IFRS® Foundation

IFRS Standards and research opportunities

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AAA International Accounting Section mid year meeting
IAAER joint conference

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IFRS

IASB and research

- IASB is required to undertake evidence-based standard setting
- We collect evidence from:
  - Outreach with stakeholders
  - Meetings with consultative groups and national standard setters
  - Staff research
  - Focus groups, field testing
  - Public reports eg accounting firms, security market regulators
  - External research eg academic research

IASB and research

- Evidence feeds into the standard setting process from the beginning
  - What is the problem to be solved?
  - Nature, extent, pervasiveness, importance, impact.
- Staff prepare a literature review as part of the project
  - Eg Primary financial statements, Goodwill and impairment, Extractive activities
- Academic evidence is included in the post-implementation review of Standards
  - Did the Standard achieve its objectives?
  - Is the Standard working as intended?
  - IFRS 8 *Segments*, IFRS 13 *Fair Value Measurement*, IFRS 3 *Business Combinations*.

Research opportunities – Post-implementation reviews

New Standards bring many changes to IFRS accounting

We are looking for evidence from studies:

- about the impact of these changes
- that use a range of methods

Pre and post application

- what changes in accounting practice are observed?
- what are the financial impacts of the changes?

Market effects

- what are the effects for market participants of the changes?
- what market outcomes are observed?

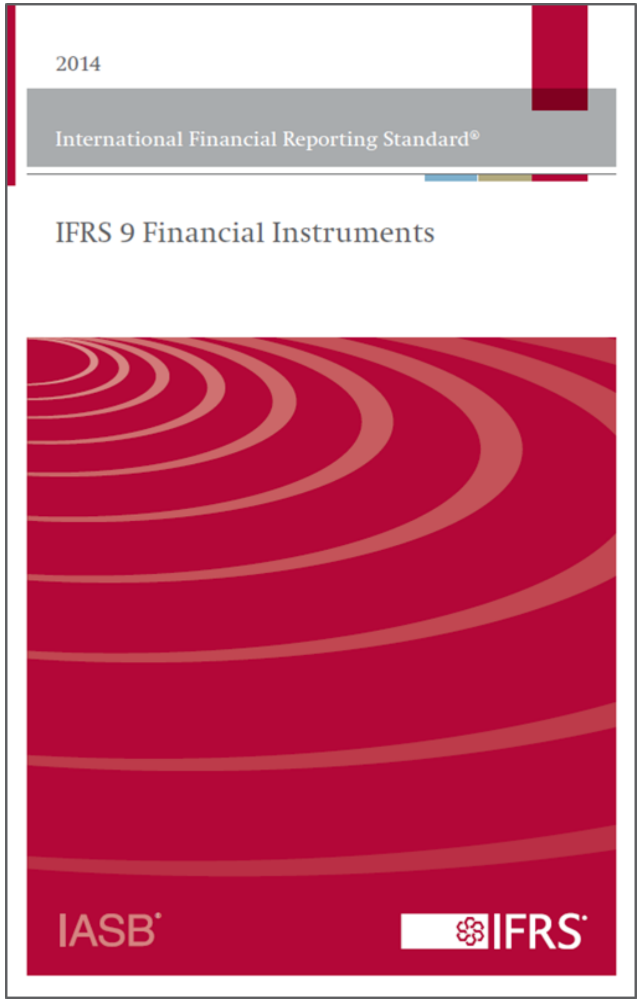
PIR Research opportunities…

- Have much in common with the established research agenda in financial reporting/international accounting. Looking at impact/effect…
- Prior research provides benchmarks (what has happened in the past) and starting points (models, techniques) (Michelon et al., 2020)
- Research has addressed similar questions, in a variety of ways.
- Interview data complements archival studies
- Study design challenge: impact of single standard
- Capturing country differences is difficult (but interesting)
- Consider improvements in data sources and methods that are particularly relevant to PIR research

PIR Research opportunities…

- Preliminary work can be relevant to PIR (study can be developed further for academic publication)
- Evidence for PIRs in enhanced by:
  - Many studies, various methods. Single country and cross-country studies
  - Speak to practitioners – understand practice as part of developing your study design
  - Detailed descriptive statistics (like gold to IASB) – what is the impact, what has changed
  - Give clear explanations (avoid the jargon) and reach conclusions (or explain why you cannot)

IFRS 9 at a glance



- Effective 1 January 2018
- Replaced IAS 39
- First stage of post-implementation review starting now

Classification and measurement

- A logical, single classification approach driven by cash flow characteristics and how it is managed

Impairment

- A much needed and strongly supported forward-looking ‘expected loss’ model

Hedge accounting

- An improved and widely welcomed model that better aligns accounting with risk management

Investment in equity instruments

All equity instruments must be measured at fair value,
but there is a presentation alternative to present fair value changes in other comprehensive income (OCI)

Scope

- Must be equity as defined in IAS 32
- Not eligible if held for trading

Features

- Irrevocable election at initial recognition
- Instrument by instrument election
- Dividends recognised in P&L
- No recycling of gains and losses in P&L
- No impairment

Not 'AFS' accounting and not the same as the FVOCI classification for debt instruments

Benefits of the ECL model

Forward-looking model that is responsive to changes in credit risk and responds to the calls of the G20 and others

- Broader range of information required to be considered
  - Ensures more timely recognition of expected credit losses
  - Elimination of IAS 39 threshold
- Builds on existing systems to balance costs and benefits
  - Approximates 2009 ED in more operational manner
  - Similar concepts to regulatory capital models
- Single model reduces complexity of multiple approaches
- Enhanced disclosures:
  - Illustrate how an entity has applied the requirements
  - Show assets which have significantly increased in credit risk

Disclosure objectives - ECL

To enable users
to understand the ***effect of credit risk***
on the ***amount, timing*** and ***uncertainty***
of ***future cash flows***

Entities' ***credit risk management practices*** and how they relate to recognition and measurement of ECL

Quantitative and qualitative information to evaluate amounts in the financials arising from ECL

Entities' ***credit risk exposure*** including significant credit risk concentrations

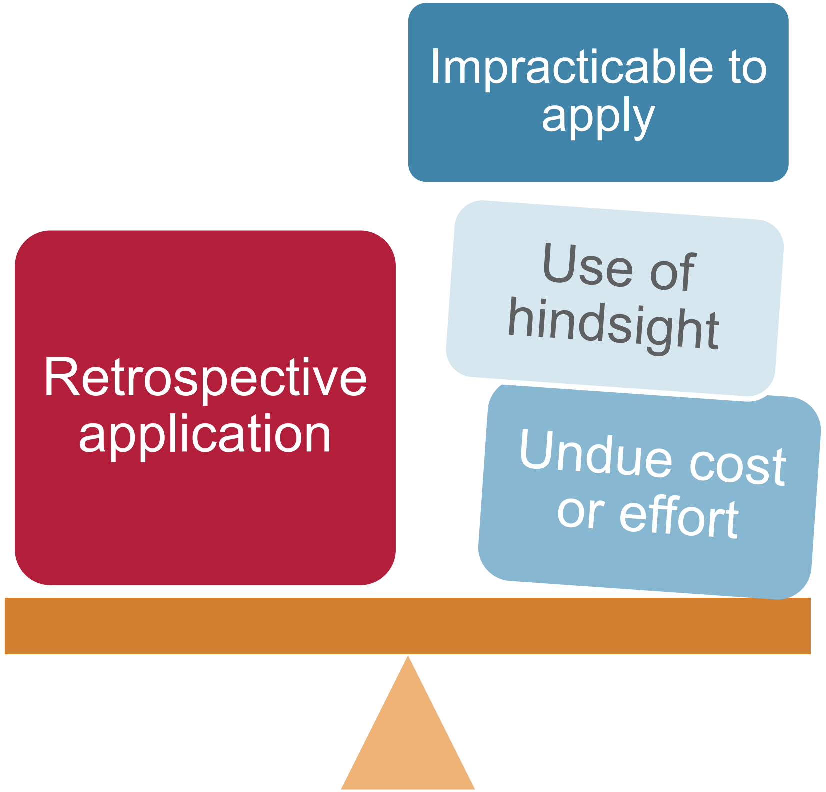
Major improvements - hedging

- A principle-based hedge effectiveness prospective assessment … and all ineffectiveness in P&L
- Designate risk components of non-financial instruments
- Ability to hedge aggregated exposures (combinations of derivatives and non-derivatives)
- Introduction of ‘costs of hedging’ to improve the transparency around some hedging instrument
- Disclosures that meet the objectives of understanding the hedged risks, how those are managed and the effect of hedging

For now, entities can choose to continue to apply IAS 39 hedge accounting

Dynamic Risk Management is a separate project

Transition to IFRS 9



Classification and measurement

- Assessment as at date of initial application of IFRS 9
- Impracticability alternatives

Impairment

- Undue cost or effort

Restatement of comparative reporting period

Research on IFRS 9 Classification, Measurement

- Loew, Schmidt, Thiel (2019) (n=78 European banks)
- Expectations
  - CET1 ratio to decrease (0-100 bp; av. 50bp)
  - Insignificant change to classification and measurement
  - Impairment earlier, larger loan loss reserves (13-50%)
  - Cliff effect (sudden increase in impairment) less under IFRS 9
  - Front loading (earlier loan loss recognition) more under IFRS 9

Research on IFRS 9 Classification, Measurement

- Loew, Schmidt, Thiel (2019) (n=78 European banks)
- Observations
  - Lower equity, CET1 down av. 30bp (47% sample in 0-50 bp)
  - Classification/measurement effect on equity = insignificant
  - Classification/measurement largely unchanged
  - Diversity in impairment effects by company/country
  - Loan loss provisions did not increase on average
    - Bonds and loans decreased 9% - ECL stage 2 only 6-7% of loan portfolio
    - Benign economic conditions

Research on IFRS 9 Classification, Measurement

- IFRS 9 changes treatment of available for sale (AFS) equity securities.
  - Measurement of equity securities Default = Fair value, Profit or Loss
  - Strategic investment = Fair Value OCI but NO recycling.
- Several papers explore information content provided by FV of AFS, gains/losses included in OCI and recycled.
  - There is scope to explore these issues for entities using IFRS 9
- Re AFS and recycling, research has shown:
  - Entities recycle gains and losses to manage earnings, avoid or reduce loss or to take ‘big bath’ (Barth, Gomez-Biscarri, Kasznik, López-Espinosa
  - 2017).

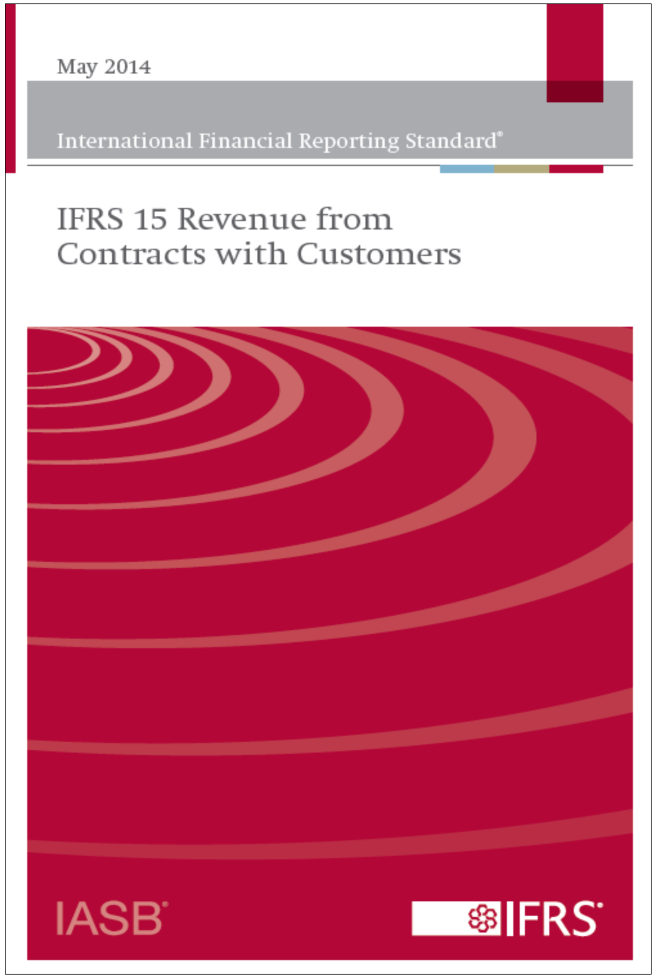
Research on IFRS 9 Classification, Measurement

- Some European entities oppose the required IFRS 9 treatment, claim
  - Investor's performance not be properly reflected
  - Long-term investors may be disincentivised to hold equity investments on a long-term basis
- Further research to address
  - Impact of IFRS 9 on equity investments
  - Would IFRS 9 be improved by re-introducing recycling and impairment for OCI equity investments?
- Sources of data
  - Insurance companies in Aust. and Japan, using IFRS 9 (equity securities)
  - US companies following similar accounting (FVPL)

Research on transition and disclosure

- Why transition?
  - Analysts need time series data for modelling
  - IASB allowed transition choices (cost vs benefit)
  - Did we get the balance/compromise right?
- Why disclosure?
  - Rich avenue for exploration – given importance of disclosure to analysts and sensitivities around disclosure for preparers
  - Tensions around costs vs benefits, between ‘boilerplate’ and ‘disclosure overload’
  - IASB is using disclosure objectives (see IFRS 7; See Targeted Standards-level Review of Disclosure) https://www.ifrs.org/projects/work-plan/standards-level-review-of-disclosures/
  - Evidence from your research can help us progress this work

IFRS 15 at a glance



- Issued in 2014
- Effective annual reporting periods from 1 January 2018
- Replaces IAS 18 and IAS 11

Key points:

- Comprehensive framework for determining *when* and *how much* revenue to recognise
- Developed jointly with FASB

The 5 steps to apply IFRS 15

Recognise revenue to depict transfer of goods or services in an amount of consideration to which the entity expects to be entitled

- Identify the contract(s) with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations
- Recognise revenue when (or as) the entity satisfies a performance obligation

Disclosure requirements

To enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

Revenue

- Disaggregation of revenue
- Amounts recognised relating to performance in previous periods

Contracts

- Information about contract balances and changes
- Information about performance obligations
- Amounts allocated to remaining performance obligations

Significant judgments

- Timing of and methods for recognising revenue
- Determining the transaction price and amounts allocated to performance obligations

Research on IFRS 15

- Napier, C.J. and Stadler, C. (2020): Annual report data 50 Stoxx Europe companies; comment letters from these companies on IASB *Revenue* ED/2011/6; interviews (preparer, advisor, auditor).
- From Financial Statements, report on:
  - changes in reported numbers
  - Content/quality of disclosure
- Investigate ‘real effects’
  - Implementation costs (comment letters, interviews)
  - Contractual changes (interviews)
  - Behavioural changes (interviews)

IFRS 15 suggested future research

- Napier and Stadler (IASB Research Forum 2020 – see recording IFRS Foundation website)
- Recognition and measurement
  - Do changes have market effects? Consider industries more affected by the Standard
- Disclosure
  - Financial statements – quantity and quality
- Information effects/real effects
  - Interviews
- Capital market effects
  - Properties of analysts’ forecasts

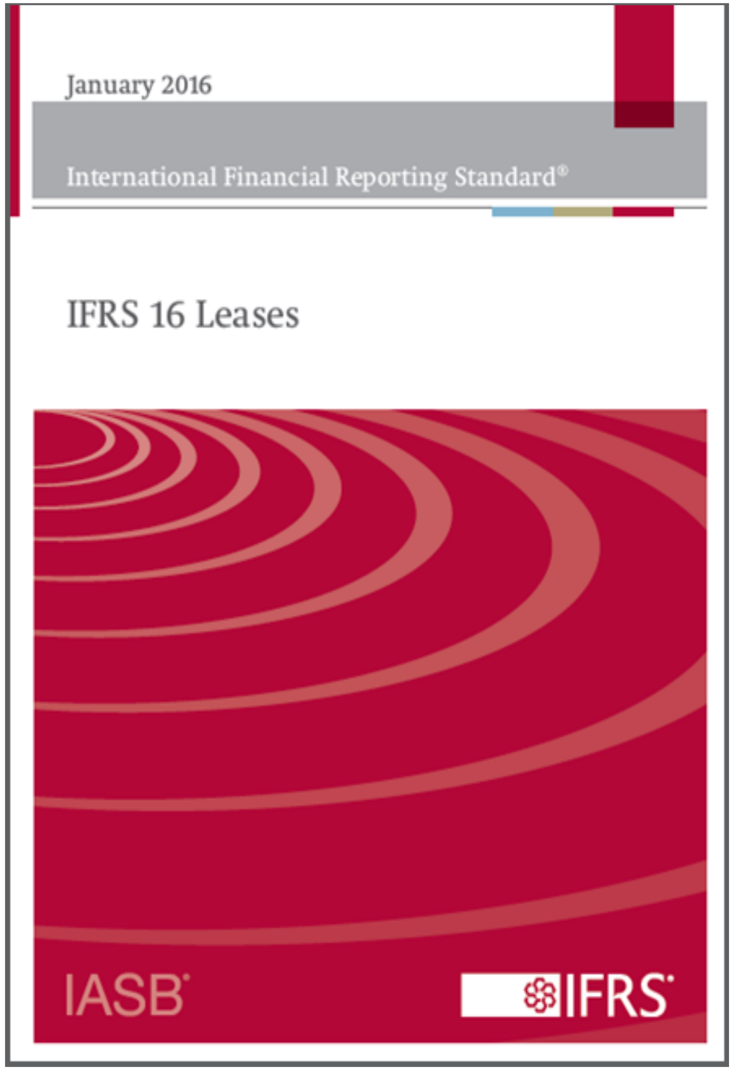
Approaching disclosure research

- Tsalavoutas, Tsoligkas, Evans (2020)
  - Literature review paper – Compliance with IFRS disclosure requirements
  - Comments on state of research:
    - Mainly single country, developing economies
    - Lack of studies of financial institutions
    - Lack of consideration of effect of corporate governance on compliance
    - Lack of consideration of market effects
  - Suggestions for improvements in research designs
  - No published research (to date) on compliance with IFRS 15

Approaching disclosure research

- UK FRC Report on IFRS 15 (2020:3)
- Reports on IFRS 15 disclosures (n=22/n=50 UK listed companies)
- To assess comprehensiveness and quality of disclosure, considered:
  - Timing of revenue recognition
  - Variable consideration
  - Revenue disaggregation
  - Contract balances
  - Significant judgements
  - Costs to obtain and fulfil a contract
- Provided examples of ‘better practice’ and ‘inadequate disclosure’

IFRS 16 at a glance



- Issued in January 2016
- Effective for annual reporting periods beginning on or after 1 January 2019
- Replaced IAS 17

Key points:

- Brings almost all leases onto the balance sheet for lessees
- Significant change for lessees; little change for lessors

Why IFRS 16? The need for change

Leases are an important and flexible source of financing – listed companies using IFRS Standards or US GAAP estimated to have US$3.3trillion lease commitments

Over 85% of lease commitments did not appear on balance sheet before IFRS 16 was implemented[1]

↓

This created **challenges** for **users of financial statements**

[1] Data from the Board's IFRS 16 Effects Analysis: https://cdn.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf

The Board's objectives

"The new Standard will provide much-needed transparency on companies' lease assets and liabilities.... It will also improve comparability between companies that lease and those that borrow to buy"

(Hans Hoogervorst; 13 January 2016)

Is IFRS 16 achieving its objectives?

(1) Providing transparency about companies' lease assets and liabilities

(2) Improving comparability

- An opportunity for researchers to provide evidence on specific questions in relation to a widespread change – most operating leases now capitalised, were previously expensed
- Research (Giner and Pardo 2018) finds 'as if' capitalised operating lease assets and liabilities to be value relevant. The issue can now be explored with live data

Feedback on adoption of IFRS 16 - Preparers

- Davern, Hanlon, Gyles, Shah (2019).
  - Implementation challenges – additional data collection and system changes
  - Higher quality of underlying lease data and externally reported information
  - Improved operational decision making
  - Improvements to comparability and transparency expected

Research opportunities IFRS 16

- Cost of change
  - Most studies try to measure benefits, few address costs. IASB interested in both
- Change to systems and processes
  - ‘you manage what you measure’
  - Connection of internal and external reporting
- More useful information – comparable, transparent
  - What is impact on financial ratios?
  - What is the impact on properties of analyst forecasts? Consider industries with large IFRS 16 impact.

Feedback on adoption of IFRS 16 - Investors

- Davern, Gyles, Hanlon, Frick (2020) (interviews with investors in Australia).
- Generally pleased with enhanced transparency and comparability from improved underlying lease data and quality of information
- Mixed views as to whether the Standard reduced the need for adjustments and non-GAAP disclosures
- Concerns about impact on historical data modelling and the interpretation of EBITDA

Research opportunities IFRS 16

- How did investors adjust models?
- What new information was available from database providers?
- How did XBRL help/hinder?
- Is there convergence and understanding in the non-GAAP information provided?
- What was quality of information (usefulness) in financial statements note disclosure, in management commentary and investor presentations?
- What is impact on usefulness of cash flow statements information?

Feedback on adoption of IFRS 16 - Disclosure

- Report from Financial Reporting Council in UK September (2020:2-3, n = 20 listed companies)
  - Most companies gave sufficient information to enable readers to understand the impact of adopting IFRS 16
  - Year end disclosure were more comprehensive than interim disclosures
  - Many companies gave boilerplate disclosures with insufficient entity-specific disclosure
  - Descriptions of judgements made by management in the application of accounting policy were absent or inadequate
  - Disclosure about future cash outflows of leases not provided
  - Disclosures were not in a single note or cross referenced as required

Research opportunities IFRS 16

- Challenge - determining some measure of disclosure quality
- For PIRs, attempts to measure attributes of disclosure (extent, comprehensiveness, pervasiveness, location, material vs boilerplate) are valued
- With some measure of disclosure, researchers are set up to consider:
  – Pre/post comparisons, within and between companies and industries
- Interim disclosures – how useful the information provided? Why the variation?

Conclusion

- I encourage you to engage in PIR relevant research
  - Use your strengths
  - Contribute to policy relevant research
  - Show the impact of your research (IASB cites papers!)
- There are publication opportunities in the usual outlets, also
  - IFRS Research Forum 2021, 2022
  - Journal Special Issues (IFRS 9, Disclosure research)
- Catch the three webinars for academics – IFRS 9, IFRS 15, IFRS 16.
- Further details - See News section of IASB Website Academic resources
- https://www.ifrs.org/academics/

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- Napier, C.J. and Stadler, C. (2020): The real effects of a new accounting standard: the case of IFRS 15 Revenue from Contracts with Customers. *Accounting and Business Research*, 50(5): 474-503.

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- Tsalavoutas, I., Tsoligkas, F., & Evans, L. (2020). Compliance with IFRS mandatory disclosures requirements: a review and synthesis of the relevant literature. *Journal of International Accounting, Auditing and Taxation*. In press.
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  - https://www.frc.org.uk/getattachment/72f67d70-f042-4853-bdff-8de7e17bd324/IFRS-15-Thematic-Report-2020-Final.pdf
- UK FRC IFRS 16 Leases – a thematic review in the first year of application, September 2020.
  - https://www.frc.org.uk/getattachment/ea878d9a-dd03-45a3-9c00-7bda96775f5d/IFRS-16.pdf

Relevant materials IFRS 9

- Overview: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/
- List of supporting materials: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-9/#webcasts
  - Project Summary: https://www.ifrs.org/-/media/project/financial-instruments/project-summaries/ifrs-9-project-summary-july-2014.pdf
  - Articles: https://www.ifrs.org/-/media/feature/resources-for/investors/investor-perspectives/investor-perspective-jul-2014.pdf
- https://www.ifrs.org/-/media/project/financial-instruments/features/article-by-sue-lloyd-big-changes-ahead-march-2015.pdf
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Relevant materials IFRS 15

- Overview: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-15-revenue-from-contracts-with-customers/
- List of supporting materials: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-15/#education
  - Project Summary and Feedback Statement: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-15/#education
  - Articles: https://www.ifrs.org/-/media/feature/resources-for/investors/investor-perspectives/investor-perspective-jun-2014-1.pdf
- https://www.ifrs.org/news-and-events/2016/04/ian-mackintosh-amendments-revenue-standard/
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Relevant materials IFRS 16

- Overview: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-16-leases/
- List of supporting materials: https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-16/
  - Effects Analysis: *https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf*
  - Project Summary and Feedback Statement: https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-project-summary.pdf
  - Articles: https://www.ifrs.org/-/media/feature/resources-for/investors/investor-perspectives/investor-perspective-jan-2016.pdf

Relevant materials IFRS 16

- https://www.ifrs.org/news-and-events/2016/03/hans-hoogervorst-article-shining-the-light-on-leases
- https://www.ifrs.org/-/media/project/leases/ifrs/educational-materials/ifrs16-leases-article-jan2017.pdf
- https://www.ifrs.org/news-and-events/2016/01/gary-kabureck-article-little-to-fear-in-new-world-of-lease-accounting/

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