The Institute of Chartered Accountants of Pakistan

CA PAKISTAN

ACCOUNTING STANDARDS BOARD

IFRS 9 – Financial Instruments

IFRS 9 – Financial Instruments

Contents

Introduction

- The work on IFRS 9 started in 2009 and **after 5 years of extensive technical work** and stakeholders consultations, the final standard was issued **in July 2014**
- IFRS 9 replaces IAS 39
- IFRS 9 includes requirements for: recognition and measurement, impairment, derecognition and general hedge accounting

IFRS 9 Development

- The criticism on IAS-39, in brief :
  - Fair value accounting was said to have created cycles of accounting write downs and distressed selling of assets during the Crisis
  - The application of IAS-39 impairment model for loan loss provisions results in delayed recognition of credit losses
  - The over complexity of IAS-39 such as mixed valuation models, multiple impairment approaches, complicated category transfer rules and hedge accounting requirements

IFRS 9 Development cont.

- In view of the criticism, IASB received calls to reduce the complexity of accounting standards for financial instruments from G-20, the Financial Stability Board, the European Union and regulators and other stakeholders from around the world.

IFRS 9 Development cont.

- The IASB completed its project to develop IFRS 9 and replace IAS 39 in three phases:
  - Phase 1 – Classification and measurement
  - Phase 2 – Impairment methodology
  - Phase 3 – Hedge accounting

Key Changes

- Classification and measurement of financial instrument aligned with business model
- Impairment of credit exposures (expected credit losses model)
- Hedge accounting simplified

Classification and Measurement

IAS 39 Classification

- Rule-based
- Complex and difficult to apply
- Multiple impairment models
- Own credit gains and losses recognised

in profi t or loss for fair value option (FVO)

liabilities

- Complicated reclassifi cation rules

IFRS 9 Classification

- Principle-based
- Classification based on business model and

nature of cash fl ows

- One impairment model
- Own credit gains and losses presented in

OCI for FVO liabilities

- Business model-driven reclassification

Impairment – Expected Loss Model

- The impairment requirements applies to debt instruments such as loans, debt securities, bank deposits, lease receivables, loan commitments and financial guarantee contracts.
- Under the expected loss model impairment is recognized over the life of assets on the basis of future expected loss events
- In other words, impairment allowance is made even before there any objective evidence of impairment or occurrence of default event
- The scope of impairment requirements, therefore is much broader and are designed to result in earlier recognition of credit losses
- This model will potentially address the concerns about IAS 39 incurred loss model i.e. too little and too late

Impairment Requirements cont.

Overview of Expected Loss Model

- 3 stage model which recognizes impairment over time based on changes in credit quality since origination of loans

Stage 1	Stage 2	Stage 3
Performing	Under-performing	Non-performing
Loans with low credit risk and with no significant increase in credit risk since origination	Loans for which credit risk has increased significantly since initial recognition	Loans with objective evidence of impairment

Hedge Accounting

- A major overhaul of hedge accounting & introduced significant improvements, principally by aligning the accounting more closely with risk management
- Information about all hedges is now required to be provided in a single location in the notes to the financial statements

Implementation Challenges

Components	Implementation challenges
Portfolio segmentation	▶ Determine segmentation criteria ▶ Consider existing models and data availability for various portfolios ▶ Criteria for low credit risk
Transfer criteria	▶ Definition of trigger events ▶ Significant deterioration in credit
Expected loss modeling	▶ Determination of models for 12 month and lifetime expected loss ▶ Discount rate
Sources of information	▶ Internal data (internal credit ratings, historical loss experiences) ▶ External data – Macro economic statistics and credit ratings ▶ Update of internal data used for credit risk management regularly

Due Process

Evaluate

- The relevant Committees of the Institute have evaluated IFRS 9 for implementation in the non-financial, financial sector and insurance sector

Seminar

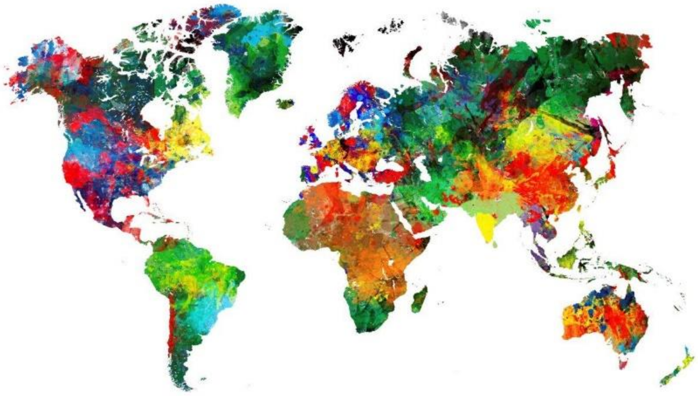
- First awareness seminar on IFRS 9 was held on 6th December at Karachi
- Training Session held for SBP staff at SBP request

Transition

- An entity shall apply IFRS 9 retrospectively in accordance to IAS 8
- Not applicable to items derecognized on date of initial application
- An entity may choose as its accounting policy to continue to apply the hedge accounting requirements of IAS 39
- An entity shall apply the hedge accounting requirements of IFRS 9 prospectively

Global Adoption Status

- EU
- India
- Australia
- Malaysia
- Hong Kong
- South Africa
- Singapore



Recommendation

- ✓ Financial Sector Committee proposed to adopt IFRS 9 for the financial sector in a phased manner.
- ✓ IFRS 4 provides option to insurance companies of a temporary exemption from applying IFRS 9 until 2021. Therefore, IFRS 9 to be deferred for insurance sector.
- ✓ **IFRS 9 could be made applicable for the non - financial sector from the effective date that is periods beginning on or after January 1, 2018.**