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KPMG

Implementing IFRS 9

Considerations for systemically important banks

Time is running out. Audit committees need to be active now, providing strong governance for robust implementation.

A quick guide to the GPPC's June 2016 paper

The weight of expectations bears heavily on banks who are due to adopt IFRS 9 *Financial Instruments* by 2018. Six years in the making, the new standard responds to the requests from the G20 for a forward-looking approach to loan loss provisioning following the financial crisis.

Implementing the new impairment requirements will be challenging

Alongside the demand for transparent disclosures about impairment, the new impairment requirements pose three particular challenges that banks will need to address in order to maintain the confidence of investors and other stakeholders in their financial reporting:

- increased complexity for preparers;
- a diverse range of approaches and outcomes; and
- time and effort to implement.

Audit committees of banks are expected to play an oversight role during the implementation phase and beyond.

Guidance to help audit committees oversee implementation

In a rare move, the Global Public Policy Committee – which comprises representatives from BDO, Deloitte, EY, Grant Thornton, KPMG and PwC – has published a joint paper[1] that seeks to help audit committees meet their responsibilities.

The paper includes:

- recommendations on governance and controls;
- factors affecting selection of modelling approaches; and
- ten key questions for audit committees to use to focus their discussions with management.

This quick guide outlines the background to and key themes in the paper.

1. *The implementation of IFRS 9 requirements by banks – Considerations for those charged with governance of systemically important banks.*

The GPPC's June 2016 paper

The guidance will help audit committees identify the elements of high-quality implementation and evaluate management progress.

What is it?

The paper is addressed to audit committees of systemically important banks, but the principles are relevant to other banks and financial institutions in a proportionate way. It builds on some of the themes outlined by banking supervisors in the Basel Committee on Banking Supervision's *Guidance on credit risk and accounting for expected credit losses*, issued in December 2015.

The paper has been structured to help the two key groups that will be instrumental in ensuring a high quality implementation of IFRS 9:

- those charged with governance, who will set the tone for and oversee implementation, including related controls; and
- finance, risk management, IT and other executives who will implement the new requirements.

Why has it been produced?

Joint papers from the large accounting networks are rare – so why did they decide to publish this one?

IFRS 9 will no doubt be one of the most momentous changes in accounting for many banks – considered by many to be bigger than the initial adoption of IFRS – but the new impairment requirements pose three particular challenges, as set out below.

Banks will need to address these challenges – and the demand for transparent disclosures about impairment – to maintain the confidence of investors and other stakeholders in their financial reporting.

Implementation will be challenging, as application is complex and there is a range of approaches and outcomes.

What challenges are banks likely to face?

Increased complexity for preparers

Under IFRS 9, banks will need to provide for expected credit losses (ECLs). While this notion is largely intuitive, it may be more difficult for audit committees to understand the detailed application, as well as the systems and controls implications. The paper seeks to direct audit committees to key implementation issues.

Diverse range of approaches and outcomes

IFRS 9's principles-based approach aims to cater for the diversity of organisations within its scope. Therefore, it generally does not prescribe specific detailed methods. Selecting techniques and estimating expected credit losses involves a high degree of management judgement, and methods may vary between institutions.

The paper outlines factors for banks to consider in developing approaches to implementation and provides example approaches. It also stresses the importance of strong governance and controls over the way judgement is exercised.

Time and effort to implement

Only 18 months remain until IFRS 9's effective date. Implementation programmes may be large, complex and expensive, so audit committees need to be active now.

The guidance includes recommendations on governance and controls, factors affecting selection of modelling approaches and transition.

What guidance does it provide?

The paper has two main sections.

Key focus areas for those charged with governance	– Recommendations for governance and control frameworks to provide clear oversight – Factors to consider when determining the sophistication of the modelling approaches to be adopted – Transition considerations – Ten questions for audit committees to discuss with management
Key modelling principles	– Example of a sophisticated approach for a number of important concepts and parameters, including: - definition of default - probability of default - exposure – period and amount at default - loss given default - discounting - stage assessment - macro-economic forecasts and forward-looking information – Considerations for simpler approaches – Examples of approaches that are not compliant

What is its status?

The paper is not intended to amend or interpret the requirements of IFRS 9 and the GPPC is not empowered to do so.

The information in the paper is of a general nature, and banks will need to undertake further analysis to apply the standard in their own circumstances. However, we expect that the six large accountancy networks will each use the paper when assessing the quality of individual banks' IFRS 9 implementation.

The paper focuses only on the implementation of the new impairment requirements. However, it does not intend to understate the importance of high quality implementation of other IFRS 9 accounting requirements, such as the classification and measurement of financial instruments, hedge accounting and related disclosures.

Ten key questions

Audit committees can focus their discussions with management using these ten key questions.

Key questions for audit committees to ask management

Key decisions and interpretations of IFRS 9	– What plans are in place to conclude on key decisions, build and test necessary models and infrastructure, execute dry/parallel runs and deliver high quality implementation by 2018? – What are the key accounting interpretations and judgements and why are they appropriate? – How will implementation decisions be monitored to ensure they remain appropriate?
Expected credit loss modelling	– What are the planned levels of sophistication for different portfolios and why are these appropriate? – How will a 'significant increase in credit risk' be identified and why are the chosen criteria appropriate? – How will a representative range of forward-looking scenarios be used to capture non-linear and asymmetric impacts?
Systems and controls	– Has the bank identified all changes to existing systems and processes, including data requirements and internal controls, to ensure they are appropriate for use under IFRS 9? – How will reporting processes and controls be documented and tested, particularly where systems and data sources have not previously been subject to audit?
Transparency	– What KPIs and management information will be used to monitor drivers of expected credit loss and support effective governance over key judgements? – How will the IFRS disclosure requirements be met and how will those disclosures facilitate comparability?

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If you would like further information on any of the matters discussed in this guide, please talk to your usual local KPMG contact or call any of KPMG firms' offices.