IFRS 9

FINANCIAL INSTRUMENTS

IFRS 9 introduces new requirements that will affect entities across all industry sectors. Although it is true that the most significant effects will be for entities in the financial sector, it would be a mistake to assume that there will be limited effects elsewhere. Revisions to the boundary between amortised cost and fair value measurement will change the profile of balance sheets and whether changes in fair value are recognised in profit or loss or other comprehensive income. The new forward looking expected credit loss impairment model may require significant changes to systems and processes, with provisions being greater in size and recognised earlier than under the current incurred loss model. Hedge accounting requirements will also change, with these being more closely linked to internal risk management practices.

The effects of the revised classification and measurement requirements will vary, depending on the precise facts and circumstances, but will be relevant across a wide range of industry sectors. For example, regardless of whether it is in the financial sector, an entity might invest in government or corporate bonds. If these investments might be sold significantly prior to their contractual maturity, IFRS 9 analyses them as being in a business model that is designed to generate cash inflows by collecting contractual cash flows (interest) and by selling the asset. Because cash flows will be collected via interest income and realisation of the fair value of the investment, IFRS 9 requires these investments to be recorded on balance sheet at fair value, with entries in profit or loss being based on amortised cost measurement which requires the application of the expected loss impairment model. The balance is recorded in other comprehensive income, with the related reserve being recycled to profit or loss on the disposal of the investment. As a result, it is necessary to maintain dual fair value and amortised cost accounting records.

For financial institutions with lending activities (including banks, credit unions and lessors), the new expected loss impairment model will require extensive changes to systems and processes, with provisions being greater in size and recognised earlier than under the current incurred loss model. For some entities in this sector, the move to the new expected loss model is considered to be more significant than the previous entire move from local GAAP to IFRS. Enhanced disclosures are also required.

For other entities, there will be similar, albeit less significant, effects from the expected loss model because it applies to trade receivables, inter-company loans and financial guarantee contracts. However, for trade receivables there are some simplifications to the detailed requirements and because these balances are not central to business activities, the extent of change is typically less significant. However, substantial work is still likely to be required; the new model is not equivalent to a general provisions model.

IFRS 9 introduces requirements for hedge accounting that make it more straightforward to qualify for hedge accounting. The application of hedge accounting means that instead of changes in the fair value of derivatives (such as interest rate swaps and foreign currency forward contracts) always being recorded immediately in profit or loss on a stand-alone basis, the recognition of those gains and losses will be deferred until the hedged transaction occurs, or matched with changes in the fair value of the hedged item.

Transition

On transition, the new requirements for the classification and measurement of financial assets and liabilities, and the impairment of financial assets, are applied on a retrospective basis with most of the hedge accounting requirements being applied prospectively. There is then a choice of two approaches:

- Restatement of comparative information for each prior reporting period that is presented in the financial statements (excluding those aspects of hedge accounting which are required to be accounted for prospectively)
- A cumulative catch up approach under which comparative information is not restated, with the cumulative effect of the adoption of IFRS 9 being recognised as an adjustment at the start of the reporting period in which the standard is adopted.

There are detailed and prescriptive transitional requirements, with key elections needing to be made and documentation completed as at the date of initial application (for example, for hedge accounting, and the voluntary designation of financial assets and liabilities in specific categories). There is also an option to continue with the hedge accounting requirements in IAS 39 instead of adopting the new approach in IFRS 9. This may be an option to consider for those entities which have systems and processes set up to comply with the IAS 39 requirements as IFRS 9 will require changes to be made. For the new impairment requirements, a number of simplifications are available on transition which will not be available in future years, meaning that work is likely to be required to improve systems and processes for some time after 2018.

For the adoption of IFRS 9, questions which should be asked include:

Project management, Board sponsorship and communication with those charged with governance:

- What is the plan for transition?
- Which transitional approach and options are being adopted and why?
- Who is responsible?
- What resources are available?
- What sponsorship does the project have at executive board level?
- How has the audit committee been briefed?

Detailed effects:

- What are the likely effects on the classification and measurement of financial assets and liabilities?
- What sources of information have been identified in order that expected credit losses can be calculated?
- What are the likely effects arising from the changes to the hedge accounting requirements?
- How will changes in amounts recognised in the financial statements affect bonus payments, share option plans, banking covenants and costs, and dividend policy?
- How will brokers and analysts react?
- What changes to systems and processes will be required (including the identification of a significant increase in credit risk for the purposes of the impairment test)?
- What are the staff training requirements (including sales and marketing staff, as well as finance staff)?
- How will marketing, credit and finance departments need to liaise and communicate with each other in future?

Find out more

If you would like to speak to us about any of these changes and determine how they may impact you, please get in touch with our team of experts who will be happy to help.

Riaz Ali FCCA, CA
International Liaison Partner

Office: 868-625-8662
Email: rali@bdo.tt

Daniel Bissoondial CA, FCCA, MBA
Director, Audit and Assurance

Office: 868-625-8662 (ext 304)
Email: dbissoondial@bdo.tt

www.bdo.tt