Current Developments: IFRS

December 2018

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Quarterly update

Each quarter, we provide a summary of newly effective and forthcoming standards as well as other accounting and financial reporting developments. This edition covers current developments as of December 31, 2018.

The effective date of IFRS 16 *Leases* has arrived

Communication and the transparent disclosures of the expected impact of adopting IFRS 16 on the financial statements are required as per IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and are expected by investors and regulators. Information about the impacts should be known or reasonably estimable and so entities should be able to provide entity specific qualitative and quantitative information in their 2018 annual financial statements.

What happened this quarter?

At its December meeting, the International Accounting Standards Board (the 'IASB' or the 'Board'):

- tentatively proposed an amendment to IFRS 17's presentation requirements that aims to provide practical relief to insurers by requiring them to present insurance contracts on the balance sheet at portfolio level – a higher level of aggregation than currently required.
- decided to add the IBOR Reform and the Effects on Financial Reporting project to the Board's standard-setting programme.

At its November meeting, the IASB tentatively proposed that the mandatory effective date of IFRS 17 *Insurance Contracts* and the fixed expiry date for the optional temporary exemption from applying IFRS 9 *Financial Instruments* granted to insurers be deferred by one year, to January 1, 2022.

In October the IASB:

- issued amendments to IFRS 3 that provide more guidance on the definition of a business.
- refined its definition of 'material' and issued practical guidance on applying the concept of materiality.

The IASB also continued its work on the projects Dynamic Risk Management and Rate-regulated Activities.

Highlights from the previous quarters

In the second quarter the IASB published a discussion paper for the project 'Financial Instruments with Characteristics of Equity'.

In the first quarter the IASB issued a narrow scope amendment to IAS 19 *Employee Benefits*, and released the revised *Conceptual Framework for Financial Reporting*.

In addition, the IFRS 17 Insurance Transition Resource Group held three substantive meetings to understand the implementation questions raised with respect to the new Standard and to share their views on the accounting analysis.

Current Quarter's Financial Reporting Matters

New Guidance

- Definition of a business (Amendments to IFRS 3 Buisness Combinations)
- Definition of Material (Amendments to IAS 1 and IAS 8)

Previous Quarters' Financial Reporting Matters

New Guidance

- Plan Amendment, Curtailment or Settlement *(*Amendments to IAS 19 *Employee Benefits)*
- Revised Conceptual Framework for Financial Reporting

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Current Quarter's Financial Reporting Matters

New Guidance

Definition of a business (Amendments to IFRS 3 *Business Combinations*)

With a broad business definition, determining whether a transaction results in an asset or a business acquisition has long been a challenging but important area of judgment.

In October 2018, the IASB issued amendments to IFRS 3 *Business Combinations*, that seek to clarify whether a transaction results in an asset or a business acquisition.

The amendments include an election to use a concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets.

If a preparer chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

The effect of these changes is that the new definition of a business is narrower – this could result in fewer business combinations being recognized.

The amendment applies to businesses acquired in annual reporting periods beginning on or after January 1, 2020. Earlier application is permitted.

For additional information, refer to KPMG's *web article*.

Definition of Material (Amendments to IAS 1 and IAS 8)

In October 2018, the IASB refined its definition of material to make it easier to understand. It is now aligned across IFRS Standards and the Conceptual Framework for Financial Reporting. The amendments provide a definition and explanatory paragraphs in one place. Some stakeholders were concerned that the previous definition might encourage entities to disclose immaterial information in their financial statements. In response, the IASB promoted the concept of 'obscuring' to the definition, alongside the existing references to 'omitting' and 'misstating'. Additionally, the IASB increased the threshold of 'could influence' to 'could reasonably be expected to influence'.

The amendments are effective from January 1, 2020 but may be applied earlier. However, the IASB does not expect significant change – the refinements are not intended to alter the concept of materiality.

For additional information, refer to KPMG's *web article*.

Previous Quarters' Financial Reporting Matters

New Guidance

Plan Amendment, Curtailment or Settlement *(Amendments to IAS 19 Employee Benefits)*

In February 2018, the IASB issued amendments to IAS 19 *Employee Benefits*, clarifying that:

- on amendment, curtailment or settlement of a defined benefit plan, a company now uses updated actuarial assumptions to determine its current service cost and net interest for the period; and
- the effect of the asset ceiling is disregarded when calculating the gain or loss on any settlement of the plan and is dealt with separately in other comprehensive income (OCI).

Some entities may see major changes from the requirement to recalculate current service cost and net interest for changes in the plan.

The amendments apply for plan amendments, curtailments or settlements that occur on or after January 1, 2019. Earlier application is permitted.

For additional information, refer to KPMG's *web article.*

Revised Conceptual Framework for Financial Reporting

In March 2018, the IASB published its revised Conceptual Framework for Financial Reporting – the foundation on which the IASB develops new accounting standards. The revised Framework is more comprehensive than the old one and covers all aspects of standard setting from the objective of financial reporting, to presentation and disclosures. Effective immediately, it largely codifies the Board's recent thinking – but it also introduces some new, untested concepts.

The main changes to the Framework's principles have implications for how and when assets and liabilities are recognized and derecognized in the financial statements. The Conceptual Framework primarily serves as a tool for the IASB to develop standards and to assist IFRIC in interpreting them. It does not override the requirements of individual IFRSs.

For additional information, refer to KPMG's *web article.*

Looking Ahead

IFRS 16 Leases

The January 1, 2019 - Effective Date of the New Leases Standard - Has Arrived

IFRS 16 represents a fundamental change in lease accounting. Stakeholders and regulators will be looking for information about potential implications, whether that be to particular line items, certain processes, or maybe lines of business that are heavily impacted. To view an illustrative example of how IFRS 16 might impact your company's financial statements, please refer to our publication *IFRS 16 Illustrative Disclosures Supplement.*

Leases Under IFRS 16 – a recap

IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance finance leases and off-balance sheet operating leases. Instead, IFRS 16 introduces a single, on-balance sheet accounting model that is similar to current finance lease accounting. And while lessor accounting remains substantially similar to current practice – i.e., lessors continue to classify leases as finance and operating leases, there are some differences, including the fact that lessors look to the new Revenue Standard to split the lease component of a contract from non-lease components.

All entities that lease major assets for use in their business will see an increase in reported assets and liabilities. In addition, entities will also now recognize a front-loaded pattern of expense for most leases, even when they pay constant annual rentals. This will affect a wide variety of organizations across all industries that lease real estate, equipment, and vehicles. The larger the lease portfolio, the greater the impact on key reporting measures.

For companies with significant leases of property, our *Real estate leases – The tenant perspective* publication covers key areas of IFRS 16 that are particularly relevant to tenants in real estate leases. Each section is illustrated with examples based on real-life terms and conditions.

The new standard makes the distinction between contracts that meet the definition of a lease rather than a service contract even more critical, as leases will now be recognized on the balance sheet. There may be a number of arrangements that are currently accounted for as leases that fall outside the new definition of a lease introduced in IFRS 16. The new definition also increases the focus on who controls the use of the underlying asset throughout the term of the arrangement.

On transition to IFRS 16, companies can choose whether to apply a practical expedient to 'grandfather' their previous assessment of which existing contracts are, or contain, leases. Our *Lease Definition* publication provides a detailed analysis of the key elements of the lease definition and the related transition provisions.

Lessee Accounting

For each major lease, a lessee will recognize a liability for the present value of future lease payments. The lease liability will be measured at amortized cost using the effective interest rate, which creates a front-loaded interest expense. The lessee will also recognize a 'right-of-use' asset, which will be measured at the amount of the lease liability plus initial direct costs, prepaid lease payments, and estimated costs to dismantle, less any incentives received. Lessees will generally depreciate the right-of-use asset on a straight-line basis.

Additionally, IFRS 16 introduces a requirement to reassess key judgements, such as lease term, which is a significant change from current guidance. It is no longer possible to compute a lease amortization schedule on lease commencement and roll that schedule forward at each reporting date. Instead, companies will need to consider whether to re-measure the lease liability and right-of-use asset upon the

occurrence of a significant event or change of circumstances within the control of the lessee. Significant judgement will likely be needed in determining whether there is a change in relevant factors, or a change in the lessee's economic incentive to exercise or not exercise renewal or termination options.

What Discount Rate?

A key estimate in IFRS 16 relates to the discount rate used to measure the present value of the lease payments. While the definitions of the discount rate are consistent with IAS 17 *Leases*, the application of these definitions in the new standard may be complex, especially for lessees, as a discount rate will have to be determined for most leases previously classified as operating leases. The exceptions are leases for which the lessee applies the recognition exemptions. The determination of the appropriate discount rate will be particularly demanding at transition, especially if IFRS 16 is adopted retrospectively.

The discount rate affects the amount of the lessee's lease liabilities and a host of key financial ratios. The financial statement impacts of having a higher or lower discount rate may be pervasive. For example, the discount rate will impact the allocation of total expense between depreciation and interest throughout the lease term. A higher discount rate will reduce depreciation and increase interest expense in each reporting period. Estimating discount rates and documenting the basis of those estimates will be a major task. To help you prepare to adopt IFRS 16, KPMG has published, *Leases Discount Rates – What's the correct rate?*, which provides an overview of how to determine the appropriate discount rate and how this will affect your financial statements.

What's Included in the Lease Liability?

The lease liability is measured at the present value of the lease payments. But the determination of which lease payments should be included in the lease liability, initially and subsequently will determine the scale of the impact of the new standard for lessees.

One key difference from current practice is that certain lease payments are reassessed over the term of the lease, and the lease liability adjusted accordingly. This introduces new balance sheet volatility.

It also requires new systems and processes to determine the revised lease payments and recalculate the lease liability.

Identifying the relevant payments to include in the liability is key to measuring the lease liability. KPMG has published *Lease payments – What's included in the lease liability?* which provides an overview of how to determine the lease payments.

Lease Modifications

Lease modifications are very common but the resulting accounting can be complicated. Moreover, many companies will need to address historical lease modifications now — as part of their transition project. In addition, all companies will need to prepare for lease modifications that will take place after transition — a key 'day two' aspect of the new world of lease accounting.

Our publication *Lease modifications* contains practical guidance and examples showing how to account for the most common forms of lease modifications.

Effective Date and Transition

The standard is effective for annual reporting periods beginning on or after January 1, 2019.

The choice of transition options will have a significant impact on the extent of data gathering and the timing of system and process changes. Upon adoption, an entity will be able to choose either of the following transition approaches:

(a) Retrospective approach

An entity may choose to retrospectively adjust all prior periods presented.

(b) Modified retrospective approach

An entity may choose not to restate comparatives and instead adjust opening retained earnings at the date of initial application.

While there are two broad transition approaches, there are many individual options and practical expedients that can be elected independently of each other, some on a lease-by-lease basis. Most of the transition options involve a trade-off between the costs of implementation and the comparability of the resulting financial information. For lessees with significant lease portfolios, it may be worthwhile to model the different transition options early since the decisions made on transition will continue to affect the company's financials until the last lease in place on transition has expired. Before the effective date, companies will need to gather significant additional data about their leases, and make new estimates and calculations, as well as decisions about transition. For some companies, a key challenge will be gathering the required data. For others, more judgemental issues will dominate – e.g., identifying which transactions contain leases. Our *Leases – Transition options* publication provides an overview of the transition options and expedients and how they would affect your financial statements.

For additional information, refer to KPMG's *IFRS – Leases* hot topics page.

IFRS 17 Insurance Contracts

In May 2017, the IASB issued the new insurance contracts standard IFRS 17 which will bring fundamental changes to insurance accounting. The new standard will give users of financial statements a whole new perspective, and the ways in which analysts interpret and compare companies will change. The impact on insurers is significant, but will vary between insurers and jurisdictions.

Benefits of the new standard include increased transparency about the profitability of new and in-force business which will provide more insight into an insurer's financial health. Other effects may include greater volatility in financial results and equity due to the use of current discount rates and assumptions around future cash flows.

Other changes include:

- separate presentation of underwriting and finance results, providing information surrounding the sources of profit and quality of earnings;
- premium volumes will no longer drive the 'top line' as investment components and cash received are no longer considered to be revenue; and
- accounting for options and guarantees will be more consistent and transparent.

IFRS 17 applies not only to entities that are generally considered insurance entities, but to all entities that:

- issue insurance or reinsurance contracts;
- hold reinsurance contracts; or
- issue investment contracts with a discretionary participation feature (provided that they also issue insurance contracts).

IFRS 17 introduces:

- a single measurement model based on a current fulfillment value that incorporates available information in a way that is consistent with observable market information; and
- a single revenue recognition principle to reflect services provided.

IFRS 17 becomes effective on January 1, 2021, however, the timescale will be a challenge. To address this at its November 2018 meeting, the IASB tentatively decided to propose that:

- the mandatory effective date of IFRS 17 be deferred by one year to 2022; and
- the fixed expiry date for the optional temporary exemption from applying IFRS 9 *Financial Instruments*, granted to insurers meeting certain criteria, also be deferred by one year to 2022.

This means that insurance entities preparing financial statements under IFRS would be required to apply both IFRS 9 and IFRS 17 for annual periods beginning on or after January 1, 2022. For more information refer to KPMG's *web article.*

Implementation of IFRS 17 will require the coordination of several functions, including Finance, Actuarial, and IT as well as the introduction of new or upgraded systems, processes and controls. Although the IASB has proposed a one-year deferral of the effective date, insurers should maintain the pace of progress on implementation.

IFRS 17 has already raised a variety of implementation questions from stakeholders. To help support implementation and reduce the potential for diversity in practice, the IASB has set up a Transition Resource Group (TRG), which held meetings in February, May and September 2018. Our online magazine *Insurance – Transition to IFRS 17* tracks the TRG's activities and contains our summary of and observations on the topics discussed.

To assist in the implementation of IFRS 17 in Canada, the Accounting Standards Board also established a TRG, which held its meetings in February, April and September 2018.

At its October 2018 meeting, the IASB undertook its first comprehensive update aimed at addressing stakeholders' concerns and implementation challenges. Notably, they set criteria for evaluating possible amendments to IFRS 17, and also discussed concerns and challenges identified by insurers and other stakeholders. For more information refer to KPMG's *web article*.

At its December 2018 meeting the IASB tentatively decided to propose a change to require presenting insurance contracts on the balance sheet at portfolio level – a higher level of aggregation than currently required by IFRS 17. This means that offsetting, for presentation purposes only, would be applied between groups in the same portfolio.

Many insurers are likely to welcome the proposal, but it remains to be seen where else the Board will seek to ease the challenges insurers have identified. For more information refer to KPMG's *web article*.

Our guide *Insurers - Illustrative disclosures* provides a comprehensive illustration for financial statements for an annual period beginning on January 1, 2021 when IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments* are applied for the first time.

For additional information, refer to KPMG's webcast series, *Navigating the new world*, Insurance Hot Topics *IFRS - Insurance*, *web article,* and publication *Insurance Contracts – First Impressions*

Annual Improvements to IFRSs 2015-2017 Cycle

In December 2017, as part of its process to make non-urgent but necessary amendments to IFRS, the IASB issued narrow-scope amendments to IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements,* IAS 12 *Income Taxes* and IAS 23 *Borrowing Costs*.

The amendments to IFRS 3 and IFRS 11 clarify how a company accounts for increasing its interest in a joint operation that meets the definition of a business:

- if a party maintains (or obtains) joint control, then the previously held interest is not remeasured; and
- if a party obtains control, then the transaction is a business combination achieved in stages and the acquiring party remeasures the previously held interest at fair value.

The amendments to IAS 12 clarify that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognized consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI or equity.

The amendments to IAS 23 clarify that the general borrowings pool used to calculate eligible borrowing costs excludes only borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale – or any non-qualifying assets – are included in that general pool.

The amendments are effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted. Each of the amendments has its own specific transition requirements.

For additional information, refer to KPMG's *web article.*

Prepayment Features with Negative Compensation (Amendments to IFRS 9)

In October 2017, the IASB issued amendments to IFRS 9 *Financial Instruments* clarifying the accounting for financial assets with prepayment features that may result in negative compensation.

For a debt instrument to be eligible for measurement at amortized cost or fair value through other comprehensive income (FVOCI), IFRS 9 requires its contractual cash flows to meet the SPPI criterion – i.e. the cash flows are 'solely payments of principal and interest'.

Under IFRS 9, a prepayment option in a financial asset meets this criterion if the prepayment amount substantially represents unpaid amounts of principal and interest, which may include 'reasonable additional compensation' for early termination of the contract.

Some prepayment options could result in the party that triggers the early termination receiving compensation from the other party (negative compensation) – e.g. a lender could receive an amount less than the unpaid amounts of principal and interest even though the borrower chooses to prepay. In other cases, an event outside the control of both parties may cause early termination.

Applying IFRS 9 would probably result in these instruments being measured at fair value through profit or loss (FVTPL). The Board believed this to be inappropriate because measuring them at amortized cost, using the effective interest method, provides useful information about the amount, timing and uncertainty of their future cash flows.

The amendment removes the word 'additional' so that negative compensation may be regarded as 'reasonable compensation' irrespective of the cause of the early termination. Financial assets with these prepayment features can therefore be

measured at amortized cost or at FVOCI if they meet the other relevant requirements of IFRS 9.

The amendment is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted. Retrospective application is required, subject to relevant transitional reliefs.

For additional information, refer to KPMG's *web article.*

Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)

In October 2017, the IASB issued amendments to IAS 28 *Investments in Associates and Joint Ventures*, clarifying that an entity applies IFRS 9 *Financial Instruments* (including its impairment requirements) to long-term interests in an associate or joint venture to which the equity method is not applied.

The amendment will affect companies that finance these entities with preference shares or with loans for which repayment is not expected in the foreseeable future (referred to as long-term interests or 'LTI'). This is common in the extractive and real estate sectors.

In the amendments to IAS 28 and the accompanying example the IASB clarified that LTI are in the scope of both IFRS 9 and IAS 28 and explain the annual sequence in which both standards are to be applied. In effect, this is a three step annual process:

- apply IFRS 9 independently, ignoring any prior years' IAS 28 loss absorption;
- true-up past allocations – if necessary, prior years' IAS 28 loss allocation is trued-up in the current year because the IFRS 9 carrying value may have changed. This may involve recognizing more prior years' losses, reversing these losses, or re-allocating them between different LTI instruments; and
- recognize current year equity share – any current year IAS 28 losses are allocated to the extent that the remaining LTI balance allows. Any current year IAS 28 profits reverse any unrecognized prior years' losses and then allocations against LTI.

The amendment applies for annual periods beginning on or after January 1, 2019, with transitional reliefs. Early adoption is permitted.

For additional information, refer to KPMG's *web article.*

Uncertainty over Income Tax Treatments (IFRIC Interpretation 23)

In June 2017, the IASB issued IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* in response to diversity in practice for various issues in circumstances in which there is uncertainty in the application of the tax law. While IAS 12 *Income Taxes* provides requirements on the recognition and measurement of current and deferred tax liabilities and assets, there is diversity in the accounting for income tax treatments that have yet to be accepted by tax authorities.

The Interpretation requires:

- an entity to determine if it is probable that the tax authorities will accept the uncertain tax treatment;
- if it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value depending on whichever method better predicts the resolution of the uncertainty;
- an entity to reassess the judgements and estimates applied if facts and circumstances change (e.g. as a result of examination or action by tax authorities, following changes in tax rules or when a tax authority's right to challenge a treatment expires); and

- an entity to consider whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution.

The Interpretation is applicable for annual periods beginning on or after January 1, 2019 and may be applied on a fully retrospective basis, if this is possible without the use of hindsight, or on a modified retrospective basis, with an adjustment to equity on initial application. Earlier application is permitted.

For additional information, refer to KPMG's *web article.*

Update on Financial Instruments Projects

Financial Instruments with Characteristics of Equity

IAS 32 *Financial Instruments: Presentation* sets out how an issuer distinguishes between a financial liability and equity and works well for many, simpler financial instruments. However, classifying more complex financial instruments under IAS 32 – e.g. those with characteristics of equity – can be more challenging, leading to diversity in practice. In response, the IASB has published a discussion paper *Financial Instruments with Characteristics of Equity* that seeks to improve IAS 32 by:

- establishing clearer principles for classifying financial instruments as either financial liabilities or equity;
- improving the clarity and consistency of the classification requirements for the more complex financial instruments that create a challenge in practice – e.g. derivatives on own equity; and
- enhancing the presentation and disclosures about financial liabilities and equity.

These proposals could mean more liabilities and less equity, and enhanced presentation and disclosure for hybrid capital instruments.

The comment period for the discussion paper ends January 7, 2019. The Board will consider the comments received on this discussion paper before deciding whether to develop an exposure draft with proposals to amend or replace parts of IAS 32 and/or to develop non-mandatory guidance.

In the third quarter the IASB published a series of slides and webcasts for the discussion paper on its website. In the webcasts, IASB staff explain the Board's preferred approach. All the webcasts and supporting materials are available on the IASB's *FICE project page*.

To learn more about the Board's proposals, read our *web article*.

Dynamic Risk Management

In December 2017, the Board decided to: (1) focus first on developing a core model for the most important issues; and (2) to seek feedback on the feasibility of the core model. The manner in which feedback is obtained will be determined at a later date; and to (3) address the non-core issues as a final step.

In February 2018, the Board discussed the role of the asset profile within the Dynamic Risk Management Accounting model (the Model); in particular, the application of qualifying criteria to the asset profile, as well as designation of items within the asset profile and documentation requirements. The Board decided the staff should continue developing the Model.

In March 2018, the Board discussed the role of the target profile within the Model; in particular, what is a target profile, how it is determined, consistency of the asset profile and target profile, and the time horizon of the target profile. The Board tentatively decided the staff should continue developing the Model.

In April 2018, the Board discussed the application of qualifying criteria to the target profile, as well as designation of items within the target profile, core demand deposits and the documentation requirements. The Board decided the staff should continue developing the Model. In addition, through a series of hypothetical scenarios, the Board discussed how the dynamic nature of portfolios will affect both the asset and target profiles in the Model. The Board also discussed how the dynamic nature of portfolios will affect the interaction between the asset and target profiles.

In June 2018, the Board discussed derivative financial instruments, including designation and de-designation of derivatives. In addition, the Board started the discussion of financial performance in the context of the Model, including the results reported in the statement of profit or loss, deferrals and reclassifications and the existence of a continuing economic relationship. The Board plans to continue discussing performance in the context of the Model.

In September 2018, the Board discussed the information that should be provided in situations of imperfect alignment (i.e. when the asset profile, in conjunction with the designated derivatives, are not aligned with the target profile). It agreed that, for items designated in the model, measuring imperfect alignment provides information about the extent to which an entity has achieved its risk management strategy and therefore quantifies the resulting potential impact on the entity's future economic resources. The Board also discussed how an entity applying the Model should reflect a change in the risk management strategy.

In December 2018 meeting the Board tentatively decided that an entity can apply the Model if designation of the asset profile, target profile and designated derivatives does not reflect an imbalance that would create misalignment that could result in an accounting outcome inconsistent with the purpose of the Model. The Board also tentatively decided that, subject to further articulation, there must be an economic relationship between the target profile and the combination of the asset profile and designated derivatives. The Board emphasised its previous tentative decision not to define a quantitative threshold.

IBOR Reforms and the Accounting Impacts

In many markets around the world benchmark rates are interbank offer rates (IBOR). However, there have been various issues related to these rates in the last decade, especially in the UK.

Regulators, international bodies and organizations around the world recently started various initiatives and consultations related to replacing or supplementing such rates with alternative benchmarks that are more robust, reliable and closer to a risk free rate.

In March 2018 Canadian Alternative Reference Rate Working Group (CARR) was established to identify and seek to develop a new term risk-free Canadian dollar interest rate benchmark. Such a term risk-free rate would operate alongside the existing Canadian Dollar Offered Rate (CDOR). CARR will also explore possible enhancements to the existing Canadian overnight risk-free rate, the Canadian Overnight Repo Rate Average. CARR held meetings in October, November and December 2018. For more details refer to the Bank of Canada website.

Impacting IBOR-benchmark contracts, it may be important to think about possible accounting implications of these initiatives.

One issue to consider is the impact on existing hedging relationships. In particular, if an entity has hedge designations whereby changes in a specified IBOR were designated as the hedged risk, then a question arises whether hedge accounting should be discontinued because of a change in the benchmark interest rate away from that specified IBOR.

The other question is how to account for the changes in the instruments whose cash flows are affected by replacing an IBOR, including whether derecognition of the original instrument is triggered and whether gain or loss should be recorded.

At its June 2018 meeting, the IASB decided to add a project to its research agenda. The objective of the project was to monitor further developments in the area of potential discontinuation and/or replacing such benchmark interest rates and determine whether there are any implications for the existing accounting requirements.

At its December 2018 meeting, the IASB decided:

- to add the IBOR Reform and its Effects on Financial Reporting project to the Board's standard-setting programme; and
- that the project will prioritise the analysis of accounting issues affecting financial reporting leading up to IBOR reform, i.e. issues related to areas in hedge accounting that require forward-looking analyses. The project will then focus on issues that affect financial reporting when IBOR reform is enacted (e.g. modification versus derecognition assessment).

The potential accounting impacts are also explored in our *IFRS Newsletter: The Bank Statement.*

Update on Rate-regulated Activities Project

Some entities are subject to regulations that say how much and when they can charge their customers. Although some national accounting bodies provide specific guidance on accounting for the effects of rate regulation, IFRS does not contain any equivalent comprehensive guidance. IFRS 14 *Regulatory Deferral Accounts* provides only temporary relief to first-time adopters of IFRS that are subject to rate regulation.

Entities use different accounting models to report the effects of this rate regulation. Some of these models reflect incomplete information about how rate regulation affects an entity's underlying financial position, performance and cash flows.

The IASB's project focuses on 'Defined rate regulation' which balances:

- the needs of the customers to purchase essential goods or services at a reasonable price; with
- the needs of the entity to attract capital and remain financially viable.

Some of key tentative decisions made by the IASB before the fourth quarter 2018 were:

- the accounting model should apply to Defined Rate Regulation established through a formal regulatory framework that:

  (a) is binding on both the entity and the regulator; and

  (b) establishes a basis for setting the rate for specified goods or services that includes a rate-adjustment mechanism. That mechanism creates, and subsequently reverses, rights and obligations caused by the regulated rate in one period including amounts related to specified activities the entity carries out in a different period.

- the accounting model's general approach provides financial information that supplements information provided by other IFRS Standards. This means that a rate-regulated entity will apply other IFRS Standards, including IFRS 15, without amendment, before applying the model, i.e. an entity will then recognise rights and obligations arising from the rate-adjustment mechanism.

The IASB has also noted that the basis for setting the rate(s) typically enables a reasonably efficient entity:

(a) to recover the cost of assets utilised and operating expenses incurred in providing regulated services; and

(b) to earn a return on the cost of assets utilised in providing regulated services.

The components (a) and (b) above form part of the 'allowed revenue'. The 'allowed revenue' is used to calculate the rate ('P') based on estimated quantity ('Q').

The total expenditure that the entity is allowed to include within the regulated rate is then treated as:

(a) 'Regulatory Capital Expenditure', intended to pass through the rate over a longer period together with an allowed return on the cost of assets utilised in providing regulated services; or

(b) 'Regulatory Operating Expenditure', intended to pass through the rate in the same period as the expenses are incurred with typically no interest rate or margin applied.

Not all allowable expenditures pass through into the rate in the same period in which the expenditure is incurred. This leads to the 'regulatory timing differences' the accounting model being developed for Defined Rate Regulation aims to account for.

In the fourth quarter 2018 the IASB tentatively decided that the measurement requirements of IAS 36 *Impairment of Assets* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* should not be applied to regulatory assets and regulatory liabilities. The IASB also discussed the discount rate to be used when

measuring regulatory assets or liabilities arising from regulatory timing differences related to the following.

- 'Regulatory Capital Expenditure'. The IASB tentatively decided that an entity should include only the estimated future cash flows arising from the original regulatory timing difference and discount them at a rate of 0% — that is, the entity should exclude the cash flows relating to the regulatory overall return and recognise that overall return as revenue in profit or loss as it is included in the rate charged to customers.
- 'Regulatory Operating Expenditure'. The IASB tentatively decided that:
  (a) an entity should use a discount rate that reflects, at least, compensation for the time value of money and uncertainty inherent in the cash flows; but
  (b) when the regulatory interest rate or regulatory return rate provides an additional return above the compensation in (a), an entity should use that regulatory interest rate or regulatory return rate as the discount rate unless there is clear evidence that the excess relates to an identifiable transaction or event.
- Items of expense or income that will form part of the 'Regulatory Operating Expenditure' or the 'Regulatory Capital Expenditure' when cash is paid or received. The IASB tentatively decided to reject the staff's recommended approach. The IASB expressed concerns about how the staff's recommendations would apply to particular cases such as deferred tax and asked the staff to provide further analysis.

In the fourth quarter 2018 the IASB also discussed the presentation and disclosure requirements for the regulatory balances.

The IASB expects to publish proposals for the accounting model in either a second Discussion Paper or an Exposure Draft in the first half of 2019.

Amended and new IFRSs effective date

A reminder of standards not yet effective, but available for early adoption are listed in this table.

Effective for years ending	Standards	KPMG's Guidance
December 31, 2019	IFRS 16 *Leases*	Web article (with links to in-depth analysis)
	Uncertainty Over Income Taxes (IFRIC Interpretation 23)	Web article
	Annual Improvements 2015 - 2017 Cycle • IAS 23 *Borrowing Costs*: Borrowing costs eligible for capitalization • IFRS 3 *Business Combinations* and IFRS 11 *Joint Arrangements*: Obtaining control (or joint control) of a business that is a joint operation if the company already holds an interest in that business. • IAS 12 *Income Taxes*: Consequences of payments on instruments classified as equity	Web article
	Long-term Interests in Associates and Joint Ventures (Amendments to IFRS 9 and IAS 28)	Web article
	Prepayment Features with Negative Compensation (Amendments to IFRS 9)	Web article
	Plan Amendment, Curtailment or Settlement (Amendments to IAS 19 *Employee Benefits*)	Web article
December 31, 2020	Definition of a Business (Amendments to IFRS 3 *Business Combinations*)	Web article
	Definition of Material (Amendments to IAS 1 and IAS 8)	Web article
December 31, 2021*	IFRS 17 *Insurance Contracts*	*IFRS Newsletter: Insurance* and KPMG's website *IFRS – Insurance.*
NA**	Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)	Web article

* The IASB has tentatively proposed to defer the effective date by one year.

** The IASB has decided to defer the effective date for these amendments indefinitely. Adoption is still permitted.

IASB Work Plan

These tables are intended to act as an outlook of current IASB projects that may impact your financial statements in the future.

The following items are not included in these tables:

- *IASB's certain research projects, and*
- *Matters under discussion by IFRS Interpretations Committee.*

Standard-setting projects	Next Milestone	Expected Date	KPMG's Guidance
Management Commentary (IFRS Practice Statement)	Exposure Draft	H1 2020	
Primary Financial Statements	Discussion Paper or Exposure Draft	H2 2019	
Rate-regulated Activities	Discussion Paper or Exposure Draft	H2 2019	In the Headlines, Issue 2014/20
Research projects	**Next Milestone**	**Expected Date**	
Business Combinations under Common Control	Discussion Paper	2020	
Dynamic Risk Management	Core Model	H2 2019	IFRS Newsletter: Financial Instruments
Extractive Activities	Review Research	TBD	
Financial Instruments with Characteristics of Equity	Discussion Paper Feedback	Q1 2019	Web article
Goodwill and Impairment	Discussion Paper or Exposure Draft	H2 2019	
Pension Benefits that Depend on Asset Returns	Review Research	H2 2019	
Provisions	Review Research	H2 2019	

Maintenance projects	Next Milestone	Expected Date	KPMG's Guidance
Accounting Policies and Accounting Estimates (Amendments to IAS 8)	Decide Project Direction	Q2 2019	
Accounting Policy Changes (Amendments to IAS 8)	Decide Project Direction	TBD	
Amendments to IFRS 17	Exposure Draft	Q2 2019	Web article 1 and Web article 2
Availability of a Refund (Amendments to IFRIC 14)	IFRS Amendment	TBD	
Classification of Liabilities as Current and Non-current (Amendments to IAS 1)	IFRS Amendment	TBD	
Deferred tax related to assets and liabilities arising from a single transaction (Amendments to IAS 12)	Exposure Draft	Q2 2019	
Disclosure Initiative - Accounting Policies	Exposure draft	TBD	
Disclosure Initiative – Targeted Standards-level Review of Disclosures	Exposure Draft	TBD	
Fees in the '10 per cent' test for Derecognition (Amendments to IFRS 9)	Exposure Draft	TBD	
IBOR Reform and the Effects on Financial Reporting	Exposure Draft	Q2 2019	
Improvements to IFRS 8 Operating Segments (Amendments to IFRS 8 and IAS 34)	Feedback Statement	Q1 2019	
Lease Incentives (Amendments to Illustrative Example 13 accompanying IFRS 16)	Exposure Draft	Q2 2019	
Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)	IFRS Amendment	TBD	Web article
Onerous Contracts—Cost of Fulfilling a Contract (Amendments to IAS 37)	Exposure draft	Q2 2019	Web article

Maintenance projects	Next Milestone	Expected Date	KPMG's Guidance
Subsidiary as a First-time Adopter (Amendments to IFRS 1)	Exposure Draft	Q2 2019	
Taxation in Fair Value Measurements (Amendments to IAS 41)	Exposure Draft	Q2 2019	
Updating a Reference to the Conceptual Framework (Amendments to IFRS 3)	Decide Project Direction	Q2 2019	