in HKAS 8, but the change need not achieve full compliance with those criteria. The following specific issues are discussed below:

(a) current interest rates (paragraph 24);

(b) continuation of existing practices (paragraph 25);

(c) prudence (paragraph 26);

(d) future investment margins (paragraphs 27-29); and

(e) shadow accounting (paragraph 30).

Current market interest rates

24 An insurer is permitted, but not required, to change its accounting policies so that it remeasures designated insurance liabilities[*] to reflect current market interest rates and recognises changes in those liabilities in profit or loss. At that time, it may also introduce accounting policies that require other current estimates and assumptions for the designated liabilities. The election in this paragraph permits an insurer to change its accounting policies for designated liabilities, without applying those policies consistently to all similar liabilities as HKAS 8 would otherwise require. If an insurer designates liabilities for this election, it shall continue to apply current market interest rates (and, if applicable, the other current estimates and assumptions) consistently in all periods to all these liabilities until they are extinguished.

Continuation of existing practices

25 An insurer may continue the following practices, but the introduction of any of them does not satisfy paragraph 22:

(a) measuring insurance liabilities on an undiscounted basis.

(b) measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services. It is likely that the fair value at inception of those contractual rights equals the origination costs paid, unless future investment management fees and related costs are out of line with market comparables.

(c) using non-uniform accounting policies for the insurance contracts (and related deferred acquisition costs and related intangible assets, if any) of subsidiaries, except as permitted by paragraph 24. If those accounting policies are not uniform, an insurer may change them if the change does not make the accounting policies more diverse and also satisfies the other requirements in this HKFRS.

[*] In this paragraph, insurance liabilities include related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32.

Prudence

26 An insurer need not change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it shall not introduce additional prudence.

Future investment margins

27 An insurer need not change its accounting policies for insurance contracts to eliminate future investment margins. However, there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts, unless those margins affect the contractual payments. Two examples of accounting policies that reflect those margins are:

(a) using a discount rate that reflects the estimated return on the insurer's assets; or

(b) projecting the returns on those assets at an estimated rate of return, discounting those projected returns at a different rate and including the result in the measurement of the liability.

28 An insurer may overcome the rebuttable presumption described in paragraph 27 if, and only if, the other components of a change in accounting policies increase the relevance and reliability of its financial statements sufficiently to outweigh the decrease in relevance and reliability caused by the inclusion of future investment margins. For example, suppose that an insurer's existing accounting policies for insurance contracts involve excessively prudent assumptions set at inception and a discount rate prescribed by a regulator without direct reference to market conditions, and ignore some embedded options and guarantees. The insurer might make its financial statements more relevant and no less reliable by switching to a comprehensive investor-oriented basis of accounting that is widely used and involves:

(a) current estimates and assumptions;

(b) a reasonable (but not excessively prudent) adjustment to reflect risk and uncertainty;

(c) measurements that reflect both the intrinsic value and time value of embedded options and guarantees; and

The overlay approach

48 *Applying HKFRS 9* Financial Instruments *with HKFRS 4* Insurance Contracts (Amendments to HKFRS 4), issued in January 2017, amended paragraphs 3 and 5, and added paragraphs 35A–35N and 39K–39M and headings after paragraphs 35A, 35K, 35M and 39J. An entity shall apply those amendments, which permit insurers to apply the overlay approach to designated financial assets, when it first applies HKFRS 9 (see paragraph 35C).

49 An entity that elects to apply the overlay approach shall:

(a) apply that approach retrospectively to designated financial assets on transition to HKFRS 9. Accordingly, for example, the entity shall recognise as an adjustment to the opening balance of accumulated other comprehensive income an amount equal to the difference between the fair value of the designated financial assets determined applying HKFRS 9 and their carrying amount determined applying HKAS 39.

(b) restate comparative information to reflect the overlay approach if, and only if, the entity restates comparative information applying HKFRS 9.

50 *Interest Rate Benchmark Reform—Phase 2*, which amended HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16, issued in October 2020, added paragraphs 20R–20S and paragraph 51. An entity shall apply these amendments for annual periods beginning on or after 1 January 2021. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively in accordance with HKAS 8, except as specified in paragraph 51.

51 An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise 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 these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

Basis for Conclusions on
Hong Kong Financial Reporting Standards 4

Insurance Contracts

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

BC277 In contrast, the Board rejected a fixed expiry date for the overlay approach. Unlike insurers applying the temporary exemption from IFRS 9, insurers applying the overlay approach will provide the improved financial instrument information required by IFRS 9 and information about the effects on designated assets of moving from IAS 39 to IFRS 9. Accordingly, the rationale set out in paragraph BC276 for setting a fixed expiry date for the temporary exemption does not apply to the overlay approach. However, the forthcoming insurance contract Standard will replace IFRS 4 and therefore, the overlay approach in IFRS 4 will no longer exist when the insurer first applies that forthcoming Standard.

Amendments to IFRS 17 Insurance Contracts

BC277A In June 2020, the Board extended the expiry date for the temporary exemption from IFRS 9 by two years to annual periods beginning on or after 1 January 2023. The extension maintains the alignment between the expiry date of the temporary exemption and the effective date of IFRS 17, which replaces IFRS 4. In June 2020, the Board deferred the effective date of IFRS 17 by two years to annual periods beginning on or after 1 January 2023.

BC277B The Board was reluctant to extend the temporary exemption beyond 1 January 2021 because doing so results in some entities (including entities with significant holdings of financial assets) first applying IFRS 9 up to five years after other entities. However, the Board noted that in originally introducing a temporary exemption from IFRS 9 for some insurers, it had concluded that, for this limited population of entities, the benefit of the relief provided by the temporary exemption outweighed the disadvantages of delaying the improved information resulting from applying IFRS 9 (see paragraph BC249). For similar reasons, the Board concluded that, on balance, the benefit of extending the availability of the relief to continue to enable some insurers to first apply IFRS 17 and IFRS 9 at the same time outweighs the disadvantages of the additional delay to the application of IFRS 9.

BC277C The Board considered whether it should specify additional disclosures as a consequence of extending the expiry date of the temporary exemption. Such disclosures would require insurers applying the temporary exemption to provide additional information about expected credit losses. The Board concluded that adding such disclosures to the requirements in IFRS 4 would be disruptive when many insurers were at a late stage of IFRS 9 and IFRS 17 implementation.

Amendments for Interest Rate Benchmark Reform—Phase 2 *(August 2020)*

BC277D In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2* (2020 Exposure Draft), which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 to address issues that might affect financial reporting during the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate. The term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 102B of IAS 39 (the reform). The Board issued the final amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 in August 2020 (Phase 2 amendments). Paragraphs BC5.287–BC5.320 of the Basis for Conclusions on IFRS 9 discuss the background to these amendments.

BC277E The Board noted that paragraph 20A of IFRS 4 permits an insurer that meets specific criteria to apply IAS 39 rather than IFRS 9 for annual periods beginning before the effective date of IFRS 17 (temporary exemption from applying IFRS 9).

BC277F When the Board decided to provide a temporary exemption from applying IFRS 9 (see paragraph 20A of IFRS 4), the Board noted that, because of the temporary nature of the exemption and its relatively narrow application, a version of IAS 39 (except for its hedge accounting requirements) would not be maintained and updated for any subsequent amendments to other IFRS Standards. This would mean that an insurer applying the temporary exemption would be required to apply the requirements in IAS 39 to account for changes in the basis for determining contractual cash flows as a result of the reform; ie such an insurer would not be able to apply the amendments set out in paragraphs 5.4.5–5.4.9 of IFRS 9.

BC277G The Board noted that the financial assets and financial liabilities of such an insurer could be affected by the reform in the same way as those for other entities. The Board therefore decided the Phase 2 amendments in paragraphs 5.4.5–5.4.9 of IFRS 9 should apply to insurers that apply the IAS 39 requirements. The Board noted that amending the superseded paragraphs in IAS 39 would be inconsistent with its previous decisions that IAS 39 (except for its hedge accounting requirements) would not be maintained. However, the Board decided to amend IFRS 4 to require insurers applying the temporary exemption from IFRS 9 to apply requirements that are comparable to paragraphs 5.4.5–5.4.9 of the Phase 2 amendments to financial assets and financial liabilities for which the basis for determining the contractual cash flows of those financial assets or financial liabilities change as a result of the reform. The Board noted that this decision was due to the significance of the potential effect of the reform on insurers and reaffirmed its overall position that it will not update the classification and measurement requirements of IAS 39.

Temporary exemption from specific requirements in IAS 28

BC278 When an entity applies the equity method, paragraphs 35-36 of IAS 28 *Investments in Associates and Joint Ventures* require the entity to adjust its associate's or joint venture's accounting policies to conform them to the entity's accounting policies.

HKFRS 7
Revised ~~October 2020~~July 2021

Effective for annual periods
beginning on or after 1 January 2007

Hong Kong Financial Reporting Standard 7

Financial Instruments:

Disclosures

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Hong Kong Financial Reporting Standard 7 *Financial Instruments: Disclosures* (HKFRS 7) is set out in paragraphs 1-45 and Appendices A-~~D~~C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 7 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

(c) on discontinuation of measuring a financial instrument, or a proportion of it, at fair value through profit or loss, that financial instrument's fair value that has become the new carrying amount in accordance with paragraph 6.7.4 of HKFRS 9 and the related nominal or principal amount (except for providing comparative information in accordance with HKAS 1, an entity does not need to continue this disclosure in subsequent periods).

Uncertainty arising from interest rate benchmark reform

24H For hedging relationships to which an entity applies the exceptions set out in paragraphs 6.8.4–6.8.12 of HKFRS 9 or paragraphs 102D–102N of HKAS 39, an entity shall disclose:

(a) the significant interest rate benchmarks to which the entity's hedging relationships are exposed;

(b) the extent of the risk exposure the entity manages that is directly affected by the interest rate benchmark reform;

(c) how the entity is managing the process to transition to alternative benchmark rates;

(d) a description of significant assumptions or judgements the entity made in applying these paragraphs (for example, assumptions or judgements about when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows); and

(e) the nominal amount of the hedging instruments in those hedging relationships.

Additional disclosures related to interest rate benchmark reform

24I To enable users of financial statements to understand the effect of interest rate benchmark reform on an entity's financial instruments and risk management strategy, an entity shall disclose information about:

(a) the nature and extent of risks to which the entity is exposed arising from financial instruments subject to interest rate benchmark reform, and how the entity manages these risks; and

(b) the entity's progress in completing the transition to alternative benchmark rates, and how the entity is managing the transition.

24J To meet the objectives in paragraph 24I, an entity shall disclose:

(a) how the entity is managing the transition to alternative benchmark rates, its progress at the reporting date and the risks to which it is exposed arising from financial instruments because of the transition;

(b) disaggregated by significant interest rate benchmark subject to interest rate benchmark reform, quantitative information about financial instruments that have yet to transition to an alternative benchmark rate as at the end of the reporting period, showing separately:

(i) non-derivative financial assets;

(ii) non-derivative financial liabilities; and

(iii) derivatives; and

(c) if the risks identified in paragraph 24J(a) have resulted in changes to an entity's risk management strategy (see paragraph 22A), a description of these changes.

Fair value

25 Except as set out in paragraph 29, for each class of financial assets and financial liabilities (see paragraph 6), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.

26 In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.

27-27B [Deleted]

28 In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph B5.1.2A of HKFRS 9). In such cases, the entity shall disclose by class of financial asset or financial liability:

(a) its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price to reflect a change in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of HKFRS 9).

(b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

(c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

29 Disclosures of fair value are not required:

(a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;

(b) [deleted]

(c) for a contract containing a discretionary participation feature (as described in HKFRS 4) if the fair value of that feature cannot be measured reliably; or

(d) for lease liabilities.

30 In the cases described in paragraph 29(c), an entity shall disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those contracts and their fair value, including:

(a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;

(b) a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;

(c) information about the market for the instruments;

(d) information about whether and how the entity intends to dispose of the financial instruments; and

(e) if financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.

44GG *Interest Rate Benchmark Reform—Phase 2*, which amended HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16, issued in October 2020, added paragraphs 24I–24J and 44HH. An entity shall apply these amendments when it applies the amendments to HKFRS 9, HKAS 39, HKFRS 4 or HKFRS 16.

44HH In the reporting period in which an entity first applies *Interest Rate Benchmark Reform—Phase 2*, an entity is not required to disclose the information that would otherwise be required by paragraph 28(f) of HKAS 8.

Withdrawal of HKAS 30

45 This HKFRS supersedes HKAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*.

Basis for Conclusions on
Hong Kong Financial Reporting Standard 7

Financial Instruments:

Disclosures

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

BC35AAA Some respondents to the 2019 Exposure Draft raised concerns about the disclosure requirement in paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. This paragraph requires an entity, on the initial application of an IFRS (or amendments to an IFRS), to disclose, for the current period and each prior period presented, the amount of any adjustment for each financial statement line item affected.

BC35BBB These respondents said that requiring such disclosure for the amendments to IFRS 9 and IAS 39 would not provide useful information to users of financial statements and also would be onerous for preparers. This is because it would require an entity to maintain parallel systems in order to determine the amount of the adjustment for each financial statement line item affected. Furthermore, disclosing this information would be inconsistent with the Board's observation in paragraph BC6.550 of IFRS 9 and paragraph BC227 of IAS 39, that discontinuing hedge accounting solely due to uncertainties arising from the reform would not provide useful information to users of financial statements.

BC35CCC The Board agreed with these comments and decided to exempt entities from the requirement in paragraph 28(f) of IAS 8 in the reporting period in which an entity first applies the amendments to IFRS 9 and IAS 39.

Other Disclosures—Additional disclosures related to interest rate benchmark reform

BC35DDD In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2* (2020 Exposure Draft), which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 to address issues that might affect financial reporting during the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate. The term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of IFRS 9 (the reform). The Board issued the final amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 in August 2020 (Phase 2 amendments). Paragraphs BC5.287–BC5.320, BC6.604–BC6.660 and BC7.86–BC7.99 of the Basis for Conclusions on IFRS 9 and paragraphs BC289–BC371 of the Basis for Conclusions on IAS 39 discuss the background to these amendments.

BC35EEE In deciding whether disclosures should accompany the Phase 2 amendments, the Board acknowledged that it was important to balance the benefits of providing useful information to users of financial statements with the costs for preparers to provide the information. To achieve this balance, the Board sought to develop disclosure requirements that would provide useful information to users of financial statements about the effects of the reform on an entity's financial instruments and risk management strategy without requiring disclosures for which the cost of providing that information would outweigh the benefits of the amendments. Consequently, the Board decided not to require quantitative disclosures of what the effects of the reform would have been in the absence of the Phase 2 amendments because the cost of providing such information could outweigh the benefits provided by the amendments. For the same reason, the Board decided not to require entities to provide the disclosure that would otherwise be required by paragraph 28(f) of IAS 8.

BC35FFF In the 2020 Exposure Draft the Board proposed limited additional disclosure requirements by setting out the proposed disclosure objectives and the disclosure requirements to meet those objectives. Most respondents to the 2020 Exposure Draft supported the proposed disclosure objectives and broadly agreed with the proposed disclosures. However, respondents suggested that the Board should simplify aspects of the disclosure required by paragraph 24J(b) of IFRS 7. Furthermore, respondents asked the Board to reconsider whether disclosure of information about how an entity applied the requirements in paragraphs 5.4.6–5.4.8 of IFRS 9 would provide useful information to users of financial statements.

BC35GGG Paragraph 24J(b) of IFRS 7 in the 2020 Exposure Draft proposed requiring that entities disclose the carrying amount of non-derivative financial assets, non-derivative financial liabilities and the nominal amount of derivatives, that continue to reference interest rate benchmarks subject to the reform. Respondents to the 2020 Exposure Draft agreed that providing quantitative information about the magnitude of remaining financial instruments that still need to transition to alternative benchmark rates would be useful for understanding the entity's progress towards completing the implementation of the reform. However, respondents said that the requirement to provide this quantitative information based on the carrying amounts of the relevant non-derivative financial instruments may require an entity to make costly enhancements to its reporting systems and implement additional controls and reconciliations. In the light of a limited time frame, this would be challenging for preparers, in particular those preparers that plan to early apply the Phase 2 amendments. These respondents asked the Board to permit entities to disclose quantitative information on alternative bases—for example, if information about the carrying amounts of relevant non-derivative financial instruments is not available without undue cost or effort, an entity would be able to disclose the quantitative information on the basis that is reported internally to management as part of implementing the reform.

BC35HHH During outreach on the proposed disclosure requirements, users of financial statements told the Board that, while the quantitative information proposed in the 2020 Exposure Draft is a useful measure of an entity's progress in implementing the reform, they acknowledge the quantitative information for non-derivative financial assets and non-derivative financial liabilities is only a subset of the amounts already presented in the relevant line items of the entity's financial statements and therefore such quantitative information does not reconcile. These users of financial statements said that quantitative information would still be useful even if an entity selected another representative basis on which to disclose it.

BC35III The Board considered that the underlying objective of the disclosure required by paragraph 24J(b) of IFRS 7 is to enable users of financial statements to understand the entity's progress towards completing the transition to alternative benchmark rates. Quantitative information about financial assets and financial liabilities that—as at the end of the reporting period—reference interest rate benchmarks that are subject to the reform would therefore assist users of financial statements to assess an entity's progress towards implementing the reform. The Board also considered that for this disclosure to be useful, the quantitative information about non-derivative financial assets, non-derivative financial liabilities and derivatives that continue to reference interest rate benchmarks subject to the reform should be provided in the context of the total non-derivative financial assets, total non-derivative financial liabilities and total derivatives as at the end of the reporting period.

BC35JJJ The Board agreed that an entity could still meet the underlying objective of this disclosure requirement by providing the relevant quantitative information in different ways. Furthermore, the Board considered that permitting entities to select a basis on which to provide relevant quantitative information to achieve the disclosure objective would allow entities to leverage information that is already available and therefore would reduce the costs of providing the information.

BC35KKK Accordingly, the Board amended paragraph 24J(b) of IFRS7 to require an entity to disclose quantitative information that enables users of financial statements to understand the extent of financial assets and financial liabilities that, as at the end of the reporting period, have yet to transition to alternative benchmark rates. This information would be disaggregated by significant interest rate benchmark. An entity would select the basis for disclosing the quantitative information and explain which basis was applied. For example, the quantitative information may be based on:

(a) the carrying amounts of non-derivative financial assets, the carrying amount of non-derivative financial liabilities and the nominal amount of derivatives;

(b) the amounts related to recognised financial instruments (for example, the contractual par amount of non-derivative financial assets and non-derivative financial liabilities, and nominal amounts of derivatives); or

(c) the amounts provided internally to key management personnel (as defined in IAS 24) of the entity about these financial instruments, for example, the entity's board of directors or chief executive officer.

BC35LLL Furthermore, the Board clarified that the disclosure in paragraph 24J(b) of IFRS 7 does not require disclosure of financial instruments that are referenced to an interest rate benchmark subject to the reform at the reporting date, but which will expire prior to transitioning to an alternative benchmark rate. This is because, to meet the objective of this disclosure requirement (see paragraph BC35III), an entity is required to provide information about financial instruments that would be required to transition to alternative benchmark rates (ie before their maturity).

BC35MMM The 2020 Exposure Draft proposed requiring a description of how an entity determined the base rate and relevant adjustments to that rate, including any significant judgements the entity made to assess whether the conditions for applying the practical expedient in paragraph 5.4.7 of IFRS 9 were met. Respondents to the 2020 Exposure Draft said that in the light of the regulatory nature of the reform, entities might be unable to provide this information in a way that would be sufficiently detailed and entity-specific for it to be useful to users of financial statements. Respondents often described the potential challenges in disclosing this information in a meaningful way by reference to multinational entities that are exposed to different alternative benchmark rates. These respondents said that if the proposed disclosure was intended to confirm that the changes were economically equivalent, then the disclosure was unnecessary. The fact that an entity has applied the practical expedient would automatically inform users of financial statements that the entity has assessed that the conditions for applying the practical expedient were met. These respondents also said that, if applying those conditions required significant judgement, paragraph 122 of IAS 1 would require an entity to disclose those judgements.

BC35NNN During outreach on the proposed disclosure requirements in the 2020 Exposure Draft, users of financial statements expressed mixed views on this proposed disclosure requirement. While some users of financial statements said the proposed disclosure could be useful for understanding the extent of changes to financial instruments to which the practical expedient is being applied, others were sceptical about whether entities would be able to disclose information in sufficient detail for it to be meaningful. In particular, they highlighted the risk that the disclosures would be summarised at such an aggregated level that the information would not be useful. They also said that they would regard a requirement for an entity to explain how it has determined that it met the conditions to apply the practical expedient in paragraph 5.4.7 of IFRS 9 to be an audit or regulatory enforcement matter, rather than a matter for disclosure in the financial statements. The Board therefore decided to omit this proposed disclosure requirement from the final amendments to IFRS 7.

BC35OOO Some respondents to the 2020 Exposure Draft asked the Board to clarify whether paragraphs 24I and 24J of IFRS 7 are required for comparative periods, ie periods before the date of initial application of these amendments, even if the entity does not restate prior periods. The Board noted that the transition requirements for the Phase 2 amendments to IFRS 9, IAS 39, IFRS 4 and IFRS 16 specify that an entity is not required (but is permitted if, and only if, it is possible without the use of hindsight) to restate prior periods to reflect the application of these amendments. Therefore, if the entity does not restate prior periods, paragraphs 24I and 24J of IFRS 7 need not be applied to prior reporting periods.

Other disclosures—fair value (paragraphs 25-30)[7]

BC36 Many entities use fair value information internally in determining their overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgement of the financial markets about the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of why they are held and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. The Board decided that when an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it should provide fair value information through supplementary disclosures to assist users to compare entities on a consistent basis.

[7] IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value and for disclosing information about fair value measurements. As a consequence paragraphs 27-27B of IFRS 7 have been deleted.

HKFRS 9
Revised ~~October 2020~~July 2021

Hong Kong Financial Reporting Standard 9 (2014)

Financial Instruments

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

COPYRIGHT

CONTENTS *from paragraph*

Hong Kong Financial Reporting Standard 9 *Financial Instruments* (HKFRS 9) is set out in paragraphs 1.1–7.3.2 and Appendices A–~~D~~C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the HKFRS. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. HKFRS 9 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

(b) financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become *credit-impaired financial assets*. For those financial assets, the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.

5.4.2 An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the amortised cost of a financial asset in accordance with paragraph 5.4.1(b), shall, in subsequent reporting periods, calculate the interest revenue by applying the effective interest rate to the gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 5.4.1(b) were applied (such as an improvement in the borrower's credit rating).

Modification of contractual cash flows

5.4.3 When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a *modification gain or loss* in profit or loss. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

Write-off

5.4.4 An entity shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event (see paragraph B3.2.16(r)).

Changes in the basis for determining the contractual cash flows as a result of interest rate benchmark reform

5.4.5 An entity shall apply paragraphs 5.4.6–5.4.9 to a financial asset or financial liability if, and only if, the basis for determining the contractual cash flows of that financial asset or financial liability changes as a result of interest rate benchmark reform. For this purpose, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2.

5.4.6 The basis for determining the contractual cash flows of a financial asset or financial liability can change:

(a) by amending the contractual terms specified at the initial recognition of the financial instrument (for example, the contractual terms are amended to replace the referenced interest rate benchmark with an alternative benchmark rate);

(b) in a way that was not considered by—or contemplated in—the contractual terms at the initial recognition of the financial instrument, without amending the contractual terms (for example, the method for calculating the interest rate benchmark is altered without amending the contractual terms); and/or

(c) because of the activation of an existing contractual term (for example, an existing fallback clause is triggered).

5.4.7 As a practical expedient, an entity shall apply paragraph B5.4.5 to account for a change in the basis for determining the contractual cash flows of a financial asset or financial liability that is required by interest rate benchmark reform. This practical expedient applies only to such changes and only to the extent the change is required by interest rate benchmark reform (see also paragraph 5.4.9). For this purpose, a change in the basis for determining the contractual cash flows is required by interest rate benchmark reform if, and only if, both these conditions are met:

(a) the change is necessary as a direct consequence of interest rate benchmark reform; and

(b) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the change).

5.4.8 Examples of changes that give rise to a new basis for determining the contractual cash flows that is economically equivalent to the previous basis (ie the basis immediately preceding the change) are:

(a) the replacement of an existing interest rate benchmark used to determine the contractual cash flows of a financial asset or financial liability with an alternative benchmark rate—or the implementation of such a reform of an interest rate benchmark by altering the method used to calculate the interest rate benchmark—with the addition of a fixed spread necessary to compensate for the basis difference between the existing interest rate benchmark and the alternative benchmark rate;

(b) changes to the reset period, reset dates or the number of days between coupon payment dates in order to implement the reform of an interest rate benchmark; and

(c) the addition of a fallback provision to the contractual terms of a financial asset or financial liability to enable any change described in (a) and (b) above to be implemented.

5.4.9 If changes are made to a financial asset or financial liability in addition to changes to the basis for determining the contractual cash flows required by interest rate benchmark reform, an entity shall first apply the practical expedient in paragraph 5.4.7 to the changes required by interest rate benchmark reform. The entity shall then apply the applicable requirements in this Standard to any additional changes to which the practical expedient does not apply. If the additional change does not result in the derecognition of the financial asset or financial liability, the entity shall apply paragraph 5.4.3 or paragraph B5.4.6, as applicable, to account for that additional change. If the additional change results in the derecognition of the financial asset or financial liability, the entity shall apply the derecognition requirements.

5.5 Impairment

Recognition of expected credit losses

General approach

5.5.1 An entity shall recognise a *loss allowance* for *expected credit losses* on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d).

5.5.2 An entity shall apply the impairment requirements for the recognition and measurement of a loss allowance for financial assets that are measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However, the loss allowance shall be recognised in other comprehensive income and shall not reduce the carrying amount of the financial asset in the statement of financial position.

5.5.3 Subject to paragraphs 5.5.13–5.5.16, at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the *lifetime expected credit losses* if the credit risk on that financial instrument has increased significantly since initial recognition.

5.5.4 The objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition — whether assessed on an individual or collective basis — considering all reasonable and supportable information, including that which is forward-looking.

(b) to a hedging instrument, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedging instrument.

If the hedging relationship that the hedged item and the hedging instrument are part of is discontinued earlier than the date specified in paragraph 6.8.11(a) or the date specified in paragraph 6.8.11(b), the entity shall prospectively cease applying paragraph 6.8.6 to that hedging relationship at the date of discontinuation.

6.8.12 When designating a group of items as the hedged item, or a combination of financial instruments as the hedging instrument, an entity shall prospectively cease applying paragraphs 6.8.4–6.8.6 to an individual item or financial instrument in accordance with paragraphs 6.8.9, 6.8.10, or 6.8.11, as relevant, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of the interest rate benchmark-based cash flows of that item or financial instrument.

6.8.13 An entity shall prospectively cease applying paragraphs 6.8.7 and 6.8.8 at the earlier of:

(a) when changes required by interest rate benchmark reform are made to the non-contractually specified risk component applying paragraph 6.9.1; or

(b) when the hedging relationship in which the non-contractually specified risk component is designated is discontinued.

6.9 Additional temporary exceptions arising from interest rate benchmark reform

6.9.1 As and when the requirements in paragraphs 6.8.4–6.8.8 cease to apply to a hedging relationship (see paragraphs 6.8.9–6.8.13), an entity shall amend the formal designation of that hedging relationship as previously documented to reflect the changes required by interest rate benchmark reform, ie the changes are consistent with the requirements in paragraphs 5.4.6–5.4.8. In this context, the hedge designation shall be amended only to make one or more of these changes:

(a) designating an alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;

(b) amending the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged; or

(c) amending the description of the hedging instrument.

6.9.2 An entity also shall apply the requirement in paragraph 6.9.1(c) if these three conditions are met:

(a) the entity makes a change required by interest rate benchmark reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 5.4.6);

(b) the original hedging instrument is not derecognised; and

(c) the chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 5.4.7 and 5.4.8).

6.9.3 The requirements in paragraphs 6.8.4–6.8.8 may cease to apply at different times. Therefore, in applying paragraph 6.9.1, an entity may be required to amend the formal designation of its hedging relationships at different times, or may be required to amend the formal designation of a hedging relationship more than once. When, and only when, such a change is made to the hedge designation, an entity shall apply paragraphs 6.9.7–6.9.12 as applicable. An entity also shall apply paragraph 6.5.8 (for a fair value hedge) or paragraph 6.5.11 (for a cash flow hedge) to account for any changes in the fair value of the hedged item or the hedging instrument.

6.9.4 An entity shall amend a hedging relationship as required in paragraph 6.9.1 by the end of the reporting period during which a change required by interest rate benchmark reform is made to the hedged risk, hedged item or hedging instrument. For the avoidance of doubt, such an amendment to the formal designation of a hedging relationship constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship.

6.9.5 If changes are made in addition to those changes required by interest rate benchmark reform to the financial asset or financial liability designated in a hedging relationship (as described in paragraphs 5.4.6–5.4.8) or to the designation of the hedging relationship (as required by paragraph 6.9.1), an entity shall first apply the applicable requirements in this Standard to determine if those additional changes result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, an entity shall amend the formal designation of the hedging relationship as specified in paragraph 6.9.1.

6.9.6 Paragraphs 6.9.7–6.9.13 provide exceptions to the requirements specified in those paragraphs only. An entity shall apply all other hedge accounting requirements in this Standard, including the qualifying criteria in paragraph 6.4.1, to hedging relationships that were directly affected by interest rate benchmark reform.

Accounting for qualifying hedging relationships

Cash flow hedges

6.9.7 For the purpose of applying paragraph 6.5.11, at the point when an entity amends the description of a hedged item as required in paragraph 6.9.1(b), the amount accumulated in the cash flow hedge reserve shall be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.

6.9.8 For a discontinued hedging relationship, when the interest rate benchmark on which the hedged future cash flows had been based is changed as required by interest rate benchmark reform, for the purpose of applying paragraph 6.5.12 in order to determine whether the hedged future cash flows are expected to occur, 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.

Groups of items

6.9.9 When an entity applies paragraph 6.9.1 to groups of items designated as hedged items in a fair value or cash flow hedge, the entity shall allocate the hedged items to subgroups based on the benchmark rate being hedged and designate the benchmark rate as the hedged risk for each subgroup. For example, in a hedging relationship in which a group of items is hedged for changes in an interest rate benchmark subject to interest rate benchmark reform, the hedged cash flows or fair value of some items in the group could be changed to reference an alternative benchmark rate before other items in the group are changed. In this example, in applying paragraph 6.9.1, the entity would designate the alternative benchmark rate as the hedged risk for that relevant subgroup of hedged items. The entity would continue to designate the existing interest rate benchmark as the hedged risk for the other subgroup of hedged items until the hedged cash flows or fair value of those items are changed to reference the alternative benchmark rate or the items expire and are replaced with hedged items that reference the alternative benchmark rate.

6.9.10 An entity shall assess separately whether each subgroup meets the requirements in paragraph 6.6.1 to be an eligible hedged item. If any subgroup fails to meet the requirements in paragraph 6.6.1, the entity shall discontinue hedge accounting prospectively for the hedging relationship in its entirety. An entity also shall apply the requirements in paragraphs 6.5.8 and 6.5.11 to account for ineffectiveness related to the hedging relationship in its entirety.

Designation of risk components

6.9.11 An alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable (see paragraphs 6.3.7(a) and B6.3.8) at the date it is designated shall be deemed to have met that requirement at that date, if, and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within 24 months. The 24-month period applies to each alternative benchmark rate separately and starts from the date the entity designates the alternative benchmark rate as a non-contractually specified risk component for the first time (ie the 24-month period applies on a rate-by-rate basis).

6.9.12 If subsequently an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designated it as a non-contractually specified risk component for the first time, the entity shall cease applying the requirement in paragraph 6.9.11 to that alternative benchmark rate and discontinue hedge accounting prospectively from the date of that reassessment for all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk component.

6.9.13 In addition to those hedging relationships specified in paragraph 6.9.1, an entity shall apply the requirements in paragraphs 6.9.11 and 6.9.12 to new hedging relationships in which an alternative benchmark rate is designated as a non-contractually specified risk component (see paragraphs 6.3.7(a) and B6.3.8) when, because of interest rate benchmark reform, that risk component is not separately identifiable at the date it is designated.

Chapter 7 Effective date and transition

7.1 Effective date

7.1.1 An entity shall apply this Standard for annual periods beginning on or after 1 January 2018. Earlier application is permitted. If an entity elects to apply this Standard early, it must disclose that fact and apply all of the requirements in this Standard at the same time (but see also paragraphs 7.1.2, 7.2.21 and 7.3.2). It shall also, at the same time, apply the amendments in Appendix C.

7.1.2 Despite the requirements in paragraph 7.1.1, for annual periods beginning before 1 January 2018, an entity may elect to early apply only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss in paragraphs 5.7.1(c), 5.7.7–5.7.9, 7.2.14 and B5.7.5–B5.7.20 without applying the other requirements in this Standard. If an entity elects to apply only those paragraphs, it shall disclose that fact and provide on an ongoing basis the related disclosures set out in paragraphs 10–11 of HKFRS 7 (as amended by HKFRS 9 (2010)). (See also paragraphs 7.2.2 and 7.2.15.)

7.1.3 *Annual Improvements to HKFRSs 2010–2012 Cycle*, issued in January 2014, amended paragraphs 4.2.1 and 5.7.5 as a consequential amendment derived from the amendment to HKFRS 3. An entity shall apply that amendment prospectively to business combinations to which the amendment to HKFRS 3 applies.

7.1.4 HKFRS 15, issued in July 2014, amended paragraphs 3.1.1, 4.2.1, 5.1.1, 5.2.1, 5.7.6, B3.2.13, B5.7.1, C5 and C42 and deleted paragraph C16 and its related heading. Paragraphs 5.1.3 and 5.7.1A, and a definition to Appendix A, were added. An entity shall apply those amendments when it applies HKFRS 15.

7.1.5 HKFRS 16, issued in May 2016, amended paragraphs 2.1, 5.5.15, B4.3.8, B5.5.34 and B5.5.46. An entity shall apply those amendments when it applies HKFRS 16.

7.1.6 [This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]

7.1.7 *Prepayment Features with Negative Compensation* (Amendments to HKFRS 9), issued in November 2017, added paragraphs 7.2.29–7.2.34 and B4.1.12A and amended paragraphs B4.1.11(b) and B4.1.12(b). An entity shall apply these amendments for annual periods beginning on or after 1 January 2019. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.1.8 *Interest Rate Benchmark Reform*, which amended HKFRS 9, HKAS 39 and HKFRS 7, issued in November 2019, added Section 6.8 and amended paragraph 7.2.26. An entity shall apply these amendments for annual periods beginning on or after 1 January 2020. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.1.9 [This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]

7.1.10 *Interest Rate Benchmark Reform—Phase 2*, which amended HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16, issued in October 2020, added paragraphs 5.4.5–5.4.9, 6.8.13, Section 6.9 and paragraphs 7.2.43–7.2.46. An entity shall apply these amendments for annual periods beginning on or after 1 January 2021. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.2 Transition

7.2.1 An entity shall apply this Standard retrospectively, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 7.2.4–7.2.26 and 7.2.28. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

7.2.2 For the purposes of the transition provisions in paragraphs 7.2.1, 7.2.3–7.2.28 and 7.3.2, the date of initial application is the date when an entity first applies those requirements of this Standard and must be the beginning of a reporting period after the issue of this Standard. Depending on the entity's chosen approach to applying HKFRS 9, the transition can involve one or more than one date of initial application for different requirements.

Transition for classification and measurement (Chapters 4 and 5)

7.2.3 At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraphs 4.1.2(a) or 4.1.2A(a) on the basis of the facts and circumstances that exist at that date. The resulting classification shall be applied retrospectively irrespective of the entity's business model in prior reporting periods.

(c) may revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with the condition now in paragraph 4.2.2(a) and such designation satisfies that condition at the date of initial application.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

7.2.11 If it is impracticable (as defined in HKAS 8) for an entity to apply retrospectively the effective interest method, the entity shall treat:

(a) the fair value of the financial asset or the financial liability at the end of each comparative period presented as the gross carrying amount of that financial asset or the amortised cost of that financial liability if the entity restates prior periods; and

(b) the fair value of the financial asset or the financial liability at the date of initial application as the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of initial application of this Standard.

7.2.12 If an entity previously accounted at cost (in accordance with HKAS 39), for an investment in an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input) (or for a derivative asset that is linked to and must be settled by delivery of such an equity instrument) it shall measure that instrument at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognised in the opening retained earnings (or other component of equity, as appropriate) of the reporting period that includes the date of initial application.

7.2.13 If an entity previously accounted for a derivative liability that is linked to, and must be settled by, delivery of an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input) at cost in accordance with HKAS 39, it shall measure that derivative liability at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognised in the opening retained earnings of the reporting period that includes the date of initial application.

7.2.14 At the date of initial application, an entity shall determine whether the treatment in paragraph 5.7.7 would create or enlarge an accounting mismatch in profit or loss on the basis of the facts and circumstances that exist at the date of initial application. This Standard shall be applied retrospectively on the basis of that determination.

7.2.14A At the date of initial application, an entity is permitted to make the designation in paragraph 2.5 for contracts that already exist on the date but only if it designates all similar contracts. The change in the net assets resulting from such designations shall be recognised in retained earnings at the date of initial application.

7.2.15 Despite the requirement in paragraph 7.2.1, an entity that adopts the classification and measurement requirements of this Standard (which include the requirements related to amortised cost measurement for financial assets and impairment in Sections 5.4 and 5.5) shall provide the disclosures set out in paragraphs 42L–42O of HKFRS 7 but need not restate prior periods. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise 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 in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this Standard. If an entity's chosen approach to applying HKFRS 9 results in more than one date of initial application for different requirements, this paragraph applies at each date of initial application (see paragraph 7.2.2). This would be the case, for example, if an entity elects to early apply only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss in accordance with paragraph 7.1.2 before applying the other requirements in this Standard.

7.2.16 If an entity prepares interim financial reports in accordance with HKAS 34 *Interim Financial Reporting* the entity need not apply the requirements in this Standard to interim periods prior to the date of initial application if it is impracticable (as defined in HKAS 8).

7.2.34 In the reporting period that includes the date of initial application of these amendments, the entity shall disclose the following information as at that date of initial application for each class of financial assets and financial liabilities that were affected by these amendments:

(a) the previous measurement category and carrying amount determined immediately before applying these amendments;

(b) the new measurement category and carrying amount determined after applying these amendments;

(c) the carrying amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated; and

(d) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss.

7.2.35-7.2.42 *[These paragraphs refer to amendments that are not yet effective, and are therefore not included in this edition.]*

Transition for *Interest Rate Benchmark Reform—Phase 2*

7.2.43 An entity shall apply *Interest Rate Benchmark Reform—Phase 2* retrospectively in accordance with HKAS 8, except as specified in paragraphs 7.2.44–7.2.46.

7.2.44 An entity shall designate a new hedging relationship (for example, as described in paragraph 6.9.13) only prospectively (ie an entity is prohibited from designating a new hedge accounting relationship in prior periods). However, an entity shall reinstate a discontinued hedging relationship if, and only if, these conditions are met:

(a) the entity had discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and the entity would not have been required to discontinue that hedging relationship if these amendments had been applied at that time; and

(b) at the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments), that discontinued hedging relationship meets the qualifying criteria for hedge accounting (after taking into account these amendments).

7.2.45 If, in applying paragraph 7.2.44, an entity reinstates a discontinued hedging relationship, the entity shall read references in paragraphs 6.9.11 and 6.9.12 to the date the alternative benchmark rate is designated as a non-contractually specified risk component for the first time as referring to the date of initial application of these amendments (ie the 24-month period for that alternative benchmark rate designated as a non-contractually specified risk component begins from the date of initial application of these amendments).

7.2.46 An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise 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 these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

7.3 Withdrawal of HK(IFRIC) - Int 9, HKFRS 9 (2009), HKFRS 9 (2010) and HKFRS 9 (2013)

7.3.1 This Standard supersedes HK(IFRIC)-Int 9 *Reassessment of Embedded Derivatives*. The requirements added to HKFRS 9 in November 2010 incorporated the requirements previously set out in paragraphs 5 and 7 of HK(IFRIC)-Int 9. As a consequential amendment, HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* incorporated the requirements previously set out in paragraph 8 of HK(IFRIC)-Int 9.

7.3.2 This Standard supersedes HKFRS 9 (2009), HKFRS 9 (2010) and HKFRS 9 (2013). However, for annual periods beginning before 1 January 2018, an entity may elect to apply those earlier versions of HKFRS 9 instead of applying this Standard if, and only if, the entity's relevant date of initial application is before 1 February 2015.

Basis for Conclusions on
Hong Kong Financial Reporting Standard 9 (2014)

Financial Instruments

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

CONTENTS *from paragraph*

BASIS FOR CONCLUSIONS ON IFRS 9 *FINANCIAL INSTRUMENTS*

Prudential information

BC5.282 Some respondents to the 2013 Impairment Exposure Draft asked the IASB to ensure that the requirements for measuring expected credit losses in accordance with Section 5.5 of IFRS 9 are aligned to the prudential capital frameworks. Certain prudential regulation and capital adequacy systems, such as the framework developed by the Basel Committee on Banking Supervision, already require financial institutions to calculate 12-month expected credit losses as part of their regulatory capital requirements. However, some of those systems only use credit loss experience based on historical events to set out 'provisioning' levels over the entire economic cycle ('through-the-cycle'). Furthermore, through-the-cycle approaches consider a range of possible economic outcomes instead of those that are actually expected at the reporting date. This would result in a loss allowance that does not reflect the economic characteristics of the financial instruments at the reporting date.

BC5.283 The IASB notes that financial reporting, including estimates of expected credit losses, are based on information, circumstances and events at the reporting date. The IASB expects entities to be able to use some regulatory measures as a basis for the calculation of expected credit losses in accordance with the requirements in IFRS 9. However, these calculations may have to be adjusted to meet the measurement requirements in Section 5.5 of IFRS 9. Only information that is available without undue cost or effort and supportable at the reporting date should be considered. This may include information about current economic conditions as well as reasonable and supportable forecasts of future economic conditions, as long as the information is supportable and available without undue cost or effort when the estimates are made.

BC5.284 Some interested parties are also of the view that loss allowance balances should be used to provide a counter-cyclical effect by building up loss allowances in good times to be used in bad times. This would, however, mask the effect of changes in credit loss expectations.

BC5.285 Some users of financial statements would prefer a representation of credit losses with a conservative or prudential bias, arguing that such a representation would better meet the needs of regulators, who are responsible for maintaining financial stability, and investors. The IASB notes that the objective of the impairment requirements is to faithfully represent the economic reality of expected credit losses in relation to the carrying amount of a financial asset. The IASB does not include in this objective the recognition of a loss allowance that will sufficiently cover unexpected credit losses, because that is not the primary objective of general purpose financial reporting.

BC5.286 The impairment requirements in IFRS 9 are based on the information available at the reporting date and are designed to reflect economic reality, instead of adjusting the assumptions and inputs applied to achieve a counter-cyclical effect. For example, when credit risk improves, the measurement of the loss allowance will faithfully represent that change. This is consistent with the objective of general purpose financial statements.

Amendments for *Interest Rate Benchmark Reform—Phase 2* (August 2020)

Background

BC5.287 In 2014, the Financial Stability Board recommended the reform of specified major interest rate benchmarks such as interbank offered rates (IBORs). Since then, public authorities in many jurisdictions have taken steps to implement interest rate benchmark reform and have increasingly encouraged market participants to ensure timely progress towards the reform of interest rate benchmarks, including the replacement of interest rate benchmarks with alternative, nearly risk-free interest rates that are based, to a greater extent, on transaction data (alternative benchmark rates). The progress towards interest rate benchmark reform follows the general expectation that some major interest rate benchmarks will cease to be published by the end of 2021. The term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of IFRS 9 (the reform).

BC5.288 In September 2019 the IASB amended IFRS 9, IAS 39 and IFRS 7, to address as a priority issues affecting financial reporting in the period before the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (Phase 1 amendments). The Phase 1 amendments provide temporary exceptions to specific hedge accounting requirements due to the uncertainty arising from the reform. Paragraphs BC6.546–BC6.603 discuss the background to the Phase 1 amendments.

BC5.289 After the issuance of the Phase 1 amendments, the IASB commenced its Phase 2 deliberations. In Phase 2 of its project on the reform, the IASB addressed issues that might affect financial reporting during the reform of an interest rate benchmark, including changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate (replacement issues).

BC5.290 The objective of Phase 2 is to assist entities in providing useful information to users of financial statements and to support preparers in applying IFRS Standards when changes are made to contractual cash flows or hedging relationships because of the transition to alternative benchmark rates. The IASB observed that for information about the effects of the transition to alternative benchmark rates to be useful, the information has to be relevant to users of financial statements and faithfully represent the economic effects of that transition on the entity. This objective assisted the IASB in assessing whether it should amend IFRS Standards or whether the requirements in IFRS Standards already provided an adequate basis to account for such effects.

BC5.291 In April 2020 the IASB published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2* (2020 Exposure Draft), which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 *Leases* to address replacement issues.

BC5.292 Almost all respondents to the 2020 Exposure Draft welcomed the IASB's decision to address replacement issues and agreed that the proposed amendments would achieve the objective of Phase 2. Many respondents highlighted the urgency of these amendments, especially in some jurisdictions that have progressed towards the reform or the replacement of interest rate benchmarks with alternative benchmark rates.

BC5.293 In August 2020 the IASB amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 by issuing *Interest Rate Benchmark Reform—Phase 2* (Phase 2 amendments). The Phase 2 amendments, which confirmed with modifications the proposals in the 2020 Exposure Draft, added paragraphs 5.4.5–5.4.9, 6.8.13, Section 6.9 and paragraphs 7.1.10 and 7.2.43–7.2.46 to IFRS 9.

Changes in the basis for determining the contractual cash flows of financial assets and financial liabilities arising from the reform

BC5.294 The IASB was informed that changes to financial assets or financial liabilities arising from the reform could be made in different ways. Specifically, entities may change the basis for determining the contractual cash flows of a financial instrument by:

(a) amending the contractual terms of a financial asset or a financial liability to replace the referenced interest rate benchmark with an alternative benchmark rate;

(b) altering the method for calculating the interest rate benchmark without amending the contractual terms of the financial instrument; and/or

(c) triggering the activation of an existing contractual term such as a fallback clause.

BC5.295 To meet the objective described in paragraph BC5.290, the IASB concluded that the scope of the Phase 2 amendments in paragraphs 5.4.5–5.4.9 of IFRS 9 should include all changes to a financial asset or financial liability as a result of the reform, regardless of the legal form triggering those changes. In each situation outlined in paragraph BC5.294 the basis for determining the contractual cash flows of a financial instrument changes as a result of the reform. Therefore, for the purpose of the Phase 2 amendments, the IASB collectively refers to these changes as 'changes in the basis for determining the contractual cash flows of a financial asset or a financial liability'.

What constitutes 'a change in the basis for determining the contractual cash flows of a financial asset or a financial liability'

BC5.296 In the IASB's view, determining whether a change in the basis for determining the contractual cash flows of a financial instrument has occurred will be straightforward in most cases, for example, when the contractual terms of a financial instrument are amended to replace the interest rate benchmark with an alternative benchmark rate. However, it may be less straightforward if the basis for determining the contractual cash flows changes after the initial recognition of the financial instrument, without an amendment to the contractual terms of that financial instrument—for example, when, to effect the reform, the method for calculating the interest rate benchmark is altered. Although the contractual terms of the financial instrument may not be amended, such a change in the method for calculating the interest rate benchmark may change the basis for determining the contractual cash flows of that financial instrument compared to the prior basis (ie the basis immediately preceding the change).

BC5.297 The IASB noted that paragraph 5.4.3 of IFRS 9 refers to the 'modification or renegotiation of the contractual cash flows' of a financial asset, while paragraph 3.3.2 of IFRS 9 refers to the 'modification of the terms' of an existing financial liability. The IASB noted that although these paragraphs use different words, both refer to a change in the contractual cash flows or contractual terms after the initial recognition of the financial instrument. In both cases, such a change was not specified or considered in the contract at initial recognition.

BC5.298 The IASB considered that if the amendments in paragraphs 5.4.6–5.4.9 of IFRS 9 applied only to cases in which the contractual terms are amended as a result of the reform, the form rather than the substance of the change would determine the appropriate accounting treatment. This could cause the economic effects of a change in the basis for determining the contractual cash flows arising as a result of the reform to be obscured by the form of the change and not reflected in the financial statements, and result in changes with equivalent economic effects being accounted for differently.

BC5.299 Consequently, the IASB highlighted that the basis for determining the contractual cash flows of a financial asset or a financial liability can change even if the contractual terms of the financial instrument are not amended. In the IASB's view, accounting consistently for a change in the basis for determining the contractual cash flows arising as a result of the reform, even if the contractual terms of the financial instrument are not amended, would reflect the economic substance of such a change and would therefore provide useful information to users of financial statements.

BC5.300 In addition, as noted in paragraph BC5.294(c), the IASB also learned that some entities may implement the reform through the activation of existing contractual terms, such as fallback provisions. For example, a fallback provision could specify the hierarchy of rates to which an interest rate benchmark would revert in case the existing benchmark rate ceases to exist. The IASB decided these situations—ie revisions to an entity's estimates of future cash payments or receipts arising from the activation of existing contractual terms that are required by the reform—should also be within the scope of the Phase 2 amendments. Doing so, avoids differences in accounting outcomes simply because the changes in the basis for determining the contractual cash flows were triggered by an existing contractual term instead of by a change in the contractual cash flows or contractual terms after the initial recognition of the financial instrument. Such diversity in accounting outcomes would reduce the usefulness of information provided to users of financial statements and would be burdensome to preparers.

Changes required by the reform

BC5.301 As set out in paragraph 5.4.7 of IFRS 9, the Phase 2 amendments provide a practical expedient that requires entities to apply paragraph B5.4.5 of IFRS 9 to account for changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required by the reform. In reaching that decision, the IASB considered the usefulness of the information that would result from applying the requirements in IFRS 9 that would otherwise apply to these changes.

BC5.302 In the absence of the practical expedient in paragraph 5.4.7 of IFRS 9, when a financial asset or financial liability is modified, an entity applying IFRS 9 is required to determine whether the modification results in the derecognition of the financial instrument. Different accounting for the modification is specified depending on whether derecognition is required. IFRS 9 sets out separate requirements for derecognition of financial assets and derecognition of financial liabilities.

BC5.303 The IASB noted that, because alternative benchmark rates are intended to be nearly risk-free while many existing interest rate benchmarks are not, it is likely that a fixed spread will be added to compensate for a basis difference between an existing interest rate benchmark and an alternative benchmark rate to avoid a transfer of economic value between the parties to a financial instrument. If these are the only changes made, the IASB considers that it would be unlikely that the transition to an alternative benchmark rate alone would result in the derecognition of that financial instrument.

BC5.304 Paragraph 5.4.3 of IFRS 9 applies to modifications of financial assets that do not result in derecognition of those assets. Applying that paragraph, a modification gain or loss is determined by recalculating the gross carrying amount of the financial asset as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate. Any resulting modification gain or loss is recognised in profit or loss at the date of the modification. The accounting for other revisions in estimated future contractual cash flows, including modifications of financial liabilities that do not result in the derecognition of those liabilities (see paragraph B5.4.6 of IFRS 9), is consistent with the accounting for modified financial assets that do not result in derecognition.[*]

BC5.305 Thus, in the absence of the practical expedient in paragraph 5.4.7 of IFRS 9, an entity would generally apply the requirements in paragraphs 5.4.3 or B5.4.6 of IFRS 9 to a change required by the reform, by recalculating the carrying amount of a financial instrument with any difference recognised in profit or loss. In addition, an entity would be required to use the original effective interest rate (ie the interest rate benchmark preceding the transition to the alternative benchmark rate) to recognise interest revenue or interest expense over the remaining life of the financial instrument.

[*] Paragraph B5.4.6 does not apply to changes in estimates of expected credit losses.

BC5.306 In the IASB's view, in the context of the reform, such an outcome would not necessarily provide useful information to users of financial statements. In reaching this view, the IASB considered a situation in which a financial instrument was amended only to replace an interest rate benchmark with an alternative benchmark rate. Using the interest rate benchmark-based effective interest rate to calculate interest revenue or interest expense over the remaining life in this situation would not reflect the economic effects of the modified financial instrument. Maintaining the original effective interest rate could also be difficult, and perhaps impossible, if that rate is no longer available.

BC5.307 The IASB therefore decided that applying the practical expedient, which requires an entity to apply paragraph B5.4.5 of IFRS 9 to account for changes in the basis for determining the contractual cash flows of financial assets and financial liabilities as a result of the reform, would provide more useful information to users of financial statements in circumstances when the changes are limited to changes required by the reform and would be less burdensome for preparers for the reasons noted in paragraph BC5.306.

BC5.308 Applying the practical expedient in paragraph 5.4.7 of IFRS 9, an entity would account for a change in the basis for determining the contractual cash flows of a financial asset or a financial liability required by the reform as being akin to a 'movement in the market rates of interest' applying paragraph B5.4.5 of IFRS 9. As a result, an entity applying the practical expedient to account for a change in the basis for determining the contractual cash flows of a financial asset or a financial liability that is required by the reform would not apply the derecognition requirements to that financial instrument, and would not apply paragraphs 5.4.3 or B5.4.6 of IFRS 9 to account for the change in contractual cash flows. In other words, changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required by the reform would not result in an adjustment to the carrying amount of the financial instrument or immediate recognition of a gain or loss. The IASB concluded that the application of the practical expedient would provide useful information about the effect of the reform on an entity's financial instruments in the circumstances in which it applies.

BC5.309 The IASB considered the risk that the practical expedient could be applied too broadly, which could result in unintended consequences. The IASB decided to limit the scope of the practical expedient so that it applies only to changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required by the reform. For this purpose, applying paragraph 5.4.7 of IFRS 9, a change is required by the reform if, and only if, the change is necessary as a direct consequence of the reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the change). This is consistent with the conditions proposed in the 2020 Exposure Draft.

BC5.310 In the 2020 Exposure Draft, the IASB considered only changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required as a direct consequence of the reform. This condition was designed to capture changes in the basis for determining the contractual cash flows that are necessary—or in other words, changes that are required—to implement the reform.

BC5.311 Furthermore, because the objective of the reform is limited to the transition to alternative benchmark rates—ie it does not encompass other changes that would lead to value transfer between the parties to a financial instrument—in the 2020 Exposure Draft, the IASB proposed economic equivalence as the second condition for applying the practical expedient. That is, to be within the scope of the practical expedient, at the date the basis is changed, the new basis for determining the contractual cash flows would be required to be economically equivalent to the previous basis.

BC5.312 In discussing the concept of economic equivalence, the IASB considered circumstances in which an entity makes changes necessary as a direct consequence of the reform in a way so that the overall contractual cash flows (including amounts relating to interest) of the financial instrument are substantially similar before and after the changes. For example, a change would be economically equivalent if it involved only replacing an interest rate benchmark with an alternative benchmark rate plus a fixed spread that compensated for the basis difference between the interest rate benchmark and the alternative benchmark rate. The IASB observed that, in this situation, applying paragraph B5.4.5 of IFRS 9 (that is, revising the effective interest rate when cash flows are re-estimated) would have an accounting outcome similar to applying paragraph 5.4.3 or B5.4.6 of IFRS 9 (that is, recognising a modification gain or loss) because it is unlikely that the resulting modification gain or loss would be significant.

BC5.313 With respect to the proposed condition described in paragraph BC5.310, some respondents to the 2020 Exposure Draft asked whether the practical expedient would apply even if the transition to alternative benchmark rates is not required by law or regulation, or if the existing interest rate benchmark is not being discontinued. For example, these respondents said that some existing interest rate benchmarks prevalent in their jurisdictions are not—at least in the near future—being discontinued. Nonetheless, entities are expected to transition to alternative benchmark rates because, for example, they anticipate reduced liquidity for the existing benchmark or want to align with global market developments. In response, the IASB noted that the practical expedient is not limited to only particular ways of effecting the reform, provided the reform is consistent with the description in paragraph 6.8.2 of IFRS 9. The IASB also noted that the Phase 2 amendments encompass changes that are required to implement the reform—or, in other words, changes that are necessary as a direct consequence of the reform—even if the reform itself is not mandatory.

BC5.314 With respect to the proposed condition described in paragraph BC5.311, some respondents to the 2020 Exposure Draft asked the IASB to specify whether an entity would need to perform detailed quantitative analysis of the cash flows of a financial instrument to demonstrate that a particular change meets the economic equivalence condition. For example, some respondents asked whether an entity would need to determine that the discounted present value of the cash flows of the affected financial instrument or its fair value are substantially similar before and after the transition to alternative benchmark rates.

BC5.315 The IASB intended 'economic equivalence' to be principle-based and therefore decided not to include detailed application guidance related to the assessment of that condition. Acknowledging that different entities in different jurisdictions would implement the reform differently, the IASB did not require a particular approach for assessing this condition. The IASB noted that because it set no 'bright lines', an entity is required to apply judgement to assess whether circumstances meet the economic equivalence condition. For example, assuming that the entity determines that replacing an interest rate benchmark with an alternative benchmark rate is necessary for the affected financial instrument as a direct consequence of the reform (ie the condition in paragraph 5.4.7(a) of IFRS 9 is met), the entity determines:

(a) what alternative benchmark rate will replace the interest rate benchmark and whether a fixed spread adjustment is necessary to compensate for a basis difference between the alternative benchmark rate and the interest rate benchmark preceding replacement. The entity would assess the overall resulting cash flows, including amounts relating to interest (ie alternative benchmark rate plus any fixed spread adjustment), to determine whether the economic equivalence condition is met. In other words, in this example, the entity would assess whether the interest rate remained substantially similar before and after the replacement—specifically, whether the interest rate after replacement (eg the alternative benchmark rate plus the fixed spread) was substantially similar to the interest rate benchmark immediately preceding the replacement; and

(b) whether the alternative benchmark rate (plus the necessary fixed spread described in paragraph BC5.315(a)) was applied to the relevant affected financial instrument(s).

BC5.316 The IASB noted that for a scenario such as the one described in the example in paragraph BC5.315, that assessment would be sufficient to determine that the economic equivalence condition had been met for those changes. As described in paragraph 5.4.8(a) of IFRS 9, an entity in such circumstances would not be required to do further analysis in order to determine that the economic equivalence condition has been satisfied (eg the entity would not be required to analyse whether the discounted present value of the cash flows of that financial instrument are substantially similar before and after the replacement).

BC5.317 The IASB acknowledged that changes in the basis for determining the contractual cash flows of a financial asset or a financial liability are likely to vary significantly across jurisdictions, product types and contracts. Developing a comprehensive list of changes required by the reform—and, hence, that qualify for the practical expedient—would not be feasible. Nonetheless, the IASB decided to include in paragraph 5.4.8 of IFRS 9 some examples of changes that give rise to a new basis for determining the contractual cash flows that is economically equivalent to the previous basis. If an entity makes only the changes specified in paragraph 5.4.8 of IFRS 9, the entity would not be required to analyse these changes further to conclude that the changes meet the condition in paragraph 5.4.7(b) of IFRS 9—ie the changes in paragraph 5.4.8 of IFRS 9 are examples of changes that satisfy that condition. The IASB concluded that adding such examples would assist entities in understanding and applying the amendments. These examples are not exhaustive.

Changes that are not required by the reform

BC5.318 The IASB noted that during negotiations with counterparties to agree on changes to the contractual cash flows required by the reform, entities could simultaneously agree to make changes to the contractual terms that are not necessary as a direct consequence of the reform or are not economically equivalent to the previous terms (eg to reflect a change in the counterparty's credit worthiness). If there are changes in addition to those required by the reform, an entity would first apply the practical expedient in paragraph 5.4.7 of IFRS 9 to account for the changes to the basis for determining the contractual cash flows of a financial asset or financial liability determined to be required by the reform (ie changes that meet the conditions in paragraph 5.4.7 of IFRS 9) by updating the effective interest rate based on the alternative benchmark rate. Then the entity would apply the relevant requirements in IFRS 9 to determine if the additional changes to that financial instrument (ie any changes to which the practical expedient does not apply) result in the derecognition of the financial instrument. If the entity determines that the additional changes do not result in derecognition of that financial asset or financial liability, the entity would account for the additional changes (ie changes not required by the reform) by applying paragraph 5.4.3 or paragraph B5.4.6 of IFRS 9. In the IASB's view, this approach would provide useful information to users of financial statements about the economic effects of any changes to financial instruments not required by the reform while consistently accounting for changes required by the reform.

Other classification and measurement issues

BC5.319 In anticipation of the potential financial reporting implications of changes to financial instruments as a result of the reform, including the potential derecognition of existing financial instruments and the recognition of new financial instruments, some stakeholders asked the IASB to consider additional matters related to applying the classification and measurement requirements in IFRS 9 to financial assets and financial liabilities. These matters included:

(a) whether IFRS 9 provides an adequate basis to account for the derecognition of a financial instrument in the statement of financial position and the recognition of any resulting gain or loss in the statement of profit or loss when an entity determines that it is required to derecognise a financial asset or financial liability because of the reform.

(b) determining whether derecognition of a financial asset following changes in the basis for determining the contractual cash flows resulting from the reform affects an entity's business model for managing its financial assets.

(c) assessing the contractual cash flow characteristics of a financial asset that refers to an alternative benchmark rate. Specifically, assessing whether some alternative benchmark rates are consistent with the description of 'interest' in paragraph 4.1.3(b) of IFRS 9 including if the time value of money element of that rate is modified (ie imperfect).

(d) assessing the effect on expected credit losses of derecognising an existing financial asset and recognising a new financial asset as a result of the reform.

(e) determining potential effects on the accounting for embedded derivatives in the context of the reform. Specifically, following the transition to alternative benchmark rates, whether entities reassess whether an embedded derivative is required to be separated from the host contract.

(f) determining whether the practical expedient in paragraph 5.4.7 of IFRS 9 applies to a hybrid financial liability that has been separated into a host contract (measured at amortised cost) and an embedded derivative (measured at fair value through profit or loss). Specifically, determining whether the practical expedient applies when the interest rate benchmark is not a contractual term of the host contract but instead is imputed at initial recognition.

BC5.320 The IASB discussed these matters and concluded that IFRS 9 provides an adequate basis to determine the required accounting for each of these matters. Therefore, considering the objective of Phase 2, the IASB made no amendments for these matters. Specific to paragraph BC5.319(f), the IASB observed that the practical expedient in paragraph 5.4.7 of IFRS 9 would apply to such a host contract if the conditions set out in paragraph 5.4.7 of IFRS 9 are met.

Hedge accounting (Chapter 6)

BC6.1–BC6.75 [Relocated to paragraphs BCE.174–BCE.238]

The objective of hedge accounting

BC6.76 Hedge accounting is an exception to the normal recognition and measurement requirements in IFRS. For example, the hedge accounting guidance in IAS 39 permitted:

Effective date and transition

BC6.600 The IASB decided that entities shall apply the amendments for annual periods beginning on or after 1 January 2020, with earlier application permitted.

BC6.601 The IASB decided that the amendments apply retrospectively. The IASB highlighted that retrospective application of the amendments would not allow reinstating hedge accounting that has already been discontinued. Nor would it allow designation in hindsight. If an entity had not designated a hedging relationship, the exceptions, even though applied retrospectively, would not allow the entity to apply hedge accounting in prior periods to items that were not designated for hedge accounting. Doing so would be inconsistent with the requirement that hedge accounting applies prospectively. Retrospective application of the exceptions would enable entities to continue hedge accounting for a hedging relationship that the entity had previously designated and that qualifies for hedge accounting applying IFRS 9.

BC6.602 Many respondents to the 2019 Exposure Draft commented on the clarity of the proposed retrospective application and suggested that further explanation be provided in the Standard. Consequently, the IASB amended the transition paragraph to specify that retrospective application applies only to those hedging relationships that existed at the beginning of the reporting period in which an entity first applies those requirements or were designated thereafter, and to the amount accumulated in the cash flow hedge reserve that existed at the beginning of the reporting period in which an entity first applies those requirements. The IASB used this wording to permit an entity to apply the amendments from the beginning of the reporting period in which an entity first applies these amendments even if the reporting period is not an annual period.

BC6.603 The IASB noted that these amendments would also apply to entities adopting IFRS Standards for the first time as required by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Accordingly, the IASB did not provide specific transition provisions for those entities.

Amendments for *Interest Rate Benchmark Reform—Phase 2* (August 2020)

Amendments to hedging relationships

BC6.604 The Phase 2 amendments relating to the hedge accounting requirements in IFRS 9 apply to hedging relationships directly affected by the reform as and when the requirements in paragraphs 6.8.4–6.8.8 of IFRS 9 cease to apply to a hedging relationship (see paragraphs 6.8.9–6.8.13 of IFRS 9). Therefore, an entity is required to amend the hedging relationship to reflect the changes required by the reform as and when the uncertainty arising from the reform is no longer present with respect to the hedged risk or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument. The scope of the hedging relationships to which the Phase 2 amendments apply is therefore the same as the scope to which the Phase 1 amendments apply, except for the amendment to the separately identifiable requirement, which also applies to the designation of new hedging relationships (see paragraph 6.9.13 of IFRS 9).

BC6.605 As part of the Phase 1 amendments, the IASB acknowledged that, in most cases, for uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows arising from the reform to be resolved, the underlying financial instruments designated in the hedging relationship would have to be changed to specify the timing and the amount of alternative benchmark rate-based cash flows.

BC6.606 The IASB noted that, applying the hedge accounting requirements in IFRS 9, changes to the basis for determining the contractual cash flows of a financial asset or a financial liability (see paragraphs 5.4.6–5.4.9 of IFRS 9) that are designated in a hedging relationship would affect the designation of such a hedging relationship in which an interest rate benchmark was designated as a hedged risk.

BC6.607 The IASB observed that amending the formal designation of a hedging relationship to reflect the changes required by the reform would result in the discontinuation of the hedging relationship. This is because, as part of the qualifying criteria for hedge accounting to be applied, IFRS 9 requires the formal designation of a hedging relationship to be documented at inception. The hedge documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess hedge effectiveness. IFRS 9 permits the hedge designation and documentation to be amended without causing the discontinuation of hedge accounting only in limited circumstances. In all other circumstances, amendments to the hedge designation as documented at inception of the hedging relationship, result in the discontinuation of hedge accounting.

BC6.608 The IASB therefore concluded that, in general, the hedge accounting requirements in IFRS 9 are sufficiently clear about how to account for hedging relationships directly affected by the reform after the Phase 1 exceptions set out in paragraphs 6.8.4–6.8.8 of IFRS 9 cease to apply. However, consistent with the IASB's objective for Phase 2 (see paragraph BC5.290) and its objective for Phase 1 (see paragraph BC6.550), the IASB considered that discontinuing hedge accounting solely due to the effects of the reform would not always reflect the economic effects of the changes required by the reform on a hedging relationship and therefore would not always provide useful information to users of financial statements.

BC6.609 Accordingly, the IASB decided that if the reform requires a change to a financial asset or a financial liability designated in a hedging relationship (see paragraphs 5.4.6–5.4.8 of IFRS 9), it would be consistent with the IASB's objective for Phase 2 to require the hedging relationship to be amended to reflect such a change without requiring discontinuation of that hedging relationship. For these reasons, in the 2020 Exposure Draft, the IASB proposed that an entity would be required to amend the formal designation of the hedging relationship as previously documented to make one or more of these changes:

(a) designating the alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;

(b) amending the description of the hedged item so it refers to the alternative benchmark rate; or

(c) amending the description of the hedging instrument so it refers to the alternative benchmark rate.

BC6.610 Respondents to the 2020 Exposure Draft agreed with the proposed amendments because those proposals would generally result in an entity continuing to apply hedge accounting to hedging relationships directly affected by the reform. Respondents also said that changes to the hedge designation necessary to reflect changes required by the reform are not expected to represent a change in an entity's risk management strategy or risk management objective for hedging their exposure to interest rate risk. Therefore, the IASB concluded that continuing to apply hedge accounting to the affected hedging relationships when making changes required by the reform would correspond with the IASB's objective for issuing the Phase 1 amendments in September 2019.

BC6.611 However, notwithstanding their general agreement with the proposed amendments, some respondents asked the IASB to clarify the scope and timing of the required changes to the affected hedging relationships.

BC6.612 Regarding the scope of the required changes to the affected hedging relationships, the IASB acknowledged it may be necessary to amend the designated hedged portion of the cash flows or fair value being hedged when the hedging relationship is amended to reflect the changes required by the reform. The IASB also noted that the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 were implicit in the required amendments to the hedging relationships as proposed in the 2020 Exposure Draft. In considering the timing of when entities are required to amend an affected hedging relationship, the IASB sought to balance the operational effort needed to amend the hedging relationships with maintaining the required discipline in the amendments to hedging relationships. Specifically, it sought to address the challenges associated with specifying the timing of when entities have to amend hedging relationships as required in paragraph 6.9.1 of IFRS 9—particularly in the context of the large volume of changes that entities may need to make in a relatively short time—while also ensuring that the amendments to hedging relationships are accounted for in the applicable reporting period.

BC6.613 In response to respondents' requests, the IASB revised the proposed wording in paragraph 6.9.1 of IFRS 9 so that:

(a) amending the description of the hedged item includes amending the description of the designated portion of the cash flows or fair value being hedged;

(b) the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 are relevant when amending the formal designation of a hedging relationship; and

(c) amendments to hedging relationships are required to be made by the end of the reporting period during which the respective changes to the hedged item, hedged risk or hedging instrument are made.

BC6.614 The IASB noted that the Phase 1 amendments may cease to apply at different times to directly affected hedging relationships and to the different elements within a hedging relationship. Therefore, an entity may be required to apply the applicable Phase 2 exceptions in paragraphs 6.9.1–6.9.12 of IFRS 9 at different times, which may result in the designation of a particular hedging relationship being amended more than once. The Phase 2 amendments to the hedge accounting requirements in IFRS 9 apply only to the requirements specified in these paragraphs. All other hedge accounting requirements in IFRS 9, including the qualifying criteria in paragraph 6.4.1 of IFRS 9, apply to hedging relationships directly affected by the reform. In addition, consistent with the IASB's decision for the Phase 1 amendments (see paragraph BC6.568), the Phase 2 amendments also do not provide an exception from the measurement requirements for a hedging relationship. Therefore, entities apply the requirements in paragraphs 6.5.8 or 6.5.11 of IFRS 9 to account for any changes in the fair value of the hedged items or hedging instruments (also see paragraphs BC6.623–BC6.627).

BC6.615 As set out in paragraph BC5.318, the IASB considered that changes might be made to a financial asset or a financial liability, or to the formal designation of a hedging relationship, in addition to those changes required by the reform. The effect of such additional changes to the formal hedge designation on the application of the hedge accounting requirements would depend on whether those changes result in the derecognition of the underlying financial instrument (see paragraph 5.4.9 of IFRS 9).

BC6.616 The IASB therefore required an entity first to apply the applicable requirements in IFRS 9 to determine if those additional changes result in discontinuation of hedge accounting, for example, if the financial asset or financial liability designated as a hedged item no longer meets the qualifying criteria to be an eligible hedged item as a result of changes in addition to those required by the reform. Similarly, if an entity amends the hedge designation to make a change other than the changes described in paragraph 6.9.1 of IFRS 9 (for example, if it extends the term of the hedging relationship), the entity would first determine if those additional changes to the hedge designation result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, the designation of the hedging relationship would be amended as required by paragraph 6.9.1 of IFRS 9.

BC6.617 Some respondents to the 2020 Exposure Draft said that entities may change a hedging relationship as a result of the reform, but such a change is not necessary as a direct consequence of the reform. This could include, for example, designating a basis swap as a new hedging instrument to mitigate ineffectiveness arising from the difference between the compounding of the alternative benchmark rates used for cash products and derivatives. These respondents asked the IASB to permit such changes to be in the scope of the required changes to the hedging relationship set out in paragraph 6.9.1 of IFRS 9. The IASB however decided not to extend the scope of paragraph 6.9.1 of IFRS 9 to other changes an entity makes as a result of the reform. The IASB considered that its objective for the Phase 2 amendments is not only to support entities in applying the IFRS requirements during the transition to alternative benchmark rates, but also to provide users of financial statements with useful information about the effect of the reform on an entity's financial statements. To balance achieving this objective with maintaining the discipline that exists in the hedge accounting requirements in IFRS 9, the IASB limited the scope of the changes required to the designation of hedging relationships to only those changes that are necessary to reflect the changes required by the reform (as described in paragraphs 5.4.6–5.4.8 of IFRS 9).

Replacement of hedging instruments in hedging relationships

BC6.618 Respondents to the 2020 Exposure Draft said that, instead of changing the contractual terms of a derivative designated as a hedging instrument, counterparties may facilitate the transition to alternative benchmark rates using approaches that result in outcomes equivalent to changing the contractual terms of the derivative. These respondents asked whether using such an approach would be within the scope of the Phase 2 amendments—ie whether paragraph 6.9.1(c) of IFRS 9 would apply—if the approach results in an economic outcome that is similar to changing the basis for determining the contractual cash flows of the derivative.

BC6.619 The IASB confirmed that, consistent with the rationale in paragraph BC5.298, it is the substance of an arrangement, rather than its form, that determines the appropriate accounting treatment. The IASB considered that the conditions in paragraph 5.4.7 of IFRS 9—ie the change is necessary as a direct consequence of the reform and is done on economically equivalent basis—are helpful in analysing the amendments to the contractual terms of derivatives described in paragraph BC6.618. In this context, the IASB noted that if these other approaches result in derivatives with substantially different terms from those of the original derivative, the change may not have been made on an economically equivalent basis. The IASB also noted that if a hedging instrument is derecognised, hedge accounting is required to be discontinued. Therefore, the IASB decided that for hedge accounting to continue it is also necessary that the original hedging instrument would not be derecognised.

BC6.620 The IASB considered these approaches described by respondents:

(a) *close-out and replace on the same terms (ie off-market terms)*—An entity applying this approach would enter into two new derivatives with the same counterparty. These two would be, a new derivative that is equal and offsetting to the original derivative (so both contracts are based on the interest rate benchmark to be replaced), and a new alternative benchmark-based derivative with the same terms as the original derivative so its fair value at initial recognition is equivalent to the fair value—on that date—of the original derivative (ie the new derivative is off-market). Under this approach, the counterparty to the new derivatives is the same as to the original derivative, the original derivative has not been derecognised and the terms of the alternative benchmark rate derivative are not substantially different from that of the original derivative. The IASB therefore concluded that such an approach could be regarded as consistent with the changes required by the reform as required in paragraph 6.9.1 of IFRS 9.

(b) *close-out and replace on substantially different terms (eg on-market terms)*—An entity applying this approach would terminate (close-out) the existing interest rate benchmark-based derivative with a cash settlement. The entity then enters into a new on-market alternative benchmark rate derivative with substantially different terms, so that the new derivative has a fair value of zero at initial recognition. Some respondents to the 2020 Exposure Draft were of the view that since this approach does not result in any gain or loss recognised in profit or loss, it suggests the exchange was done on an economically equivalent basis. The IASB disagreed with this view because the original derivative is extinguished and replaced with an alternative benchmark rate derivative with substantially different contractual terms. Therefore, this approach is not considered consistent with the changes required by the reform as required in paragraph 6.9.1 of IFRS 9.

(c) *add a new basis swap*—An entity applying this approach would retain the original interest rate benchmark-based derivative but enter into a basis swap that swaps the existing interest rate benchmark for the alternative benchmark rate. The combination of the two derivatives is equivalent to modifying the contractual terms of the original derivative to replace the interest rate benchmark with an alternative benchmark rate. The IASB noted that, in principle, the combination of an interest rate benchmark-based derivative and an interest rate benchmark-alternative benchmark rate swap could achieve an outcome economically equivalent to amending the original interest rate benchmark-based derivative. However, the IASB observed that, in practice, basis swaps are generally entered into on an aggregated basis to economically hedge an entity's net exposure to basis risk, rather than on an individual derivative basis. The IASB, therefore, noted that for this approach to be consistent with the changes required by the reform as described in paragraph 6.9.1 of IFRS 9, the basis swap must be coupled or linked with the original derivative, ie done on an individual derivative basis. This is because a change to the basis for determining the contractual cash flows of a hedging instrument is made to an individual instrument and, to achieve the same outcome, the basis swap would need to be coupled with an individual derivative.

(d) *novating to a new counterparty*—An entity applying this approach would novate the original interest rate benchmark-based derivative to a new counterparty and subsequently change the contractual cash flows on the novated derivative to replace the interest rate benchmark with an alternative benchmark rate. The IASB noted that novation of a derivative would result in the derecognition of the original derivative and thus would require hedge accounting to be discontinued in accordance with paragraph 6.5.6 of IFRS 9 (see further paragraphs BC6.336–BC6.338). Therefore, this approach is not consistent with the changes required by the reform as set out in paragraph 6.9.1 of IFRS 9.

BC6.621 The IASB therefore added paragraph 6.9.2 of IFRS 9 so that, an entity also applies paragraph 6.9.1(c) of IFRS 9 if these three conditions are met:

(a) the entity makes a change required by the reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 5.4.6 of IFRS 9);

(b) the original hedging instrument is not derecognised; and

(c) the chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 5.4.7 and 5.4.8 of IFRS 9).

BC6.622 The IASB decided not to add further amendments or provide application guidance because IFRS 9 as amended provides an adequate basis for analysing the accounting requirements in context of the approaches described in paragraph BC6.620.

Remeasurement of the hedged item and hedging instrument

BC6.623 In paragraph BC6.568, the IASB explained that no exceptions were made in Phase 1 to the measurement requirements for hedged items or hedging instruments. The IASB concluded that the most useful information would be provided to users of financial statements if requirements for recognition and measurement of hedge ineffectiveness remain unchanged (see paragraph BC6.567). This is because recognising ineffectiveness in the financial statements based on the actual results of a hedging relationship faithfully represents the economic effects of the reform, thereby providing useful information to users of financial statements.

BC6.624 Applying the hedge accounting requirements in IFRS 9, a gain or loss arising from the remeasurement of the hedged item attributable to the hedged risk or from remeasuring the hedging instrument is reflected in profit or loss when measuring and recognising hedge ineffectiveness.

BC6.625 When deliberating the Phase 2 amendments, the IASB considered that changes in the fair value of the hedged item or hedging instrument could arise when the formal designation of a hedging relationship is amended. The IASB considered whether to provide an exception from the requirement to include in hedge ineffectiveness such fair value changes when they arise. The IASB considered, but rejected, these approaches:

(a) *recognising the measurement adjustment in profit or loss over time*—An entity applying this approach would recognise the measurement adjustment in profit or loss over time (ie amortised) as the hedged item affects profit or loss. The IASB rejected this approach because it would require an offsetting entry to be recognised either in the statement of financial position or as an adjustment to the carrying amount of the hedged item or hedging instrument. Such an offsetting entry would fail to meet the definition of an asset or a liability in the *Conceptual Framework*. Adjusting the carrying amount of the hedged item or hedging instrument would result in the recognition of a net measurement adjustment of zero and would be inconsistent with the IASB's decision that no exceptions would be made to the measurement of hedged items or hedging instruments. The IASB also noted that such an approach would likely result in increased operational complexity because an entity would need to track adjustments that occur at different times for the purpose of amortising the adjustments in the period(s) in which the hedged item affects profit or loss.

(b) *recognising the measurement adjustment as an adjustment to retained earnings*—An entity applying this approach would recognise the measurement adjustment as an adjustment to retained earnings during the period in which the measurement difference arises. However, the IASB rejected this approach because the changes to the hedged risk might be driven by amendments to hedging relationships that may occur in different reporting periods. Therefore, recognising adjustments to retained earnings over time would be inconsistent with the IASB's previous decisions (throughout IFRS Standards) that an adjustment to retained earnings only applies on transition to new requirements in IFRS Standards. Furthermore, the IASB noted that the measurement adjustment would meet the definition of income or expense in the *Conceptual Framework* and therefore should be recognised in the statement of profit or loss. The IASB also noted that recognising measurement adjustments directly in retained earnings would be inconsistent with the decision that no exceptions should be made to the measurement of hedged items or hedging instruments.

BC6.626 Some respondents to the 2020 Exposure Draft said they would not expect any significant changes in fair value to arise from the remeasurement of a hedged item or hedging instrument based on the alternative benchmark rate. That is because these amendments would apply only when the conditions in paragraph 5.4.7 of IFRS 9 are met, which require that changes are made on an economically equivalent basis. The IASB acknowledged these comments noting that, applying paragraph 6.9.1 of IFRS 9, a significant change in fair value arising from the remeasurement of the hedged item or the hedging instrument indicates that the changes were not made on an economically equivalent basis. Furthermore, the IASB observed that the requirement in paragraph 6.9.1(b) of IFRS 9, which requires the description of the designated portion for the cash flows or fair value being hedged enables entities to amend a hedging relationship to minimise fair value changes on the remeasurement of the hedged item or the hedging instrument.

BC6.627 The IASB therefore confirmed its previous decision not to provide an exception from the requirements in IFRS 9 regarding the measurement and recognition of hedge ineffectiveness. Therefore, an entity would apply the requirements in paragraphs 6.5.8 (for a fair value hedge) and 6.5.11 (for a cash flow hedge) of IFRS 9 for the measurement and recognition of hedge ineffectiveness. The IASB considered that accounting for such fair value changes in any other way would be inconsistent with the decision to continue applying hedge accounting for such amended hedging relationships (see paragraph 6.9.1 of IFRS 9). In the IASB's view, applying the requirements in IFRS 9 for the recognition and measurement of ineffectiveness reflects the economic effects of the amendments to the formal designation of a hedging relationship and therefore, provides useful information to users of financial statements.

Accounting for qualifying hedging relationships

Assessment of the economic relationship between the hedged item and the hedging instrument

BC6.628 The Phase 1 exception in paragraph 6.8.6 of IFRS 9 requires an entity to assume that, for the purpose of assessing the economic relationship between the hedged item and the hedging instrument as required by paragraphs 6.4.1(c)(i) and B6.4.4–B6.4.6 of IFRS 9, the interest rate benchmark on which the hedged cash flows and/or the hedged risk (contractually or non-contractually specified) are based, is not altered as a result of the reform. As noted in paragraph 6.8.11 of IFRS 9, this exception ceases to apply to the hedged item and the hedging instrument, respectively, at the earlier of, when there is no longer uncertainty about the hedged risk or the timing and the amount of the interest rate benchmark-based cash flows; and when the hedging relationship that the hedged item and the hedging instrument are a part of is discontinued.

BC6.629 Consistent with the IASB's considerations on the highly probable requirement (see paragraphs BC6.630–BC6.631), the IASB considered that, when the formal designation of a hedging relationship has been amended (see paragraph 6.9.1 of IFRS 9), the assessment of the economic relationship between the hedged item and the hedging instrument should be performed based on the alternative benchmark rate on which the hedged cash flows and/or the hedged risk will be based. The IASB therefore provided no exceptions from the assessment of the economic relationship between the hedged item and the hedging instrument for the period after the Phase 1 exception in paragraph 6.8.6 of IFRS 9 ceases to apply.

Amounts accumulated in the cash flow hedge reserve

BC6.630 During the period in which a hedging relationship is affected by uncertainty arising from the reform, paragraph 6.8.4 of IFRS 9 requires an entity to assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered for the purpose of determining whether a forecast transaction (or a component thereof) is highly probable. An entity is required to cease applying this exception at the earlier of the date the uncertainty arising from the reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and the date the hedging relationship of which the hedged item is a part of is discontinued.

BC6.631 The IASB considered that uncertainty about the timing and the amount of the hedged cash flows would no longer be present when the interest rate benchmark on which the hedged cash flows are based is altered as required by the reform. In other words, uncertainty would no longer be present when an entity amends the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged, applying paragraph 6.9.1(b) of IFRS 9. Thereafter, applying the requirement in paragraph 6.3.3 of IFRS 9, the assessment of whether the hedged cash flows are still highly probable to occur would be based on the contractual cash flows determined by reference to the alternative benchmark rate.

BC6.632 The IASB noted that the amendment in paragraph 6.9.1(b) of IFRS 9 for amending the formal designation of a hedging relationship could lead to changes in the hedged item. Therefore, if an entity uses a hypothetical derivative—that is, a derivative that would have terms matching the critical terms of the designated cash flows and the hedged risk, commonly used in cash flow hedges to represent the forecast transaction—the entity may need to change the hypothetical derivative to calculate the change in the value of the hedged item to measure hedge ineffectiveness.

BC6.633 Consequently, as hedge accounting would not be discontinued when a hedging relationship is amended for changes required by the reform (see paragraph 6.9.1 of IFRS 9), the IASB decided that an entity would deem the amount accumulated in the cash flow hedge reserve at that point to be based on the alternative benchmark rate on which the hedged future cash flows are determined. Therefore, in applying paragraph 6.5.11(d) of IFRS 9, the amount accumulated in the cash flow hedge reserve would be reclassified to profit or loss in the same period(s) during which the hedged cash flows based on the alternative benchmark rate affect profit or loss.

BC6.634 The approach described in paragraph BC6.633 is consistent with the IASB's view that, when a hedging relationship is amended for changes required by the reform, more useful information is provided to users of financial statements if hedge accounting is not discontinued and amounts are not reclassified to profit or loss solely due to the changes required by the reform. This is because such an approach will more faithfully reflect the economic effects of changes required by the reform.

BC6.635 Consistent with the requirements in paragraphs 6.8.5 and 6.8.10 of IFRS 9, the IASB considered whether to provide similar relief for any discontinued hedging relationships in which the previously designated hedged item is subject to the reform. The IASB observed that although a hedging relationship may have been discontinued, the amount accumulated in the cash flow hedge reserve arising from that hedging relationship remains in the reserve if the hedged future cash flows are still expected to occur. The IASB noted that if the hedged future cash flows are still expected to occur, the previously designated hedged item will be subject to a change required by the reform, even if the hedging relationship has been discontinued.

BC6.636 The IASB therefore decided that, for the purpose of applying paragraph 6.5.12 of IFRS 9, an entity deems the amount accumulated in the cash flow hedge reserve for a discontinued hedging relationship to be based on the alternative benchmark rate on which the contractual cash flows will be based, which is similar to the amendment in paragraph 6.9.7 of IFRS 9. That amount is reclassified to profit or loss in the same period(s) in which the hedged future cash flows based on the alternative benchmark rate affect profit or loss.

BC6.637 Some respondents to the 2020 Exposure Draft asked the IASB to clarify whether the requirements in paragraphs 6.9.7–6.9.8 of IFRS 9 require the retrospective measurement of the hedged item based on the alternative benchmark rate-based cash flows—in other words, whether an entity would be required to recalculate what the amount accumulated in the cash flow hedge reserve would have been if the hedged item was based on the alternative benchmark rate since inception.

BC6.638 The IASB considered that the cash flow hedge reserve is adjusted as required by paragraph 6.5.11(a) of IFRS 9 (ie the cash flow hedge reserve is not subject to separate measurement requirements, but instead is derived from the cumulative changes in the fair value of the hedged item (present value) and hedging instrument). The Phase 2 amendments do not include an exception from the measurement requirements in IFRS 9. Accordingly, the fair value of the hedging instrument or of the hedged item (ie the present value of the cumulative changes in the hedged expected future cash flows) is determined at the measurement date based on the expected future cash flows and assumptions that market participants would use. In other words, the fair values are not determined retrospectively. The IASB therefore considered that the cash flow hedge reserve is not remeasured as if it had been based on the alternative benchmark rate since inception of the hedging relationship.

BC6.639 The IASB confirmed that the amendments in paragraphs 6.9.7 and 6.9.8 of IFRS 9 extend to cash flow hedges, regardless of whether the cash flow hedge is for an open or closed hedged portfolio. The general reference to cash flow hedges in these paragraphs reflects such scope, therefore the IASB considered that explicitly addressing open or closed hedged portfolios was unnecessary.

Groups of items

BC6.640 The IASB considered that for groups of items designated as hedged items in a fair value or cash flow hedge, the hedged items could consist of items still referenced to the interest rate benchmark as well as items already referenced to the alternative benchmark rate. Therefore, an entity could not amend the description of the hedged risk or the hedged item, including the designated portion of the cash flows or fair value being hedged, with reference only to an alternative benchmark rate for the whole group. The IASB also considered that it would be inconsistent with the objectives of the Phase 2 amendments to require the discontinuation of such a hedging relationship solely because of the effects of the reform. In the IASB's view, the same requirements and relief that apply to other hedging relationships should apply to groups of items designated as hedged items, including dynamic hedging relationships.

BC6.641 Paragraphs 6.9.9–6.9.10 of IFRS 9 therefore require an entity to allocate the individual hedged items to subgroups based on the benchmark rate designated as the hedged risk for each subgroup and to apply the requirements in paragraph 6.6.1 of IFRS 9 to each subgroup separately. The IASB acknowledged this approach is an exception to the hedge accounting requirements in IFRS 9 because other hedge accounting requirements, including the requirements in paragraphs 6.5.8 and 6.5.11 of IFRS 9, are applied to the hedging relationship in its entirety. However, in the IASB's view, the robustness of the hedge accounting requirements is maintained because if any subgroup fails to meet the requirements in paragraph 6.6.1 of IFRS 9, the entity is required to discontinue hedge accounting for that entire hedging relationship. The IASB concluded this accounting outcome is appropriate because the basis for designating the hedged item on a group basis is that the entity is managing the designated hedge for the group as a whole.

BC6.642 The IASB acknowledged that preparers may incur additional costs to assess each subgroup in a hedging relationship separately, and to track items moving from one subgroup to another. However, the IASB concluded that an entity is likely to have such information available because IFRS 9 already requires it to identify and document hedged items designated within a hedging relationship with sufficient specificity. Therefore, the IASB concluded that the benefits of avoiding the discontinuation of hedge accounting and the resulting accounting impacts outweigh the associated costs of this exception.

BC6.643 Respondents to the 2020 Exposure Draft asked the IASB whether the requirement for groups of items applies to dynamic hedges of interest rate benchmark-based items when the items mature and are replaced with alternative benchmark-based items. The IASB considered that although the objective of the Phase 2 amendments is to provide relief when individual items transition to an alternative benchmark rate, the replacement of items that have expired with items that reference the alternative benchmark rate is a natural consequence of a dynamic hedging relationship. Therefore, the IASB observed that new items designated as part of the group to replace interest rate benchmark-based items that have matured would be allocated to the relevant subgroup based on the benchmark rate being hedged.

BC6.644 Respondents also asked the IASB to clarify how the requirements in paragraphs 6.9.9–6.9.10 of IFRS 9 apply to the hypothetical derivative in a cash flow hedge, specifically, whether the hypothetical derivative could be amended (and therefore measured) based on the alternative benchmark rate if the actual hedged item (such as a floating rate loan) has not yet transitioned to the alternative benchmark rate. The IASB considered that IFRS 9 does not include specific requirements for the hypothetical derivative but mentions it as one possible way of calculating the change in the value of the hedged item to measure ineffectiveness (see paragraph B6.5.5 of IFRS 9). Therefore, the terms on which the hypothetical derivative is constructed replicate the hedged risk and the hedged cash flows of the hedged item an entity is hedging. The hypothetical derivative cannot include features in the value of the hedged item that exist only in the hedging instrument (but not in the hedged item). The IASB therefore decided that the identification of an appropriate hypothetical derivative is based on the requirements to measure hedge ineffectiveness and it would not be appropriate to include specific amendments for applying the requirements in paragraphs 6.9.9–6.9.10 to the hypothetical derivative.

Designation of risk components

End of application of the Phase 1 exception

BC6.645 An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. Paragraphs 6.3.7(a) and B6.3.8 of IFRS 9 allow entities to designate only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component).

BC6.646 When developing the Phase 1 amendments, the IASB decided not to set an end date for applying the exception for the separately identifiable requirement (see paragraphs 6.8.7–6.8.8 of IFRS 9). The IASB considered that including an end date for that exception could require an entity to immediately discontinue hedge accounting at a point in time because, as the reform progresses, a risk component based on the interest rate benchmark may no longer be separately identifiable (for example, as the market for the alternative benchmark rate is established). As noted in paragraph BC6.597, in the IASB's view, such an immediate discontinuation of hedge accounting would be inconsistent with the objective of this exception in Phase 1. Therefore, when issuing the Phase 1 amendments, the IASB decided that an entity should cease applying the Phase 1 exception from the separately identifiable requirement to a hedging relationship only when that hedging relationship is discontinued applying the requirements in IFRS 9.

BC6.647 Having considered the interaction between the Phase 1 exception from the separately identifiable requirement and the Phase 2 amendments to the hedge accounting requirements in IFRS 9, the IASB decided it is necessary to specify that an entity is required to cease applying the Phase 1 exception from the separately identifiable requirement when the uncertainty arising from the reform, which led to that exception, is no longer present.

BC6.648 The IASB considered that continuing to apply the Phase 1 amendments after the uncertainty arising from the reform is no longer present would not faithfully represent the actual characteristics of the elements of the hedging relationship in which the uncertainty has been eliminated nor the economic effects of the reform. The IASB therefore added paragraph 6.8.13 to IFRS 9 so the Phase 1 exception from the separately identifiable requirement ceases to apply at the earlier of:

(a) when changes required by the reform are made to the non-contractually specified risk component as set out in paragraph 6.9.1 of IFRS 9; or

(b) when the hedging relationship in which the non-contractually specified risk component was designated is discontinued.

Application of the 'separately identifiable' requirement to an alternative benchmark rate

BC6.649 In developing the Phase 2 amendments, the IASB was aware that considerations similar to those discussed in paragraphs BC6.645–BC6.648 apply to designating an alternative benchmark rate as a non-contractually specified risk component in either a cash flow hedge or a fair value hedge. This is because an entity's ability to conclude that the alternative benchmark rate meets the requirements in paragraphs 6.3.7(a) and B6.3.8 of IFRS 9 that a risk component must be separately identifiable and reliably measurable could be affected in the early stages of the reform.

BC6.650 Specific application guidance and examples on the separately identifiable requirement are already set out in paragraphs B6.3.9–B6.3.10 of IFRS 9. However, the IASB considered that an entity might expect an alternative benchmark rate to meet the separately identifiable requirement in IFRS 9 within a reasonable period of time even though the alternative benchmark rate does not meet the requirement when designated as a risk component.

BC6.651 The amendment in paragraph 6.9.11 of IFRS 9 applies to a different set of instruments from the Phase 1 exception. For items within the scope of paragraph 6.9.11 of IFRS 9, the separately identifiable requirement has never been satisfied. In contrast, the population of hedging relationships to which the Phase 1 relief applied had already satisfied the qualifying criteria for hedge accounting to be applied. The IASB therefore considered that any relief from the separately identifiable requirement in Phase 2 should be temporary.

BC6.652 Consequently, in the 2020 Exposure Draft, the IASB proposed that an alternative benchmark rate that does not meet the requirement to be separately identifiable at the date it is designated as a non-contractually specified risk component would be deemed to have met the requirement at that date if, and only if, an entity reasonably expects that the alternative benchmark rate will be separately identifiable within 24 months from the date it is designated as a risk component.

BC6.653 Respondents to the 2020 Exposure Draft agreed with this proposed amendment but asked the IASB to clarify the date from which the 24-month period applies. The IASB acknowledged respondents' concerns, and considered whether the 24-month period applies:

(a) on a hedge-by-hedge basis—that is, to each hedging relationship individually, beginning from the date an alternative benchmark rate is designated as a risk component in that relationship; or

(b) on a rate-by-rate basis—that is, to each alternative benchmark rate separately, beginning from the date when an entity first designates an alternative benchmark rate as a hedged risk for the first time.

BC6.654 The IASB acknowledged that applying the 24-month period to each hedging relationship individually (as proposed in the 2020 Exposure Draft)—that is, on a hedge-by-hedge basis—is consistent with the basis on which hedging relationships are designated. For each new hedge designation, an entity is required to assess whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, have been met. However, the IASB also considered that applying the 24-month period to different hedging relationships (with the same alternative benchmark rate designated as a risk component) at different times could add an unnecessary operational burden as the period would end at different times and thus would need to be monitored over different periods, for different hedging relationships. For example, if an entity designates the alternative benchmark rate as the risk component in two hedging relationships—the first designated on 31 March 20X1 and the second on 30 June 20X1—the 24-month period for each hedge would begin and end at different dates, although the designated risk is the same in both hedging relationships.

BC6.655 Therefore, the IASB decided that the requirement in paragraph 6.9.11 would apply on a rate-by-rate basis so the 24-month period applies to each alternative benchmark rate separately and hence, starts from the date that an entity designates an alternative benchmark rate as a non-contractually specified risk component for the first time (but see also paragraph 7.2.45 of IFRS 9). The IASB considered that if an entity concludes for one hedging relationship that it no longer has a reasonable expectation that the alternative benchmark rate would meet the requirements within the 24-month period, it is likely that the entity would reach the same conclusion for all other hedging relationships in which that particular alternative benchmark rate has been designated. Applying this requirement to the example in paragraph BC6.654, the 24-month period will begin on 31 March 20X1 for that alternative benchmark rate.

BC6.656 Despite the requirement to apply the 24-month period to each alternative benchmark rate separately, the requirement to assess whether an alternative benchmark rate is separately identifiable continues to separately apply to each hedging relationship. In other words, an entity is required to assess, for each hedge designation, whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, are met for the remainder of the 24-month period (ie until 31 March 20X3 following from the example in paragraph BC6.654).

BC6.657 Consistent with the requirement in IFRS 9 to continuously assess the separately identifiable requirement, an entity's ability to conclude that an alternative benchmark rate is a separately identifiable component requires assessment over the life of the hedging relationship including during the 24-month period discussed in paragraph BC6.655. However, the IASB decided that to avoid the complexity of detailed judgements during the 24-month period, an entity is required to cease applying the requirement during the 24-month period if, and only if, the entity reasonably expects that the alternative benchmark rate will not meet the separately identifiable requirement within that period. If an entity reasonably expects that an alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designates it as a non-contractually specified risk component for the first time, the entity is required to cease applying the requirement in paragraph 6.9.11 of IFRS 9 to that alternative benchmark rate and discontinue applying hedge accounting prospectively from the date of that reassessment to all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk component.

BC6.658 The IASB acknowledged that 24 months is an arbitrary period. However, in the IASB's view, a clearly defined end point is necessary because of the temporary nature of the amendment. The exception described in paragraphs 6.9.11–6.9.13 is a significant relief from one of the requirements that is a basis for the robustness of the hedge accounting requirements, therefore the relief is intentionally short-lived. The IASB considered that a period of 24 months will assist entities in applying the hedge accounting requirements in IFRS 9 particularly during the early stages of the transition to alternative benchmark rates. Therefore, the IASB decided that a period of 24 months from the date an entity first designates an alternative benchmark rate as a non-contractually specified risk component is a reasonable period and would enable entities to implement the reform and comply with any regulatory requirements, while avoiding potential short-term disruption as the market for an alternative benchmark rate develops.

BC6.659 While developing the proposals in the 2020 Exposure Draft, the IASB considered proposing alternative periods for the requirement in paragraph 6.9.11 of IFRS 9, including a period of 12 months or a period longer than 24 months. However, the IASB acknowledged the diversity in the approaches to the reform or replacement of interest rate benchmarks and the timing of the expected completion across various jurisdictions. The IASB was concerned that 12 months would not provide sufficient time across all jurisdictions. At the same time, the IASB considered that entities may not be able to have a reasonable expectation that an alternative benchmark rate would satisfy the separately identifiable requirement over a period longer than 24 months.

BC6.660 The IASB emphasised that the amendments apply only for the separately identifiable requirement and not the reliably measurable requirement. Therefore, if the risk component is not reliably measurable, either when it is designated or thereafter, the alternative benchmark rate would not meet the qualifying criteria to be designated as a risk component in a hedging relationship. Similarly, if the hedging relationship fails to meet any other qualifying criteria set out in IFRS 9 to apply hedge accounting, either at the date the alternative benchmark rate is designated or during the 24-month period, the entity is required to discontinue hedge accounting prospectively from that date. The IASB decided that providing relief only for the separately identifiable requirement would achieve the objective described in paragraph BC5.290.

Effective date and transition (Chapter 7)

Effective date

Requirements issued in IFRS 9 (2009)

BC7.1 The IASB recognises that many countries require time for translation and for introducing the mandatory requirements into law. In addition, entities require time to implement new standards. The IASB usually sets an effective date of between six and eighteen months after issuing a Standard. However, the IASB has adopted a phased approach to publishing IFRS 9, so this is not possible.

BC7.2 In the response to the 2009 Classification and Measurement Exposure Draft, respondents urged that:

(a) it would be helpful to preparers if the IASB were to permit all phases of the project to replace IAS 39 to be adopted at the same time.

(b) it would be helpful to entities that issue insurance contracts if the effective date of IFRS 9 were aligned with the forthcoming Standard on accounting for insurance contracts. Most of an insurer's assets are financial assets and most of its liabilities are insurance liabilities or financial liabilities. Thus, if an insurer applies IFRS 9 before it applies any new Standard on insurance contracts, it might face two rounds of major changes in a short period. This would be disruptive for both users and preparers.

be in accordance with the proposed model at that date, with an adjustment to an opening component of equity. An entity would still apply the proposed model on a (modified) retrospective basis, because the loss allowance balances would be determined on the basis of information about initial credit risk, subject to the transition relief. As a result, an entity would still assess the changes in credit risk since the initial recognition of financial instruments to decide whether, on transition to the new requirements, it should measure the loss allowance at an amount equal to lifetime or 12-month expected credit losses. A prohibition on restating comparatives would mean that an entity could only reflect the loss allowance balances that result from applying the new model in the financial statements from the beginning of the current period in which the entity applies the proposals for the first time.

BC7.83 The IASB noted that another way to address the risk of hindsight might be to allow a long lead time between issuing the new requirements and the mandatory effective date, so that an entity could calculate expected credit losses contemporaneously for comparative periods to provide restated comparative information. However, in considering a longer lead time, the IASB noted the urgency of this project. Establishing a lead time that would allow an entity to apply the proposed model on a retrospective basis, including the provision of restated comparative information, in a way that addresses the risk of hindsight would result in a significant delay between issuing the final requirements and their mandatory application.

BC7.84 The vast majority of respondents agreed with the transition proposals not to require, but to allow, the restatement of comparative information if the necessary information is available without the use of hindsight. Consequently, the IASB confirmed those proposals during redeliberations.

Transition for first-time adopters of IFRS

BC7.85 The 2013 Impairment Exposure Draft did not propose amendments to IFRS 1. However it specifically requested feedback on transition to IFRS 9 by first-time adopters of IFRS, including whether there are any unique considerations. In the redeliberations on the proposals in the 2013 Impairment Exposure Draft, the IASB confirmed that the same transition relief available on the initial application of the requirements in Section 5.5 of IFRS 9 should be available to first-time adopters of IFRS (see also paragraphs BC7.72–BC7.75).

Amendments for *Interest Rate Benchmark Reform—Phase 2* (August 2020)

Mandatory application

BC7.86 The IASB decided to require application of the Phase 2 amendments. The IASB considered that allowing voluntary application of these amendments could lead to selective application to achieve specific accounting results. The IASB also noted that the amendments are, to a large extent, interlinked and need to be applied consistently. Voluntary application, even if only possible by area or type of financial instruments, would reduce comparability of information provided in the financial statements between entities. The IASB also does not expect that mandatory application of these amendments would result in significant additional costs for preparers and other affected parties because these amendments are designed to ease the operational burden on preparers, while providing useful information to users of financial statements, and would not require significantly more effort by preparers in addition to what is already required to implement the changes required by the reform.

End of application

BC7.87 The IASB did not add specific end of application requirements for the Phase 2 amendments because the application of these amendments is associated with the point at which changes to financial instruments or hedging relationships occur as a result of the reform. Therefore, by design, the application of these amendments has a natural end.

BC7.88 The IASB noted that, in a simple scenario, the Phase 2 amendments will be applied only once to each financial instrument or element of a hedging relationship. However, the IASB acknowledged that because of differences in the approach to the reform applied in different jurisdictions, and differences in timing, implementing the reform could require more than one change to the basis for determining the contractual cash flows of a financial asset or a financial liability. This could be the case, for example, when a central authority, as the administrator of an interest rate benchmark, undertakes a multi-step process to replace an interest rate benchmark with an alternative benchmark rate. As each change to the basis for determining the contractual cash flows of the instrument is made as required by the reform, an entity would be required to apply the Phase 2 amendments to account for that change.

BC7.89 As noted in paragraph 6.9.3 of IFRS 9, the IASB considered that an entity may be required to amend the formal designation of its hedging relationships at different times, or to amend the formal designation of a hedging relationship more than once. For example, an entity may first make changes required by the reform to a derivative designated as a hedging instrument, while only making changes required by the reform to the financial instrument designated as the hedged item later. In applying the amendments, the entity would be required to amend the hedge documentation to amend the description of the hedging instrument. The hedge documentation of the hedging relationship would then have to be amended again to change the description of the hedged item and/or hedged risk as required in paragraph 6.9.1 of IFRS 9.

BC7.90 The amendment for hedges of risk components in paragraph 6.9.11 of IFRS 9 applies only at the date an entity first designates a particular alternative benchmark rate as a non-contractually specified risk component for the first time if an entity's ability to conclude that an alternative benchmark rate is separately identifiable is directly affected by the reform. Thus, an entity could not apply this amendment in other circumstances in which the entity is not able to conclude that an alternative benchmark rate is a separately identifiable risk component.

Effective date and transition

BC7.91 Acknowledging the urgency of the amendments, the IASB decided that entities must apply the Phase 2 amendments for annual periods beginning on or after 1 January 2021, with earlier application permitted.

BC7.92 The IASB decided that the amendments apply retrospectively in accordance with IAS 8 (except as discussed in paragraphs BC7.94–BC7.98) because prospective application would have resulted in entities applying the amendments only if the transition to alternative benchmark rates occurred after the effective date of the amendments.

BC7.93 The IASB acknowledged that there could be situations in which an entity amended a hedging relationship as specified in paragraph 6.9.1 of IFRS 9 in a period before the entity first applied the Phase 2 amendments; and in the absence of the Phase 2 amendments, IFRS 9 would require the entity to discontinue hedge accounting. The IASB noted that the reasons for the amendment in paragraph 6.9.1 of IFRS 9 (see paragraphs BC6.608–BC6.609), apply equally in such situations. The IASB therefore considered that discontinuation of hedge accounting solely because of amendments an entity made in hedge documentation to reflect appropriately the changes required by the reform, regardless of when those changes occurred, would not provide useful information to users of financial statements.

BC7.94 The IASB acknowledged that the reinstatement of discontinued hedging relationships is inconsistent with the IASB's previous decisions about hedge accounting in IFRS 9. This is because hedge accounting is applied prospectively and applying it retrospectively to discontinued hedging relationships usually requires the use of hindsight. However, the IASB considered that in the specific circumstances of the reform, an entity would typically be able to reinstate a discontinued hedging relationship without the use of hindsight. The IASB noted that this reinstatement of discontinued hedging relationships would apply to a very targeted population for a short period—that is, for hedging relationships which would not have been discontinued if the Phase 2 amendments relating to hedge accounting had been applied at the point of discontinuation. The IASB therefore proposed in the 2020 Exposure Draft that an entity would be required to reinstate hedging relationships that were discontinued solely due to changes required by the reform before an entity first applies the proposed amendments.

BC7.95 Respondents to the 2020 Exposure Draft generally supported and welcomed the transition proposals but asked the IASB to reconsider a specific aspect of the proposal that would require entities to reinstate particular discontinued hedging relationships. Specifically, these respondents highlighted circumstances in which reinstating discontinued hedging relationships would be challenging or have limited benefit—for example, when:

(a) the hedging instruments or the hedged items in the discontinued hedging relationships have been subsequently designated into new hedging relationships;

(b) the hedging instruments in the discontinued hedging relationships no longer exist at the date of initial application of the amendments—eg they have been terminated or sold; or

(c) the hedging instruments in the discontinued hedging relationships are now being managed within a trading mandate with other trading positions and reported as trading instruments.

BC7.96 The IASB noted that the transition requirements as proposed in the 2020 Exposure Draft to apply the amendments retrospectively in accordance with IAS 8—including the requirement to reinstate particular discontinued hedging relationships—would be subject to impracticability applying IAS 8. However, the IASB agreed with respondents' concerns that there could be other circumstances in which it would not be impracticable to reinstate the hedging relationship, but such reinstatement would be challenging or would have limited benefit. For example, if the hedging instrument or hedged item has been designated in a new hedging relationship, it appears inappropriate to require entities to reinstate the 'old' (original) hedging relationship and discontinue or unwind the 'new' (valid) hedging relationship. Consequently, the IASB added paragraph 7.2.44(b) to IFRS 9 to address these concerns.

BC7.97 In addition, the IASB concluded that if an entity reinstates a discontinued hedging relationship applying paragraph 7.2.44 of IFRS 9, for the purpose of applying paragraphs 6.9.11–6.9.12 of IFRS 9, the 24-month period for the alternative benchmark rate designated as a non-contractually specified risk component begins from the date of initial application of the Phase 2 amendments (ie it does not begin from the date the entity designated the alternative benchmark rate as a non-contractually specified risk component for the first time in the original hedging relationship).

BC7.98 Consistent with the transition requirements for Phase 1, the IASB decided that an entity is not required to restate comparative information. However, an entity may choose to restate prior periods if, and only if, it is possible without the use of hindsight.

BC7.99 The IASB decided that it did not need to amend IFRS 1. Entities adopting IFRS Standards for the first time as required by IFRS 1 would apply IFRS Standards, including the Phase 2 amendments, and the transition requirements in IFRS 1 as applicable.

Analysis of the effects of IFRS 9

Introduction

BCE.1 Before the IASB issues new requirements, or makes amendments to existing Standards, it considers the costs and benefits of the new pronouncements. This includes assessing the effects on the costs for both preparers and users of financial statements. The IASB also considers the comparative advantage that preparers have in developing information that would otherwise cost users of financial statements to develop. One of the main objectives of developing a single set of high quality global accounting Standards is to improve the allocation of capital. The IASB therefore takes into account the benefits of economic decision-making resulting from improved financial reporting. The IASB gains insight on the likely effects of the proposals for new or revised Standards through its formal exposure of proposals and through its analysis and consultations with relevant parties through outreach activities.

BCE.2 The IASB conducted extensive outreach activities with interested parties for each phase of IFRS 9. This included extensive discussions with regulators, users of financial statements, preparers and audit firms worldwide. In addition, as part of the Impairment project, the IASB formed the Expert Advisory Panel (EAP) to address some of the operational challenges of an expected cash flow approach and conducted fieldwork to assess the proposals of the 2013 Exposure Draft *Financial Instruments: Expected Credit Losses* (the '2013 Impairment Exposure Draft'). This Effects Analysis is based on the feedback received through this process.

HKFRS 16
Revised ~~April~~ July 2021

Hong Kong Financial Reporting Standard 16

Leases

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Hong Kong Financial Reporting Standard 16 *Leases* (HKFRS 16) is set out in paragraphs 1–10~~3~~6 and Appendices A–~~F~~D. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time that they appear in the Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. The Standard should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

46A As a practical expedient, a lessee may elect not to assess whether a rent concession that meets the conditions in paragraph 46B is a lease modification. A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.

46B The practical expedient in paragraph 46A applies only to rent concessions occurring as a direct consequence of the covid-19 pandemic and only if all of the following conditions are met:

(a) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;

(b) any reduction in lease payments affects only payments originally due on or before 30 June ~~2021~~ 2022 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before 30 June ~~2021~~ 2022 and increased lease payments that extend beyond 30 June ~~2021~~2022); and

(c) there is no substantive change to other terms and conditions of the lease.

(a) the seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.

(b) the buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard.

101 If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:

(a) any below-market terms shall be accounted for as a prepayment of lease payments; and

(b) any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.

102 The entity shall measure any potential adjustment required by paragraph 101 on the basis of the more readily determinable of:

(a) the difference between the fair value of the consideration for the sale and the fair value of the asset; and

(b) the difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Transfer of the asset is not a sale

103 If the transfer of an asset by the seller-lessee does not satisfy the requirements of HKFRS 15 to be accounted for as a sale of the asset:

(a) the seller-lessee shall continue to recognise the transferred asset and shall recognise a financial liability equal to the transfer proceeds. It shall account for the financial liability applying HKFRS 9.

(b) the buyer-lessor shall not recognise the transferred asset and shall recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying HKFRS 9.

Temporary exception arising from interest rate benchmark reform

104 A lessee shall apply paragraphs 105–106 to all lease modifications that change the basis for determining future lease payments as a result of interest rate benchmark reform (see paragraphs 5.4.6 and 5.4.8 of HKFRS 9). These paragraphs apply only to such lease modifications. For this purpose, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of HKFRS 9.

105 As a practical expedient, a lessee shall apply paragraph 42 to account for a lease modification required by interest rate benchmark reform. This practical expedient applies only to such modifications. For this purpose, a lease modification is required by interest rate benchmark reform if, and only if, both of these conditions are met:

(a) the modification is necessary as a direct consequence of interest rate benchmark reform; and

(b) the new basis for determining the lease payments is economically equivalent to the previous basis (ie the basis immediately preceding the modification).

106 However, if lease modifications are made in addition to those lease modifications required by interest rate benchmark reform, a lessee shall apply the applicable requirements in this Standard to account for all lease modifications made at the same time, including those required by interest rate benchmark reform.

Appendix C
Effective date and transition

This appendix is an integral part of the Standard and has the same authority as the other parts of the Standard.

Effective date

C1 An entity shall apply this Standard for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply HKFRS 15 *Revenue from Contracts with Customers* at or before the date of initial application of this Standard. If an entity applies this Standard earlier, it shall disclose that fact.

C1A *Covid-19-Related Rent Concessions*, issued in June 2020, added paragraphs 46A, 46B, 60A, C20A and C20B. A lessee shall apply that amendment for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not authorised for issue at 4 June 2020.

C1B *Interest Rate Benchmark Reform—Phase 2*, which amended HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16, issued in October 2020, added paragraphs 104–106 and C20C–C20D. An entity shall apply these amendments for annual reporting periods beginning on or after 1 January 2021. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

C1C *Covid-19-Related Rent Concessions beyond 30 June 2021*, issued in April 2021, amended paragraph 46B and added paragraphs C20BA–C20BC. A lessee shall apply that amendment for annual reporting periods beginning on or after 1 April 2021. Earlier application is permitted, including in financial statements not authorised for issue at 9 April 2021.

Transition

C2 For the purposes of the requirements in paragraphs C1–C19, the date of initial application is the beginning of the annual reporting period in which an entity first applies this Standard.

Definition of a lease

C3 As a practical expedient, an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:

(a) to apply this Standard to contracts that were previously identified as leases applying HKAS 17 *Leases* and HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*. The entity shall apply the transition requirements in paragraphs C5–C18 to those leases.

(b) not to apply this Standard to contracts that were not previously identified as containing a lease applying HKAS 17 and HK(IFRIC)-Int 4.

C4 If an entity chooses the practical expedient in paragraph C3, it shall disclose that fact and apply the practical expedient to all of its contracts. As a result, the entity shall apply the requirements in paragraphs 9–11 only to contracts entered into (or changed) on or after the date of initial application.

Lessees

C5 A lessee shall apply this Standard to its leases either:

(a) retrospectively to each prior reporting period presented applying HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or

(b) retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application in accordance with paragraphs C7–C13.

C6 A lessee shall apply the election described in paragraph C5 consistently to all of its leases in which it is a lessee.

C7 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall not restate comparative information. Instead, the lessee shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.

Leases previously classified as operating leases

C8 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall:

Sale and leaseback transactions before the date of initial application

C16 An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements in HKFRS 15 to be accounted for as a sale.

C17 If a sale and leaseback transaction was accounted for as a sale and a finance lease applying HKAS 17, the seller-lessee shall:

(a) account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application; and

(b) continue to amortise any gain on sale over the lease term.

C18 If a sale and leaseback transaction was accounted for as a sale and operating lease applying HKAS 17, the seller-lessee shall:

(a) account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; and

(b) adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognised in the statement of financial position immediately before the date of initial application.

Amounts previously recognised in respect of business combinations

C19 If a lessee previously recognised an asset or a liability applying HKFRS 3 *Business Combinations* relating to favourable or unfavourable terms of an operating lease acquired as part of a business combination, the lessee shall derecognise that asset or liability and adjust the carrying amount of the right-of-use asset by a corresponding amount at the date of initial application.

References to HKFRS 9

C20 If an entity applies this Standard but does not yet apply HKFRS 9 *Financial Instruments*, any reference in this Standard to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement*.

Covid-19-related rent concessions for lessees

C20A A lessee shall apply *Covid-19-Related Rent Concessions* (see paragraph C1A) retrospectively, recognising the cumulative effect of initially applying that amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.

C20B In the reporting period in which a lessee first applies *Covid-19-Related Rent Concessions*, a lessee is not required to disclose the information required by paragraph 28(f) of HKAS 8.

C20BA A lessee shall apply *Covid-19-Related Rent Concessions beyond 30 June 2021* (see paragraph C1C) retrospectively, recognising the cumulative effect of initially applying that amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.

C20BB In the reporting period in which a lessee first applies *Covid-19-Related Rent Concessions beyond 30 June 2021*, a lessee is not required to disclose the information required by paragraph 28(f) of HKAS 8.

C20BC Applying paragraph 2 of this Standard, a lessee shall apply the practical expedient in paragraph 46A consistently to eligible contracts with similar characteristics and in similar circumstances, irrespective of whether the contract became eligible for the practical expedient as a result of the lessee applying *Covid-19-Related Rent Concessions* (see paragraph C1A) or *Covid-19-Related Rent Concessions beyond 30 June 2021* (see paragraph C1C).

Interest Rate Benchmark Reform—Phase 2

C20C An entity shall apply these amendments retrospectively in accordance with HKAS 8, except as specified in paragraph C20D.

C20D An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise 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 these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

Withdrawal of other Standards

C21 This Standard supersedes the following Standards and Interpretations:

(a) HKAS 17 *Leases*;

(b) HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*;

(c) HK(SIC)-Int 15 *Operating Leases—Incentives*; and

(d) HK(SIC)-Int 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

Basis for Conclusions on
Hong Kong Financial Reporting Standard 16

Leases

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

(b) reduce only lease payments originally due on or before 30 June ~~2021~~ 2022.[2] The Board noted that a related increase in lease payments that extends beyond 30 June ~~2021~~ 2022 would not prevent a rent concession from meeting this condition. In contrast, if reductions in lease payments extend beyond 30 June ~~2021~~ 2022, the rent concession in its entirety would not be within the scope of the practical expedient. In developing this condition, the Board observed that the economic effects of the covid-19 pandemic could continue for some time. If the practical expedient were not limited to a particular time frame, a lessee could conclude that many future changes in lease payments would be a consequence of the covid-19 pandemic. Limiting the practical expedient to rent concessions that reduce only lease payments originally due on or before 30 June ~~2021~~ 2022 provides relief to lessees when they are expected to need it most, while being responsive to concerns from users of financial statements about comparability if lessees were to apply the practical expedient beyond when it is needed. The Board also expected the condition in paragraph 46B(b) to be easy to apply, and to help lessees in identifying rent concessions occurring as a direct consequence of the covid-19 pandemic.

(c) introduce no substantive change to other terms and conditions of the lease, considering both qualitative and quantitative factors. Consequently, if a modification to a lease incorporates other substantive changes—beyond a rent concession occurring as a direct consequence of the covid-19 pandemic—the modification in its entirety does not qualify for the practical expedient. The Board noted that, for example, a three-month rent holiday before 30 June ~~2021~~ 2022 followed by three additional months of substantially equivalent payments at the end of the lease would not constitute a substantive change to other terms and conditions of the lease.

BC205E The Board developed the practical expedient to relieve lessees from assessing whether rent concessions occurring as a direct consequence of the covid-19 pandemic are lease modifications and from applying the lease modification requirements to those concessions. The practical expedient does not otherwise interpret or change any requirements in IFRS 16. The Board observed therefore that a lessee would account for the lease liability and right-of-use asset applying the requirements in IFRS 16, which, for example, incorporate requirements in IAS 16 *Property, Plant and Equipment*. With this in mind, the Board considered how a lessee applying the practical expedient would account for three types of change in lease payments:

(a) a lessee applying the practical expedient would generally account for a forgiveness or waiver of lease payments as a variable lease payment applying paragraph 38 of IFRS 16. The lessee would also make a corresponding adjustment to the lease liability—in effect, derecognising the part of the lease liability that has been forgiven or waived.

(b) a change in lease payments that reduces payments in one period but proportionally increases payments in another does not extinguish the lessee's lease liability or change the consideration for the lease—instead, it changes only the timing of individual payments. In this case, applying paragraph 36 of IFRS 16, a lessee would continue to both recognise interest on the lease liability and reduce that liability to reflect lease payments made to the lessor.

(c) some covid-19-related rent concessions reduce lease payments, incorporating both a forgiveness or waiver of payments and a change in the timing of payments.

[2] In March 2021 the Board issued *Covid-19-Related Rent Concessions beyond 30 June 2021*, which amended the date in paragraph 46B(b) of IFRS 16 from 30 June 2021 to 30 June 2022 (see paragraphs BC205H–BC205J).

BC205F The Board was of the view that the information provided by a lessee that applies the practical expedient would be useful to users of financial statements, noting that the lease liability recognised would reflect the present value of future lease payments owed to the lessor. Users of financial statements supported a lessee recognising in profit or loss at the time of the covid-19 pandemic the effects of a rent concession occurring as a direct consequence of the pandemic. Nonetheless, the Board acknowledged concerns from users of financial statements that the practical expedient, because it is optional, could affect comparability between lessees that apply the practical expedient and those that do not—disclosure of the effects of applying the practical expedient is therefore important to meet users' information needs. Consequently, the Board decided to require a lessee applying the practical expedient to some or all eligible contracts to disclose that fact, as well as the amount recognised in profit or loss to reflect changes in lease payments that arise from rent concessions to which the practical expedient is applied (paragraph 60A of IFRS 16).

BC205G Users of financial statements also highlighted the importance of cash flow information about covid-19-related rent concessions. The main effect on cash flows would be the reduction or absence of cash outflows for leases during the period of the rent concession. For a concession that adjusts the carrying amount of the lease liability, a lessee would disclose this effect as a non-cash change in lease liabilities applying paragraph 44A of IAS 7 *Statement of Cash Flows*. The Board noted that cash flow effects, and other information about, for example, the nature of rent concessions, would be relevant regardless of whether a lessee applies the practical expedient. The Board expected paragraphs 51 and 59 of IFRS 16 to require a lessee to disclose such information, if material.

Covid-19-related rent concessions beyond 30 June 2021

BC205H In March 2021 the Board issued *Covid-19-Related Rent Concessions beyond 30 June 2021* (the 2021 amendment), which extended the availability of the practical expedient in paragraph 46A of IFRS 16 by one year. The 2021 amendment resulted in the practical expedient applying to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2022, provided the other conditions for applying the practical expedient are met.

BC205I The Board extended the availability of the practical expedient in response to stakeholder feedback about covid-19-related rent concessions being granted at the time of the 2021 amendment. The Board was informed that lessees continue to face challenges accounting for rent concessions, especially in the light of the many other challenges lessees face during the pandemic. Almost all stakeholders—including almost all users of financial statements—that provided feedback on the 2021 amendment supported extending the availability of the practical expedient. Users of financial statements agreed that the ongoing severity of the pandemic had not been envisaged when the Board originally developed the practical expedient in May 2020; they nonetheless highlighted the continued importance of limiting the availability of the practical expedient so that it can be used only when it is needed most. The Board acknowledged that lessees were no longer applying IFRS 16 for the first time, but concluded that, in all other respects, extending the scope of the practical expedient would be consistent with the Board's objectives when it originally developed the practical expedient in May 2020 (see paragraph BC205B).

BC205J The Board amended only the date within the condition in paragraph 46B(b)—it introduced neither a new practical expedient nor a new option to apply (or not apply) the practical expedient. In response to stakeholder feedback, the Board decided to highlight—in paragraph C20BC of IFRS 16—the relevance of paragraph 2 of IFRS 16 when first applying the 2021 amendment. Applying paragraph 2, a lessee that had already applied the practical expedient in paragraph 46A would be required to apply the extended scope of the practical expedient to eligible contracts with similar characteristics and in similar circumstances. Similarly, the 2021 amendment did not allow a lessee to elect to apply the practical expedient if the lessee did not apply the practical expedient to eligible rent concessions with similar characteristics and in similar circumstances, including those that reduce only lease payments due on or before 30 June 2021. At the time the Board issued the 2021 amendment, a lessee may not have established an accounting policy on applying (or not applying) the practical expedient to eligible rent concessions. Such a lessee could still decide to apply the practical expedient, however that lessee would be required to do so retrospectively and to apply it consistently to contracts with similar characteristics and in similar circumstances.

Presentation: lessee (paragraphs 47–50)

Statement of financial position (paragraphs 47–48)

BC206 The IASB decided that, if not presented separately in the balance sheet, right-of-use assets should be included within the same line item as similar owned assets. The IASB concluded that, if right-of-use assets are not presented as a line item, presenting similar leased and owned assets together would provide more useful information to users of financial statements than other approaches. This is because a lessee often uses owned assets and leased assets for the same purpose and derives similar economic benefits from the use of owned assets and leased assets.

BC207 However, the IASB noted that there are differences between a right-of-use asset and an owned asset, and that users of financial statements may want to know the carrying amount of each separately. For example, right-of-use assets may be viewed as being (a) less risky than owned assets, because a right-of-use asset may not embed residual asset risk; or (b) more risky than owned assets, because the lessee may need to replace the right-of-use asset at the end of the lease term, but may not be able to secure a similar rate for the replacement lease. Accordingly, IFRS 16 requires a lessee to provide information about the carrying amount of right-of-use assets separately from assets that are owned, either in the balance sheet or in the notes.

BC208 Similarly, the IASB decided that a lessee should present lease liabilities separately from other liabilities, either in the balance sheet or in the notes. In reaching this decision, the IASB noted that leasing is an important activity for many lessees. Although a lease liability shares many common characteristics with other financial liabilities, a lease liability is contractually related to a corresponding asset and often has features, such as options and variable lease payments, that differ from those typically found in other liabilities. Thus, presenting lease liabilities separately from other financial liabilities (along with the disclosure requirements discussed in paragraphs BC212–BC230) provides users of financial statements with information that is useful in understanding an entity's obligations arising from lease arrangements. The IASB also noted that paragraph 55 of IAS 1 requires a lessee to further disaggregate line items in the balance sheet if such presentation is relevant to an understanding of the lessee's financial position.

Statement of profit or loss and other comprehensive income (paragraph 49)

BC209 The IASB decided that a lessee should present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset in the income statement. The IASB concluded that a lessee would provide more useful information to users of financial statements by presenting interest on the lease liability together with interest on other financial liabilities and

IFRS 16 requires the seller-lessee to measure the right-of-use asset as a proportion of the asset retained as a result of the leaseback—consequently any off-market terms are effectively accounted for in measuring the gain or loss on sale.

Temporary exception arising from interest rate benchmark reform

BC267A In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2* (2020 Exposure Draft), which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 to address issues that might affect financial reporting during the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate. The term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of IFRS 9 (the reform). The Board issued the final amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 in August 2020 (Phase 2 amendments). Paragraphs BC5.287–BC5.293 of the Basis for Conclusions on IFRS 9 and paragraphs BC289–BC295 of the Basis for Conclusions on IAS 39 discuss the background to these amendments.

BC267B In developing the Phase 2 amendments, the Board also considered the potential effects of the reform on the financial statements of an entity applying the requirements of IFRS Standards, other than IFRS 9 and IAS 39. The Board specifically considered the potential effects arising in the context of IFRS 16.

BC267C Some leases include lease payments that are referenced to an interest rate benchmark that is subject to the reform as described in paragraph 6.8.2 of IFRS 9. IFRS 16 requires a lessee to include variable lease payments referenced to an interest rate benchmark in the measurement of the lease liability.

BC267D Applying IFRS 16, modifying a lease contract to change the basis for determining the variable lease payments meets the definition of a lease modification because a change in the calculation of the lease payments would change the original terms and conditions determining the consideration for the lease.

BC267E IFRS 16 requires that an entity accounts for a lease modification by remeasuring the lease liability by discounting the revised lease payments using a revised discount rate. That revised discount rate would be determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.

BC267F However, in the Board's view, reassessing the lessee's entire incremental borrowing rate when the modification is limited to what is required by the reform (ie when the conditions in paragraph 105 of IFRS 16 are met) would not reflect the economic effects of the modified lease. Such a requirement might also impose additional cost on preparers, particularly when leases that are referenced to a benchmark rate that is subject to the reform are expected to be amended at different times. This is because preparers would have to determine a new incremental borrowing rate at the effective date of each such lease modification.

BC267G For the reasons set out in paragraph BC5.306 of the Basis for Conclusions to IFRS 9, the Board provided a practical expedient to account for a lease modification required by the reform applying paragraph 42 of IFRS 16. This practical expedient requires remeasurement of the lease liability using a discount rate that reflects the change to the basis for determining the variable lease payments as required by the reform. This practical expedient would apply to all lease modifications that change the basis for determining future lease payments that are required as a result of the reform (see paragraphs 5.4.6 and 5.4.8 of IFRS 9). For this purpose, consistent with the amendments to IFRS 9, a lease modification required by the reform is a lease modification that satisfies two conditions—the modification is necessary as a direct consequence of the reform and the new basis for determining the lease payments is economically equivalent to the previous basis (ie the basis immediately preceding the modification).

BC267H The practical expedient provided for lease modifications applies only to the lease modifications required by the reform. If lease modifications in addition to those required by the reform are made, an entity is required to apply the requirements in IFRS 16 to account for all modifications made at the same time, including those required by the reform.

BC267I In contrast to the amendments for financial assets and financial liabilities in IFRS 9 (see paragraph 5.4.9 of IFRS 9), the Board decided not to specify the order of accounting for lease modifications required by the reform and other lease modifications. This is because the accounting outcome would not differ regardless of the order in which an entity accounts for lease modifications required by the reform and other lease modifications.

BC267J The Board also considered that, from the perspective of a lessor, lease payments included in the measurement of the net investment in a finance lease may include variable lease payments that are referenced to an interest rate benchmark. The Board decided not to amend the requirements for accounting for modifications to lease contracts from the lessor's perspective. The Board did not make such amendments because, for finance leases, a lessor is required to apply the requirements in IFRS 9 to a lease modification, so the amendments in paragraphs 5.4.5–5.4.9 of IFRS 9 would apply when those modifications are required by the reform. For operating leases, the Board decided that applying the requirements in IFRS 16 for lessors will provide useful information about the modification in terms and conditions required by the reform in the light of the mechanics of the operating lease accounting model.

Effective date and early application (paragraph C1)

BC268 In determining the effective date of IFRS 16, the IASB considered feedback received from preparers about the amount of time they would need to implement the requirements of IFRS 16 in the light of the transition requirements. The IASB also considered feedback received from both users and preparers of financial statements about the interaction of IFRS 16 with the implementation of other recently issued Standards (most notably IFRS 9 and IFRS 15).

BC269 The IASB acknowledged that users of financial statements would generally prefer the effective date of IFRS 16 to be 1 January 2018. This is because users would prefer IFRS 16 to have the same effective date as IFRS 9 and IFRS 15—this would avoid accounting uncertainty arising from entities implementing new Standards over a number of years. Users of financial statements also noted that, in their view, the effective date of IFRS 16 should be as soon as possible in the light of the significant improvements in financial reporting that will result from the implementation of IFRS 16. Consequently, they did not support a period of three years between publication of IFRS 16 and the effective date.

BC270 However, almost all preparers that provided feedback indicated that an effective date of 1 January 2018 would not give them adequate time to implement IFRS 16, IFRS 9 and IFRS 15. The majority of preparers reported that they would need approximately three years to implement the requirements of IFRS 16 between publication and the effective date.

BC271 The IASB concluded that implementation of IFRS 16 by 1 January 2018 would not be achievable for all preparers taking into consideration that entities are also required to implement IFRS 9 and IFRS 15 in that period of time. Consequently, the IASB decided that an entity is required to apply IFRS 16 for annual reporting periods beginning on or after 1 January 2019.

BC272 The IASB also decided to permit early application of IFRS 16 for entities that apply IFRS 15 on or before the date of initial application of IFRS 16. In reaching this decision, the IASB noted that early application would allow any entity that wishes to apply IFRS 16 at the same time as IFRS 9 and IFRS 15 to do so. The IASB also noted that early application might be beneficial to an entity that adopts IFRS for the first time between the publication of IFRS 16 and its effective date. However, the IASB decided to limit early application of IFRS 16 to entities that also apply IFRS 15. This is because some of the requirements of IFRS 16 depend on an entity also applying the requirements of IFRS 15 (and not the Standards that were superseded by IFRS 15).

Transition (paragraphs C2–C20)

Definition of a lease (paragraphs C3–C4)

BC273 The IASB decided that an entity is not required to reassess whether contracts are, or contain, leases on transition to IFRS 16. Consequently, an entity can choose to apply the requirements of IFRS 16 to all existing contracts that met the definition of a lease applying the requirements of IAS 17 and IFRIC 4. Similarly, an entity does not need to apply IFRS 16 to existing contracts that did not meet the definition of a lease applying the requirements of IAS 17 and IFRIC 4.

BC274 Preparers provided feedback that it could be costly for them to reassess all of their existing contracts using the definition of a lease requirements in IFRS 16. The IASB observed that it envisages only a limited number of scenarios in which application of the lease definition requirements in IFRIC 4 would result in a different outcome from the application of the lease definition guidance in IFRS 16. The IASB identified a small population of contracts that would be classified as leases applying IFRIC 4 but as service contracts applying IFRS 16, and none for which the converse is expected to be true. The IASB expects that the consequence of an entity not reassessing its existing contracts applying the lease definition requirements in IFRS 16 would be the recognition of slightly more leases on transition to IFRS 16 than would otherwise be the case. On this basis, the IASB concluded that the costs of requiring entities to reassess existing contracts applying the lease definition guidance in IFRS 16 would not be justified.

Dissenting opinion

Dissent of Nick Anderson and Zachary Gast from *Covid-19-Related Rent Concessions beyond 30 June 2021*

DO1 Messrs Anderson and Gast voted against the publication of *Covid-19-Related Rent Concessions beyond 30 June 2021*. They are concerned that an extension to the period during which the practical expedient is available will further impede comparability between lessees that apply the practical expedient and those that do not. They note that support from users of financial statements for *Covid-19-Related Rent Concessions* (the 2020 amendment) was predicated on limiting the practical expedient to a specific time frame that the amendment will extend by 12 months. They also note that one key reason the Board developed the 2020 amendment was because, at that time, lessees were applying IFRS 16 for the first time and that this is no longer the case.