

IFRS 9 hedge accounting – should I stay or should I go now?

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IFRS 9, the new financial instruments standard, is well recognised as having a big impact on banks. But what about corporates? There seems to be a perception that, with a few exceptions, IFRS 9 will have little or no impact. I have heard rumours that a few corporates are thinking they might 'keep' their IAS 39 accounting and not move to IFRS 9. Is this a good idea? And why are companies thinking this way?

First, let's be clear about what choice companies have. IFRS 9 gives companies a free choice on whether to adopt its new hedge accounting requirements when the rest of IFRS 9 becomes mandatory for 2018. This is an 'all or nothing' choice – a company must either move all of its hedge accounting to IFRS 9, or must continue to apply IAS 39 to all of its hedges. This choice applies to all kinds of entities – both banks and corporates; and to all kinds of hedges – both macro and micro. But it is limited to hedge accounting.

All entities must apply IFRS 9's classification, measurement and impairment requirements and the new disclosure requirements – including the new hedge accounting disclosures. This is something I return to below.

Why continue with IAS 39 hedge accounting? A corporate that has only a few 'simple' hedges that qualify for hedge accounting today would still need to do some work when it moves to IFRS 9. For example, hedge documentation must be redone to be IFRS 9 compliant and it will need to discount cash flow hedges if it hasn't in the past. This comes in a year when companies also have to adopt IFRS 15, the new revenue standard - that for many will require significant work. A company with an over-full 'to do' list and that has so far done little work on IFRS 9 (or 15!) may think that changing its hedge accounting seems like 'one thing too many'. That company may rightly point out that it can elect to apply IFRS 9 hedge accounting at a later date.

I would caution companies to think carefully before leaping to this conclusion. Moving to IFRS 9 will likely have some significant upsides. The IASB's main objective in revising IAS 39's hedge accounting requirements was to remove some of the 'rules' that can prevent economic hedges qualifying for hedge accounting. For example,

- The 80-125% 'bright line' effectiveness test is replaced with a requirement that there is an economic relationship. This removes a key reason why some hedge relationships fail to get hedge accounting today
- Companies can designate more risk components and 'layers' of groups of items.
- Hedging with options, cross currency swaps and forwards can lead to less volatility in the income statement.

It is more likely, under IFRS 9, that where a hedge is economically effective the accounting will reflect this. This is important for three reasons:

- IFRS 9 is a significant opportunity for corporates to get their accounting more in line with how they manage risk.
- IFRS 9 is a chance for companies to reassess their hedging strategies. Past strategies that were rejected because they gave rise to income statement volatility might now be used. Adopting IFRS 9 could impact risk management and not be 'just' an accounting change.
- IFRS 9 will enable companies to 'tell the risk management story' better. Investors increasingly focus on risk and how it is managed so this is a key part of any company's communication strategy.

Which brings me back to disclosure. A company that chooses to keep their IAS 39 accounting will nevertheless need to give the new IFRS 9 disclosures. These complement the IFRS 9 hedge accounting requirements. Much of the work needed to comply with IFRS 9 hedge accounting will be required for disclosures anyway. The corporate that has only a few 'simple' hedges that qualify for hedge accounting today will need to document and disclose its risk management strategy, how it determines that there is an economic relationship and how it establishes the hedge ratio for each kind of hedge. By which time it has likely done the work needed to adopt IFRS 9 hedge accounting.

My own view is that the benefits of moving to IFRS 9 will in almost all cases outweigh the costs. The one exception may be for certain kinds of macro hedge. These, however, tend to be much more prevalent for banks. So, if I were a corporate, I would not be crossing this off my 'to do' list just yet.



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