Staff paper

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Project	**Work Plan**
Topic	**Timing of the post-implementation reviews of the hedge accounting requirements of IFRS 9 and of IFRS 16**
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Purpose of the paper

1. The *Due Process Handbook* requires the International Accounting Standards Board (IASB) to conduct a post-implementation review (PIR) of each new IFRS Standard or major amendment and describes the objective, process and outcomes of a PIR. Agenda Paper 8A *Post-implementation reviews—objective and process* provides a clarified description of a PIR developed in response to stakeholder feedback, and invites IASB members' questions and comments.

2. This paper considers when the IASB should begin the PIRs of the hedge accounting requirements of IFRS 9 *Financial Instruments* and of IFRS 16 *Leases*.

3. The IASB previously discussed when to begin the PIRs of the requirements of IFRS 9 at its October−November 2020 and November 2021 meetings. The IASB decided:

    (a) to begin the PIR of the classification and measurement requirements of IFRS 9 in the second half of 2020 (October 2020 Agenda Paper 8B *Timing of post-implementation reviews of IFRS 9 and IFRS 15*);

    (b) to begin the PIR of the impairment requirements of IFRS 9 in the second half of 2022 (November 2021 Agenda Paper 8 *Timing of post-implementation reviews for impairment and hedge accounting requirements of IFRS 9, for IFRS 15 and for IFRS 16*); and

    (c) to consider in the second half of 2022 when to begin the PIR of the hedge accounting requirements of IFRS 9 (November 2021 Agenda Paper 8).

4. The IASB discussed when to begin the PIR of IFRS 16 at its November 2021 meeting and decided to consider in the second half of 2022 when to begin that PIR (November 2021 Agenda Paper 8).

Summary of staff recommendations

5. The staff recommend that the IASB consider in the second half of 2023 when to begin the PIRs of the hedge accounting requirements of IFRS 9 and of IFRS 16.

Structure of the paper

6. This paper provides:

   (a) a recap of the considerations relevant to the timing of a PIR (paragraphs 7–8);

   (b) staff analysis of the timing of the PIR of the hedge accounting requirements of IFRS 9 and a question for the IASB (paragraphs 9–21); and

   (c) staff analysis of the timing of the PIR of IFRS 16 and a question for the IASB (paragraphs 22–29).

A recap of the considerations relevant to the timing of a PIR[1]

7. The earliest a PIR would start is after the new requirements have been implemented for at least 24 months. However, financial statements that reflect 24 months of implementation are generally available in practice only about 30–36 months after the effective date of the new requirements.

8. The start date depends on the availability of information, such as:

   (a) trend data from financial statements applying the new requirements;

   (b) academic research; and

   (c) the level of experience in practice (while balancing the risk that practice may become so embedded that resistance to improvements may develop), which may depend on the level of change arising from the new requirements.

The timing of the PIR of the hedge accounting requirements of IFRS 9

Background

9. IFRS 9 was developed in discrete stages reflecting key areas of the requirements of the Standard—classification and measurement, impairment and hedge accounting—and became effective for annual periods beginning on or after 1 January 2018.

10. The hedge accounting requirements of IFRS 9 aimed to provide a better link between an entity's financial reporting and risk management. That represented a substantial change from many aspects

[1] Paragraphs 9–10 of Appendix A to Agenda Paper 8A *Post-implementation reviews—objective and process.*

of hedge accounting requirements of IAS 39 *Financial Instruments: Recognition and Measurement* and was expected to affect a variety of entities, including both financial and non-financial institutions. Areas in which the new requirements were expected to produce the greatest effect included:

(a) hedge effectiveness testing;

(b) eligibility of risk components of non-financial instruments;

(c) disclosure;

(d) accounting for the costs of hedging; and

(e) the rebalancing and discontinuation of hedging relationships.

11. In developing the hedge accounting requirements of IFRS 9, the IASB acknowledged that some entities may prefer to move directly from using the hedge accounting requirements of IAS 39 to the potential new model for accounting for macro hedging. Hence, the IASB permitted an accounting policy choice between applying the hedge accounting requirements of IFRS 9 or IAS 39. The IASB intended to permit the accounting policy choice until the completion of a separate project on dynamic risk management.

12. Applying the guidelines on the timing of a PIR (see paragraphs 7–8), the earliest the PIR of IFRS 9 could have begun is around July 2020−January 2021. The IASB began the PIRs:

(a) of the classification and measurement requirements of IFRS 9—in the second half of 2020; and

(b) of the impairment requirements of IFRS 9—in the second half of 2022.

13. The main reason the IASB decided not to begin the PIR of the hedge accounting requirements of IFRS 9 to date was the lack of information about the effects of application of those requirements. In particular, when considering the timing of the PIR of the hedge accounting requirements of IFRS 9 in November 2021, the IASB noted that:

(a) many entities, especially banks and insurance entities, were still applying the hedge accounting requirements of IAS 39. However, at least two large banks had recently started applying the hedge accounting requirements of IFRS 9, and there were other banks that could be contemplating transitioning to those new requirements in the near future. In contrast, many corporate entities had transitioned to the hedge accounting requirements of IFRS 9. That transition had made a significant effect on the statements of financial position and the statements of financial performance of many of those corporate entities.

(b) limited academic research was available on the hedge accounting requirements of IFRS 9.[2] However, more academic studies could become available in the near future, in particular at

[2] The staff had identified one academic paper on the hedge accounting requirements of IFRS 9 that used a simulation modelling technique.

the joint IASB/FASB/The Accounting Review conference in November 2022 (joint November 2022 academic conference) which designated hedge accounting as one of the research topics.

Developments since November 2021

14. The staff are not aware of significant changes in practice in transitioning to the hedge accounting requirements of IFRS 9 since the IASB last discussed the timing of the PIR. As reported to the IASB in November 2021, many corporate entities have transitioned to the new hedge accounting requirements and that transition has had a significant effect on financial statements of many of those corporate entities. In contrast, many banks and insurance entities continue to apply the hedge accounting requirements of IAS 39.

15. The staff's review of available academic research identified no new academic studies relevant to the application of the hedge accounting requirements of IFRS 9. In particular, the submissions to the joint November 2022 academic conference included no such studies.

Staff analysis and recommendation

16. As highlighted in paragraphs 14−15, information about the effects of applying the hedge accounting requirements of IFRS 9 remains limited. In particular, there is little additional information about those effects in the financial services industry and a lack of academic research.

17. If the IASB were to start the PIR of the hedge accounting requirements of IFRS 9 in the next few months, the PIR would likely focus almost solely on corporate entities. As a result, the PIR may provide incomplete information about the effects of applying those requirements. This is because the nature and complexity of hedge accounting differs between banks and corporate entities and therefore the effects of applying the new requirements could also be different. For example, as stated in paragraph 13(a), the transition to the hedge accounting requirements of IFRS 9 has made a significant effect on the financial statements of many corporate entities. At the same time, a large bank that adopted those requirements from 1 January 2020 reported that the transition had no effect on its financial statements.

18. The staff continues to think there is a balance to strike between allowing more time for the practice in the financial services industry to develop and not delaying the PIR to the extent that practice in corporate entities becomes embedded and may be resistant to change. In particular, the staff are of the view that it would not be appropriate for the IASB to wait until the Dynamic Risk Management project is complete and all entities have transitioned to and applied the new hedge accounting requirements for a number of years.

19. However, the staff can see the benefit in allowing more time for practice in the financial services industry to develop. For example, the large bank referred to in paragraph 17 has now been applying

the new hedge accounting requirements for 2 years (ie in its 2020 and 2021 financial statements), which is less than the minimum amount of time that needs to pass before a PIR can begin (see paragraph 7). Furthermore, allowing more time would enable those banks that might be considering applying the hedge accounting requirements of IFRS 9 to transition to those requirements.

20. In addition, the staff anticipate that more academic studies may become available in 2023-2024. For example, to facilitate academic research in this area, the staff and IASB members are exploring the possibilities to call for academic studies on the hedge accounting requirements of IFRS 9, possibly in collaboration with an established academic journal or an academic organisation, in the coming months. The staff anticipate that an IASB call for research on the hedge accounting requirements of IFRS 9 may generate interest in the academic community.

21. On balance, in the light of the analysis in paragraphs 16−20, the staff are of the view that it is still too early to begin the PIR of the hedge accounting requirements of IFRS 9 in 2022 or in the first half of 2023 and recommend that the IASB consider in the second half of 2023 when to begin that PIR.

Question 1 for the IASB
Do you agree with the staff recommendation in paragraph 21 that the IASB consider in the second half of 2023 when to begin the PIR of the hedge accounting requirements of IFRS 9?

The timing of the PIR of IFRS 16

Background

22. IFRS 16 became effective for annual reporting periods beginning on or after 1 January 2019. Applying the guidelines on the timing of a PIR (see paragraphs 7–8), the earliest the PIR of IFRS 16 could have begun is around July 2021−January 2022.

23. IFRS 16 has had a pervasive effect on many entities. The Standard required a lessee to recognise assets and liabilities for all leases of more than 12 months (unless the underlying asset is of low value).[3] In addition, to complement the lessee accounting model, the Standard introduced disclosure requirements requiring lessees to disclose information about:

(a) the amounts recognised in the financial statements; and

[3] Based on information obtained from entities' financial statements, the IASB estimated that listed entities using IFRS Standards or US GAAP had almost US$3 trillion of off-balance sheet lease commitments in 2014.

(b) future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities.

24. The significance of the effect of IFRS 16 varied by industry and region and between entities. However, for many entities, the effect on reported assets and financial leverage was substantial. That effect was not restricted to the statement of financial position. The lessee accounting model in IFRS 16 also had a significant effect on many entities' statements of financial performance and statements of cash flows.

25. The IASB first discussed the timing of the PIR of IFRS 16 in November 2021 and decided that it was too early to start the PIR. In making that decision, the IASB noted:

(a) implementation efforts beyond 2019. Given the extent of change the Standard introduced, the effective date of 1 January 2019 did not mark the end of implementation efforts. Instead, entities continued to refine their systems and approaches to applying the requirements, in particular the new disclosure requirements. Reviewing the requirements of the Standard while entities continued to develop their approaches could be seen as disruptive to practice.

(b) the lack of trend information. Trend information is important to users of financial statements and thus is important for the IASB in assessing the effects of a new Standard. IFRS 16 provided relief from restating comparative information when entities first applied IFRS 16 (ie in their 2019 financial statements) and many entities took advantage of that relief. Therefore, in 2021 many entities had provided information applying IFRS 16 for only two annual reporting periods.

(c) the effect of the Covid-19 pandemic on leasing activities (such as rent concessions being granted to lessees or lease renegotiations reflecting changes in lessees' business models—for example, lessees who require less office or retail space or wish to renegotiate lease terms). The PIR would benefit from information about the effects of the pandemic on leasing activities—and how IFRS 16 has coped with those effects—being further available.

(d) limited academic research on IFRS 16.[4] The IASB noted that researchers generally need to have several years of post-adoption data on a new Standard to be able to detect trends in reported amounts and information disclosed. The research is then subject to a thorough review process in high quality academic journals. In addition, the dissemination of research through conferences and workshops had slowed down during the pandemic. The IASB noted that academic papers discussing the effects of IFRS 16 were likely to be submitted to the joint November 2022 academic conference.

[4] The staff had identified one survey-based academic paper on the implementation of IFRS 16.

26. The IASB also noted that the US Financial Accounting Standards Board (FASB) had begun the PIR of its Accounting Standards Update (ASU) relating to leases—that was issued around the same time as IFRS 16—immediately after its issuance.[5] However, the first stage of the FASB PIR process includes activities that the IASB does not categorise as being part of a PIR and that are similar to the activities the IASB performed after the issuance of IFRS 16 to monitor and support the application of the Standard.

Staff analysis and recommendation

27. The staff are of the view that it still is too early to begin the PIR of IFRS 16 in 2022 or in the first half of 2023 for the reasons set out in paragraph 25. Specifically:

    (a) given the extent of changes introduced by IFRS 16, the staff understand that when the Standard was first applied in 2019, some entities had not completed their systems changes and, in some cases, relied on excel spreadsheets in preparing information required by the Standard. For some entities, 2020 was the first year when the systems changes were implemented.

    (b) given the relief from restating comparative information, for many entities annual reporting periods ending on or after 31 December 2020—for which financial statements were available only in 2021—is the first year that comparative information applying IFRS 16 was available to the market.

    (c) given the effect of the Covid-19 pandemic on leasing activities and the related May 2020 and March 2021 amendments to IFRS 16 on Covid-19-related rent concessions, trend information has been further affected. For many entities, annual reporting periods ending on or after 31 December 2022 will be the first reporting year including comparative information that has not been significantly affected by the pandemic. For some entities operating in particular parts of the world, the effects of the pandemic on leasing activities have continued to be significant into 2022.

    (d) academic research related to the application of the new requirements for leases is emerging but remains limited. Fourteen submissions on reporting leases have been made to the joint November 2022 academic conference but only two of those submissions relate to IFRS 16. One of the submissions related to IFRS 16 will be presented at the conference. The staff have not identified further academic research related to IFRS 16. The staff note that the reasons for limited academic research set out in paragraph 25(d) continue to apply.

[5] December 2020 PIR Update of the Financial Accounting Standards Board discussing Leases (Topic 842) includes an overview of the staff's plans to continue research and outreach activities.

28. The staff think the IASB could consider starting the PIR of IFRS 16 in the second half of 2023. By that time, trend information applying IFRS 16 would be expected to be more stable. However, the IASB would still need to consider other factors such as the availability of academic research.

29. On balance, the staff recommend that the IASB consider in the second half of 2023 when to begin the PIR of IFRS 16.

Question 2 for the IASB

Do you agree with the staff recommendation in paragraph 29 that the IASB consider in the second half of 2023 when to begin the PIR of IFRS 16?