IFRS WORKSHOP
IFRS 9 *Financial Instruments*

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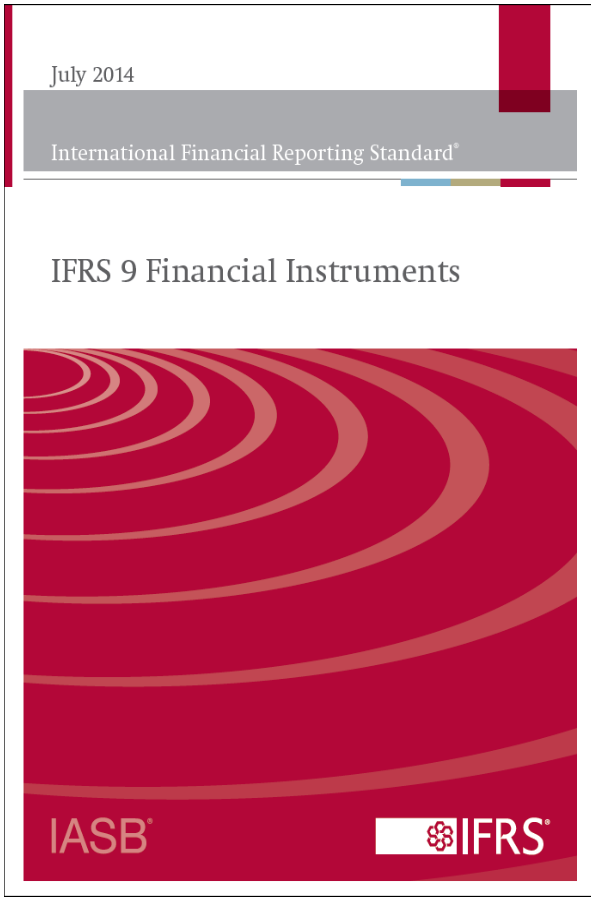
Introduction

IFRS 9 *FINANCIAL INSTRUMENTS*

01. Why IFRS 9 was introduced?



- Developed to replace existing standard IAS 39 *Financial Instruments: Recognition and Measurement*
- IAS 39 criticised by users as difficult to understand, apply and interpret
- Users have urged the IASB to develop a principle based and less complex standard for financial instruments
- IFRS 9 is the IASB’s response to the global financial crisis and represents a fundamental reconsideration of accounting requirements

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02. What is include in IFRS 9

- Classification and Measurement
- Impairment
- Hedge Accounting

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03. When it is effective?

- Effective 1 January 2018

- Early application permitted

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04. What are the changes under classification and measurement?

- A significant change in classification and measurement of financial assets
- Trade receivables could be classified as FVTPL
- Unquoted investments should be measured at fair value and no exemptions
- Gain/(losses) on restructuring of financial liabilities (loan modifications) should be charged to P/L

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05. What is the key change in impairment?

- Incurred loss model to expected loss model
- Forward looking information are required.

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06. What are the impacts of new impairment model?

- More provision
- Long term loans and inter-company loans are get affected
- Double effect on trade receivable at Day 1 (discounting receivable under IFRS 15 and impairment under IFRS 9)

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07. What are the changes to financial liabilities?

- No significant change
- No need to recognise embedded derivatives separately, if those are notional
- Loan modification/de-recognition of financial liabilities will get affected

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08. What are the requirements under IFRS 9 for loan modifications?

Exchange/modification of debt by original lender

DEBTOR

Liability 1

Liability 2

BANK

Extinguishment of financial liability + Recognition of financial liability 2

Standard Modification

Discounted Present value of cash flows under new terms -→ at least 10% different from discounted PV of CF under original terms

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08. What are the requirements under IFRS 9 for loan modifications (contd…)?

- Day 1 difference should be charged to P/L
- Retrospective adjustments are required

Classification and Measurement

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09. What are the financial assets categories under IFRS 9?

		Business models		
		Hold to collect	Hold to collect and sell	Other
Cash flow type	Solely payments of principal and interest (SPPI)	Amortised cost	FVTOCI	FVTPL
	Other	FVTPL	FVTPL	FVTPL

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10. What is business model test?

- Hold to collect
- Hold to collect and sell
- Hold to sell

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11. What is cash flow characteristics test (SPPI test)?

- Principal – initial capital

- Interest – Time value of money, credit risk, liquidity, etc.

<u>Considerations</u>

- Prepayment features
- Convertible bonds
- Participating loans

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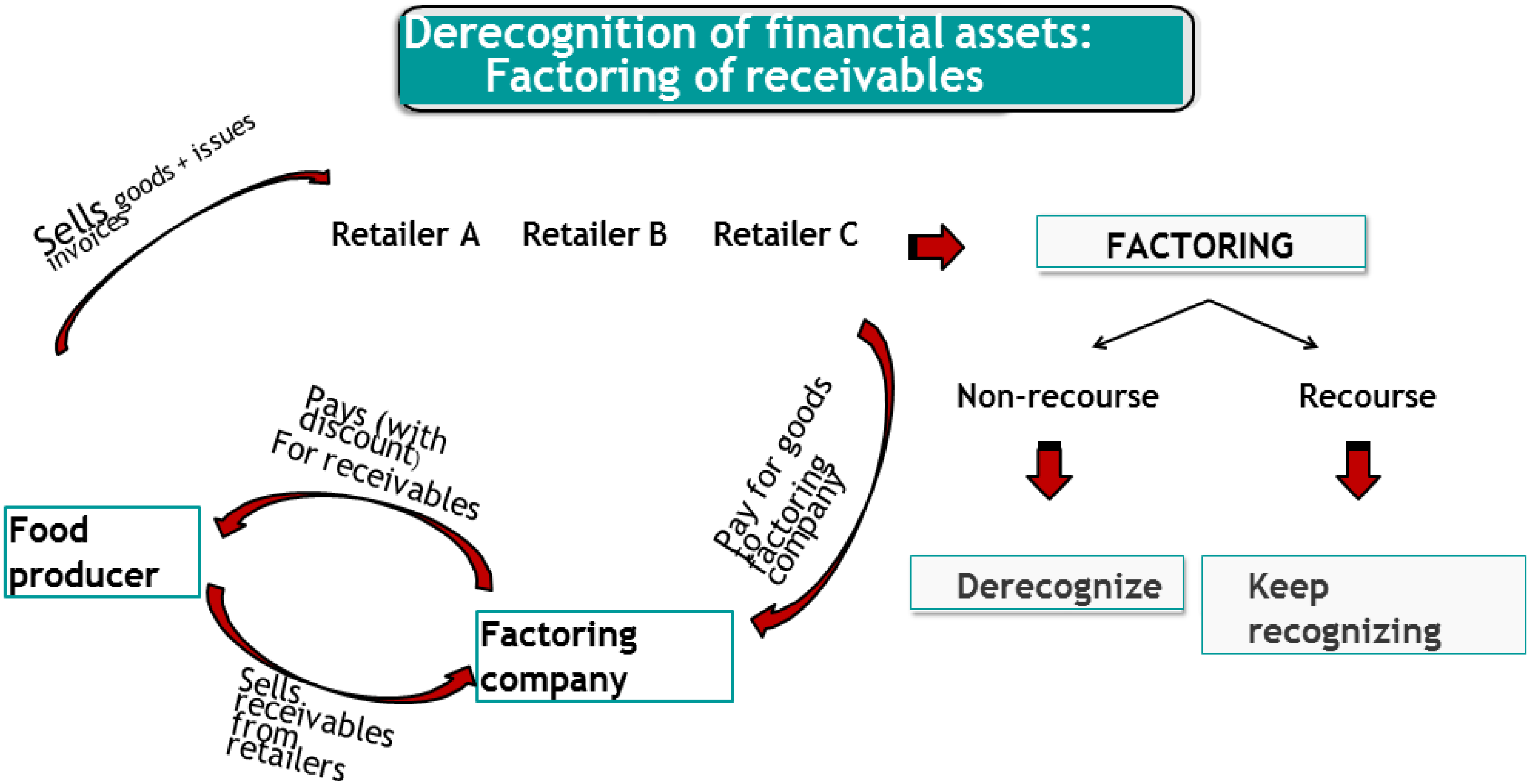
12. What is factoring? How that model explained under IFRS 9?



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13. How to classify factoring receivable?

- Amortised cost, FVTPL, FVTOCI???

Considerations

- Portfolio basis
- Policies on factoring must be in place

Impairment

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14. What are the two models of impairment?

- General impairment model
- Simplified impairment model

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15. What is general impairment model?

Change in credit risk since initial recognition

	STAGE 1 No significant increase in credit risk	STAGE 2 Significant increase in credit risk	STAGE 3 Credit impaired
Recognition of impairment	**12 month ECL**	**Lifetime ECL**	
Recognition of interest	**Effective interest on the gross carrying amount** **(before deducting ECL)**		**Effective interest on the net (carrying) amount (after deducting ECL)**

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16. What is simplified impairment model, when to use this model?

- Use to assess impairment of trade receivable, contract receivable under IFRS 15 and lease receivable

- If trade receivable or contract assets have a significant financing component, general impairment model should be applied.

- If no financing component – Optional (policy choice)

- Lease receivable – Optional (policy choice)

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17. What are the challenges in calculating ECL?

- Availability of data and possible volatility in arriving future expected cash flows
- Availability of data to assess whether credit risk increased from loan origination
- Limitations in existing IT systems

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18. What requirements should be met through ECL calculation approach ?

- Unbiased
- Segmentation
- Consider range of possible outcomes
- Probability weight of those outcomes
- Discounting

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19. What is 12 months expected credit loss and life time expected credit loss?

- Lifetime expected credit loss is the expected credit losses that result from all possible default events over the expected life of a financial instrument.

- 12 month expected credit loss is the portion of the lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

20. What is significant increase in credit risk (SIICR).

- Significant increase in credit risk from the origination of loan
- Depends on risk of default, not risk of losses
- Not an absolute test, but a relative test

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21. What are the indicators to support for "Low credit risk"?

- Low risk of default
- Strong capacity to pay when it s due
- Adverse changes will not affect significantly to make payments when it is due
- Credit ratings will not get changes significantly

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22. How to identify/determine SIICR?

- Use of qualitative and non-statistical quantitative information (e.g. operation results and future projections, stage in technological or economical environment which entity operates, credit ratings)

- Use of past due information (30 days past due, rebuttable presumption that credit risk significantly increased)

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23. How to measure SIICR?

- Measured through PD calculation
- Life time PD arriving through 12 months PD (realistic basis should be in place, frequent review of PD is required)

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24. How to calculate PD?

- Segmentation (grouping) loans based on similar risk characteristics
- Use of 90 days rebuttable presumption in identifying default event
- How to calculate - Example

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25. What is EAD, LGD and how to calculate?

- EAD - Maximum exposure at the point of default
- LGD – Loss given default

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26. What is meant by forward looking information?

- Reliable and supportable macro information which are used in determining SIICR and expected credit loss

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27. What should be consider in capturing forward looking information?

- Non linearity
- Extreme scenarios
- Scenario used for analysis should be reviewed and adjusted regularly

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28. How to take forward looking information in to ECL calculation?

- Through PD calculation
- Management overlay

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29. How to calculate ECL?

- ECL = EAD*PD*LGD*DF

- Navigating through an example

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30. How do you factor loan modification in to ECL model?

- Modification results a significant change? YES = derecognize and consider as a new loan (stage 1 loan)

- Modification results a significant change? NO = Keep recognizing and take under existing stage of loan

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31. What factors/steps should be considered in taking loan modifications in to ECL?

- Consider whether accounting policies for de-recognition is established and de-recognition is identified

- Review whether system supports to address (record) de-recognition

- Identify gaps between above 2 and apply judgements and estimates to take those loan modifications in to ECL calculation/assessment

IMPORTANT – loan modification may result a day 1 gain/loss which should be charged to P/L

32. What is provision matrix? How to calculate impairment using provision matrix?

- STEP 1 – Define the period of sales (i.e. how many years) and bad debts (write offs) related to those sales.
- STEP 2 – Calculate payment profile of the debtors
- STEP 3 – Calculate historical default loss percentage (loss/aging profile)
- STEP 4 – Adjust the loss rate for forward looking information
- STEP 5 – Calculate expected loss using those default rates

EXAMPLE

Related party loans

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33. Is inter-company loan within the scope of IFRS 9?

- Loans from parent to subsidiary
  - No repayment history
  - No documented terms and conditions

Then consider as capital contribution (investment) and not within the scope of IFRS 9

- Loans between fellow subsidiaries and loans with documented terms and conditions are within the scope of IFRS 9

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34. How to account for interest free or below market rates loans received from parent?

- Difference should be recognized as part of investment (depend on mutual understanding)

Hedge Accounting

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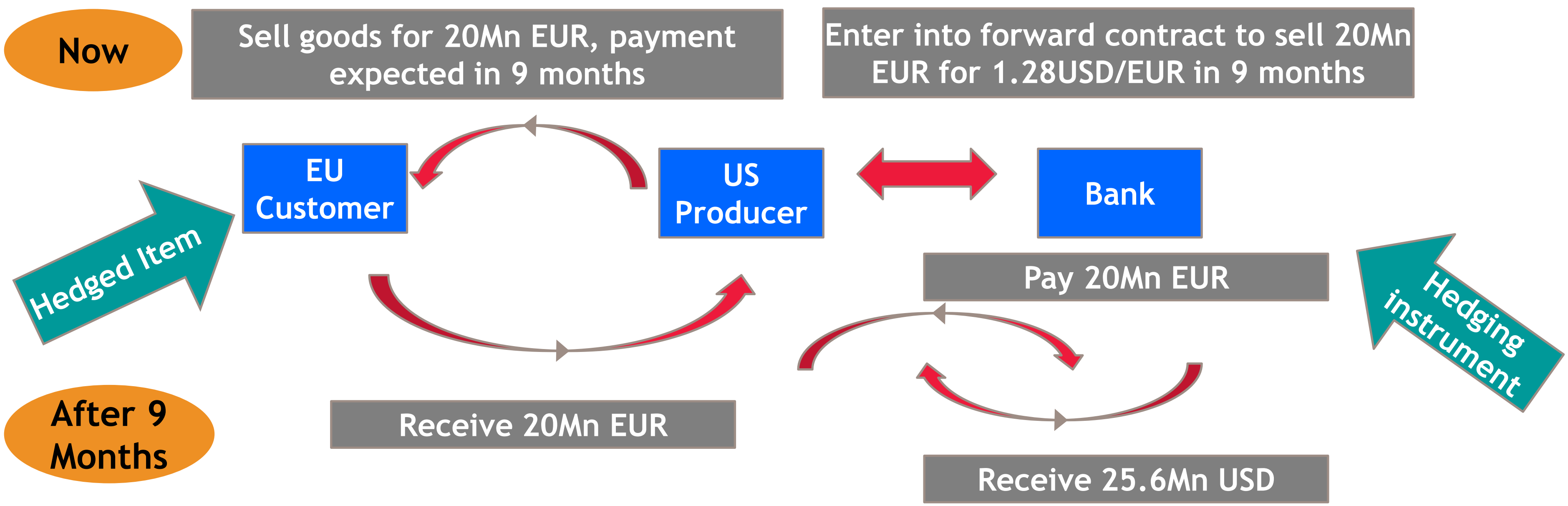
35. What is hedge accounting?

Designating one or more hedging instruments so that their changes in fair value is an offset to the change in fair value or cash flows of a hedged item



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36. What are the challenges for hedge accounting under IFRS 9?

- Hedge accounting documentation requires to change on continuous changes in risk management policies and other related factors

Other Areas

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37. Can interest be suspended under IFRS 9?

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38. How to recognise interest income under IFRS 9?

Effective interest method

5.4.1 Interest revenue shall be calculated by using the effective interest method (see Appendix A and paragraphs B5.4.1–B5.4.7). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:

(a) *purchased or originated credit-impaired financial assets*. For those financial assets, the entity shall apply the *credit-adjusted effective interest rate* to the *amortised cost* of the financial asset from initial recognition.

(b) financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become *credit-impaired financial assets*. For those financial assets, the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.

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38. How to recognise interest income under IFRS 9 (contd..)?

	General or simplified approach		
	No objective evidence of impairment exists	Objective evidence of impairment	Credit adjusted approach
Base on which interest income is calculated	Carrying amount of the asset at the beginning of the period before allowance for ECLs	Carrying value of the asset at the beginning of the period, after Allowance for ECLs	Carrying value of the asset at the beginning of the period after allowance for ECLs
Interest rate to apply to base	Effective interest rate	Effective interest rate	Credit adjusted effective interest rate

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39. Should bank deposits, other debts securities (receivables/assets) be impaired?

- Business model and SPPI test = Classification

- Follow measurement rules based on classification

Transition

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40. What transition rules/guidance are applied?

Classification and measurement	Impairment	Hedge accounting
Retrospective	Retrospective	Prospective (with certain exceptions)

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40. What transition rules/guidance are applied (contd…)?

No retrospective adjustments

- Adjustment to opening retained earnings or other reserves
- Difference between:
  - Carrying amounts before adoption of IFRS 9
  - New carrying amounts on the DIA

Retrospective adjustments

- Only available if possible without the use of hindsight
- Restate for classification and measurement based on IFRS 9 transitional provisions
- No restatement permitted for financial assets and financial liabilities already derecognised at DIA

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Thank You!