Staff paper

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IASB® meeting

Date	**December 2023**
Project	**Work plan**
Topic	**Timing of the post-implementation reviews of IFRS 16 *Leases* and of hedge accounting requirements of IFRS 9 *Financial Instruments***
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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.

2. In September 2022, the IASB discussed clarifications to the description of the objective, process and outcomes of a PIR. Following this discussion and consultation with the Due Process Oversight Committee of the IFRS Foundation Trustees, a clarified description of the PIR process was published on the IFRS Foundation website.[1]

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

[1] IFRS - IASB post-implementation reviews

Structure of the paper

4. This paper provides:
   (a) overview of the considerations relevant to the timing of a PIR (paragraphs 6–7);
   (b) staff analysis of the timing of the PIR of IFRS 16 and a question for the IASB (paragraphs 8–15); and
   (c) staff analysis of the timing of the PIR of the hedge accounting requirements of IFRS 9 and a question for the IASB (paragraphs 16–28).

Staff recommendations

5. The staff recommend that the IASB:
   (a) begin the PIR of IFRS 16 in Q2 2024; and
   (b) consider when to begin the PIR of the hedge accounting requirements of IFRS 9 after the IASB concludes its work on power purchase agreements.

Overview of the considerations relevant to the timing of a PIR

6. 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.

7. 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 IFRS 16

Background

8. IFRS 16 became effective for annual reporting periods beginning on or after 1 January 2019. The Standard had a pervasive effect on many entities. It required a lessee to recognise assets and liabilities for all leases of more than 12 months (unless the underlying asset is of low value). 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

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

9. 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.

Recap of the IASB's previous discussions

10. Applying the guidelines on the timing of a PIR (see paragraphs 6–7), the earliest time the PIR of IFRS 16 could have begun is around July 2021−January 2022. The IASB discussed the timing of that PIR in November 2021 and in September 2022 and decided that it was too early to start the PIR. At its September 2022 meeting, the IASB decided to consider again in the second half of 2023 when to begin that PIR. In reaching that conclusion, the IASB considered the following factors:

    (a) 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 a relief from restating comparative information when entities first applied the Standard (ie for annual reporting periods beginning on or after 1 January 2019). Many entities took advantage of that relief and first provided comparative information applying IFRS 16 in their financial statements for annual reporting period beginning on or after 1 January 2020, and those financial statements only became available in 2021. Consequently, in 2022, trend information applying IFRS 16 was only available for three annual reporting periods (ie 2019, 2020 and 2021).

(b) the effects of the Covid-19 pandemic—due to the effects 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) and the related May 2020 and March 2021 amendments to IFRS 16 on Covid-19-related rent concessions, trend information was further affected. For many entities, annual reporting periods beginning on or after 1 January 2022 were the first reporting year with comparative information that was not significantly affected by the pandemic. For some entities operating in particular parts of the world, the effects of the pandemic on leasing activities continued to be significant into 2022. The PIR would benefit from further information about the effects of the pandemic on leasing activities—and how IFRS 16 has coped with those effects—being available.

(c) limited academic research—researchers generally need several years of post-adoption data on a new Standard to detect trends in reported amounts and information disclosed. The research is then subject to a review process in academic journals. In 2022, the staff identified three academic papers on IFRS 16, including two submissions to the November 2022 academic conference jointly organised by the IASB, the US Financial Accounting Standards Board (FASB) and *The Accounting Review* academic journal.

(d) implementation efforts—given the extent of change the Standard introduced, the effective date of 1 January 2019 did not mark the end of implementation efforts. 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 and some 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.

11. The IASB also noted that the FASB had begun the PIR of its Accounting Standards Update 842 Leases (ASC 842)—that was issued around the same time as IFRS 16—immediately after its issuance. 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

12. The staff note that more trend information applying IFRS 16 has become available. In 2023, entities will have published financial statements with comparative information prepared applying IFRS 16 for the third time.

13. Furthermore, we reviewed the other considerations that had previously led the IASB to conclude that it was too early to begin the PIR of IFRS 16, and we think that some of them no longer apply. In particular:

    (a) entities will have had another year of application to make any necessary refinements to their systems and processes.

    (b) the World Health Organisation has declared the end of Covid-19 as a global health emergency. The effects of the pandemic and of the related amendments to IFRS 16 have been reflected in entities' financial statements for prior periods. The PIR of IFRS 16 will provide insight into how the Standard has coped with the effects of the pandemic.

14. The academic research on IFRS 16 is growing although it remains limited. We have identified approximately 10 academic papers on the application of IFRS 16, including

the submissions to the November 2022 joint academic conference. The available academic evidence mainly focuses on:

(a) the effects of IFRS 16 on entities' financial statements and on their key financial ratios;

(b) analysis of IFRS 16 related disclosures in the notes;

(c) analysis of the development of IFRS 16 and of stakeholders' feedback; and

(d) comparative analysis of IFRS 16 and ASC 842, including:

(i) the effects of IFRS 16 and ASC 842 on comparability of accounting information, entities' financial ratios, analyst forecast accuracy and consensus and information asymmetry between entities and users of financial statements; and

(ii) an evaluation of the usefulness of reporting for leases on users' decision making.

15. On balance, the staff think that sufficient information has become available. However, given that information for previous years has been affected by the Covid-19 pandemic and the related amendments to IFRS 16, we recommend that the IASB allow time for the financial statements for 2023 to become available and begin the PIR in Q2 2024. We think that an additional set of comparative data would be beneficial. It would enable the IASB to consider the effects of IFRS 16 both through a period of shock and in a stable state.

Question 1 for the IASB
Does the IASB agree with the staff recommendation in paragraph 15 to begin the PIR of IFRS 16 in Q2 2024?

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

Background

16. 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.

17. 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 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.

18. 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.[2] 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.

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[2] IFRS - Dynamic Risk Management

Recap of the IASB's previous discussions

19. Applying the guidelines on the timing of a PIR (see paragraphs 6–7), the earliest date the IASB could have begun the PIR of IFRS 9 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;[3] and

(b) of the impairment requirements of IFRS 9—in the second half of 2022.[4]

20. The IASB previously discussed when to begin the PIRs of the hedge accounting requirements of IFRS 9 at its October−November 2020, November 2021 and September 2022 meetings and decided that it was too early to start that PIR.

21. 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 for financial institutions. Specifically, the IASB noted that:

(a) many entities, especially many banks and insurance entities, were still applying the hedge accounting requirements of IAS 39. While some financial institutions have transitioned to the hedge accounting requirements of IFRS 9 and some others were contemplating transitioning to those new requirements in the near future, the practice in the financial services industry remained limited. In contrast, many corporate entities had transitioned to the new hedge accounting requirements of IFRS 9.

(b) limited academic research was available on the hedge accounting requirements of IFRS 9. However, more academic studies could become available in the near future. For example, to facilitate academic research in this area, the staff and IASB members were exploring possibilities to call for academic studies on

[3] Project Report and Feedback Statement PIR IFRS 9 Financial Instruments—Classification and Measurement

[4] IFRS - Post-implementation Review of IFRS 9—Impairment

the hedge accounting requirements of IFRS 9 in collaboration with an established academic journal. That call for research could generate interest in the academic community.

22. Accordingly, at its September 2022 meeting, the IASB decided to consider again in the second half of 2023 when to begin that PIR.

Staff analysis and recommendation

23. In making the decision at its September 2022 meeting, the IASB noted that 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 IASB noted that it would not be appropriate 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.

24. We have updated our review of available academic research. We have not identified new academic studies relevant to the application of the hedge accounting requirements of IFRS 9. In particular, no papers were submitted to the November 2022 joint academic conference which identified the hedge accounting requirements in IFRS 9 as one of its research topics. The IASB call for academic studies on the topic for a Special Issue in *Accounting and Finance* academic journal resulted in only four papers currently being considered with no guarantee of publication.

25. As discussed at the September 2022 IASB meeting, some financial institutions, in particular in Asia and Oceania, had either transitioned to the hedge accounting requirements of IFRS 9 or were planning to transition to those requirements in the near future. Accordingly, more information about the application of these requirements in the financial services industry will have become available.

26. However, in response to feedback from stakeholders and following a referral from the IFRS Interpretations Committee, in July 2023 the IASB decided to add to its work

plan a project to explore narrow-scope amendments to IFRS 9 to better reflect the effects on financial statements of power purchase agreements.[5]

27. The scope of this project includes:

(a) applying the own-use exception in IFRS 9 to physical power purchase agreements; and

(b) applying the hedge accounting requirements in IFRS 9 using a virtual power purchase agreement as the hedging instrument.

28. Accordingly, in the light of these developments, we do not think it is appropriate for the IASB to begin the PIR of the hedge accounting requirements of IFRS 9 while the IASB is exploring the feasibility of narrow-scope amendments to IFRS 9 which could affect those requirements. Instead, we recommend that the IASB considers when to begin that PIR after IASB concludes its work on power purchase agreements.

Question 2 for the IASB
Does the IASB agree with the staff recommendation in paragraph 28 to consider when to begin the PIR of the hedge accounting requirements of IFRS 9 after the IASB concludes its work on power purchase agreements?

[5] IFRS - Power Purchase Agreements