IFRS 9

Financial instruments for corporates – Are you good to go?

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Are you good to go?

IFRS 9 will change the way many corporates account for their financial instruments. You’ll need to consider the new requirements for...

Classification and measurement  Impairment  Hedge accounting

To help you drive your implementation project to the finish line, we’ve pulled together a list of key considerations that many corporates need to focus on.
For each of the following, documenting your analysis and the conclusions drawn will be essential.
Classification and measurement
How will you classify your trade receivables and debt investments?

- **Solely principal and interest?**
  - Yes
  - No

- **Holding to collect contractual cash flows?**
  - Yes
  - No

- **Collecting contractual cash flows and selling financial assets?**
  - Yes
  - No

**Classification Options**
- **Amortised cost**
- **FVOCI**
- **FVTPL**
Business model

Have you determined the business model at a level that reflects how groups of financial assets are managed together?

Think about…

- **Objectives**: Are collecting contractual cash flows and/or selling financial assets integral to the business model?
- **Sales**: What are the actual and expected frequency, value and timing?
- **Performance**: How is it evaluated and reported?
- **Risks**: How are they managed?
- **Compensation**: How are managers incentivised?
Factoring and securitisation

Do you sell trade receivables in factoring agreements or sell loans in securitisation arrangements?

Think about…
Consolidated vs separate financial statements | Guarantees given to the factor
Assessing the SPPI criterion

Do the asset’s contractual terms give rise to cash flows that are SPPI – solely payments of principal and interest?

Consider...
- Time value of money
- Credit risk
- Other basic lending risks
- Other associated costs
- Profit margin

Remember...
- Embedded derivatives are not separated from financial assets
- Exposure to risks or volatility unrelated to a basic lending arrangement is not SPPI
Prepayment features

Do any prepayment features meet the SPPI criterion?

A contractual term meets the criterion if...

it permits or requires prepayment at an amount substantially representing unpaid principal and interest

Remember...

— The amount can include reasonable compensation for early termination
— There’s an exception for certain prepayment features at par
Other features

Do other features in the contract mean that the SPPI criterion is not met?

Consider…

Non-recourse loans

Extension features

Modified time value of money
**Equity investments**

**Does your accounting policy meet IFRS 9’s requirements?**

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**You’ll need to…**

- Measure non-trading investments at FVTPL, unless you make an irrevocable policy choice on initial recognition to measure them at FVOCI
- Measure all other equity investments at FVTPL

**You can no longer…**

- Measure investments at cost
- Recognise impairment in profit or loss on FVOCI investments
- Reclassify gains or losses on FVOCI equity instruments
Financial liabilities designated at FVTPL

Do you know how new rules for presenting gains or losses attributable to own credit risk will affect your financial statements?

Gains or losses attributable to changes in own credit risk

- OCI

Remaining change in fair value

- P&L

Designation criteria are unchanged from IAS 39
Modification or exchange of financial liabilities

Do you have modifications or exchanges of fixed rate financial liabilities that do not result in derecognition?

You’ll need to…

Recalculate amortised cost
Discount the modified contractual cash flows using the original effective interest rate (EIR)

and

Recognise any adjustment in profit or loss

Remember…
This is a change from current practice | Retrospective application is required
Impairment
Scope of impairment requirements

Have you **identified all the instruments that are subject to the impairment requirements?**

- Debt instruments measured at amortised cost or at FVOCI – e.g. trade receivables
- Financial guarantees and loan commitments not measured at FVTPL
- Lease receivables
- Contract assets in the scope of the revenue standard – IFRS 15

- Equity investments
- Financial instruments measured at FVTPL
Simplified approach to measuring ECL

Will you choose to extend the simplified approach for measuring ECL?

Which approach will you apply? General

Has there been a significant increase in credit risk (SICR)?

No

Loss allowance = 12-months’ ECL

Yes

Loss allowance = lifetime ECL

Choice applies to…

Trade receivables and contract assets with a significant financing component | Lease receivables
Practical expedient

Will you use a **provision matrix** to measure ECL for trade receivables?

**Example**

<table>
<thead>
<tr>
<th>Loss rate</th>
<th>Current</th>
<th>1-30</th>
<th>31-60</th>
<th>61-90</th>
<th>&gt;90</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 9</td>
<td>0.3%</td>
<td>1.6%</td>
<td>3.6%</td>
<td>6.4%</td>
<td>10.5%</td>
</tr>
</tbody>
</table>

Based on:

- Historical credit loss exposure
- Adjustment for current conditions and forward-looking estimates

**Remember...**

All receivables balances need an ECL provision, including those in the current column
Assessing significant increase in credit risk

If you are applying the general approach, have you designed the criteria for assessing a SICR for each asset type?

Quantitative measure of probability of default (PD) vs Qualitative factors

Remember...
Low credit risk exception | ‘30 days past due’ rebuttable presumption
Definition of default

Have you defined ‘default’ for assessing SICR and measuring impairment where relevant?

The definition should be consistent with that used for internal credit risk management

Rebuttable presumption that default does not occur later than 90 days past due
Measuring expected credit losses

What data and analysis will you use for measuring ECL for different asset types?

- **Probability weighted**
  - Unbiased and probability-weighted amount

- **Present value**
  - Discount rate = Original EIR or an approximation

- **Cash shortfalls**
  - Cash flows due under the contract less cash flows you expect to receive

Remember...
Incorporate forward-looking economic scenarios
Will you **adopt IFRS 9’s hedge accounting requirements or continue to apply IAS 39?**

**Yes**

Continue to fully apply IAS 39’s hedge accounting requirements to all hedging relationships

**No**

Apply IFRS 9’s general hedging model

**Remember…**

You can choose to defer until the standard resulting from the IASB’s dynamic risk management project is completed
Alignment with risk management objectives

Have you formally documented the risk management strategy and objective for undertaking the hedge?

Hedge documentation should...

- Demonstrate how the hedge relationship is more closely aligned with the actual risk management objective
- Include an analysis of sources of hedge effectiveness
Have you considered the ‘costs of hedging’ elements that may be excluded from certain designated hedging instruments?

Excluded elements

- Time value of purchased options
- Forward element of forward contracts
- Foreign currency basis spreads of financial instruments

Accounting

- Change in fair value
- Affects profit or loss at the same time the transaction does or amortises over time

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Have you determined whether any risk components may be designated as hedged items?

Designation criteria for financial and non-financial risk components

- Separately identifiable
  - Contractually and non-contractually specified
- Reliably measurable
  - Sufficient observable forward transactions

Think about…

Particular market structure the risk relates to | Location of hedging activity
Have you considered what additional exposures may qualify as **hedged items**?
Assessing hedge effectiveness

Have you updated your systems, tools and documents to meet the **hedge effectiveness requirements**?

- Economic relationship between hedged item and instrument
- Credit risk does not dominate value changes
- Hedge ratio = Actual ratio used for risk management
Transition and disclosures
Transition requirements

Is your implementation plan aligned with the transition requirements?

Use the helpful guidance in our First Impressions and Insights into IFRS publications

Visit kpmg.com/ifrs9

There are significant exemptions from restating comparatives and retrospective application
Disclosure requirements

Have you identified the additional information and processes needed to meet the disclosure requirements?

Read our Guide to annual financial statements – IFRS 9 appendix

You’ll need to provide specific transitional disclosures and more detail about credit risk management and hedge accounting.
Checklists and next steps
### Checklist (1/2)

<table>
<thead>
<tr>
<th>Have you...?</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Determined how you will <strong>classify your trade receivables and debt investments</strong>?</td>
<td></td>
</tr>
<tr>
<td>Assessed whether collecting contractual cash flows and/or selling financial assets are <strong>integral to your business model</strong>?</td>
<td></td>
</tr>
<tr>
<td>Considered the impact of <strong>factoring or securitisation arrangements</strong>?</td>
<td></td>
</tr>
<tr>
<td>Reviewed contractual terms to assess <strong>whether cash flows are SPPI</strong>?</td>
<td></td>
</tr>
<tr>
<td>Considered whether <strong>prepayment features</strong> meet the SPPI criterion?</td>
<td></td>
</tr>
<tr>
<td>Determined whether <strong>other contract features</strong> mean that the SPPI criterion is not met?</td>
<td></td>
</tr>
<tr>
<td>Have you...?</td>
<td></td>
</tr>
<tr>
<td>Checked that your accounting policy for <strong>equity investments</strong> meets IFRS 9’s requirements?</td>
<td></td>
</tr>
<tr>
<td>Assessed what the effect of applying the new rules for presenting <strong>financial liabilities designated at FVTPL</strong> will be?</td>
<td></td>
</tr>
<tr>
<td>Determined whether you have <strong>modifications or exchanges of fixed rate financial liabilities</strong> that do not result in derecognition?</td>
<td></td>
</tr>
<tr>
<td>Identified all the instruments that are <strong>subject to the impairment requirements</strong>?</td>
<td></td>
</tr>
<tr>
<td>Decided whether you will extend the <strong>simplified approach to measure ECL</strong>?</td>
<td></td>
</tr>
<tr>
<td>Decided whether you will use the <strong>practical expedient</strong> to measure ECL for trade receivables?</td>
<td></td>
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</tbody>
</table>
## Checklist (2/2)

<table>
<thead>
<tr>
<th>Have you…?</th>
<th></th>
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<tbody>
<tr>
<td>Designed the <strong>criteria for assessing a SICR</strong> for each asset type under the general approach?</td>
<td>✔</td>
</tr>
<tr>
<td>Defined ‘default’ for assessing SICR and measuring impairment where relevant?</td>
<td>☐</td>
</tr>
<tr>
<td>Considered what data and analysis you will use for <strong>measuring ECL</strong> for different asset types?</td>
<td>☐</td>
</tr>
<tr>
<td>Decided <strong>whether to adopt IFRS 9’s hedge accounting requirements</strong>?</td>
<td>☐</td>
</tr>
<tr>
<td>Formally documented your hedge accounting policy and <strong>aligned it with your risk management objectives</strong>?</td>
<td>☐</td>
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<tbody>
<tr>
<td>Considered the ‘<strong>costs of hedging</strong> elements that may be excluded’ from certain designated hedging instruments?</td>
<td>☐</td>
</tr>
<tr>
<td>Determined whether any risk components or additional exposures may <strong>qualify, or be designated, as hedged items</strong>?</td>
<td>☐</td>
</tr>
<tr>
<td>Updated your systems and documents to meet the <strong>hedge effectiveness requirements</strong>?</td>
<td>☐</td>
</tr>
<tr>
<td>Aligned your implementation plan with the <strong>transition requirements</strong>?</td>
<td>☐</td>
</tr>
<tr>
<td>Identified the additional information and processes needed to meet the <strong>disclosure requirements</strong>?</td>
<td>☐</td>
</tr>
</tbody>
</table>
How did you do?

How many of our 22 questions have you answered ‘yes’?

All 22 – You’re good to go!
7–21   – You’re on your way
0–6   – You really need to engage
Don’t forget the broader business impacts

Have you…

— updated your management reporting, including KPIs?
— developed a transition plan for parallel runs, including reconciliations?
— thought about the tax implications?
— calculated the impact on bonus schemes?
— compared your approach with peers?
Find out more

Talk to your usual KPMG contact

Find out more at kpmg.com/ifrs9

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