

IFRS 9 Financial Instruments

Taking a closer look

*Capital Markets and Accounting
Advisory Services*



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Taking a closer look

The IASB's new financial instruments standard, IFRS 9, applies for years beginning on or after January 1, 2018 and introduces significant changes to classification and measurement, impairment and hedge accounting. Its impact is sure to reach far beyond finance to areas such as credit risk, systems, data, tax, internal audit and others. The time to act is now.

The following are the more significant changes:

Classification & measurement 	<p>IFRS 9 introduces a new model for the classification and measurement of financial assets and liabilities and in many cases, the required treatment will be different from IAS 39. For example, if you have complex financial instruments, externally regulated capital requirements, or are sensitive to the potential income statement impacts of re-measurement, careful analysis and planning can help to prevent headaches later on. Key aspects of the new model include:</p> <ul style="list-style-type: none">• 3 categories for financial assets: fair value in profit or loss (FVPL), fair value through other comprehensive income (FVOCI) and amortized cost• Two-part test for classification of debt instruments depending on related business model and cash flow characteristics• FVPL is a residual category• Option to use FVPL if it eliminates or substantially reduces a measurement inconsistency (i.e. accounting mismatch)• Recognition of changes in own credit risk through OCI for financial liabilities designated at FVPL
Impairment 	<p>IFRS 9's new impairment model is a move away from IAS 39's incurred credit loss approach to an expected credit loss model. Earlier recognition of impairment losses is likely to result and for entities with significant lending activities, an overhaul of related systems and processes will be needed. Key aspects of the new model include:</p> <ul style="list-style-type: none">• Three-stage general impairment model for financial assets that are performing, underperforming or non-performing• Stage assessment is based on relative (i.e. rather than absolute) credit risk compared to credit risk at initial recognition.• Impairment based on expected (i.e. rather than incurred) losses calculated using potential credit loss and probability of default• Practical expedient to use lifetime expected losses for trade receivables, contract assets and lease receivables held by non-financial institutions
Hedging 	<p>Less stringent quantitative testing requirements and a broader scope means that IFRS 9's new hedging guidance will be a welcomed change for most. While all entities applying hedge accounting will require updates to documentation and processes, those that previously didn't qualify for hedge accounting may find that they can under IFRS 9. Key aspects of the new model include:</p> <ul style="list-style-type: none">• Simplified requirements for quantitative analysis and closer alignment to the entity's risk management activities• Ability to hedge risk components of non-financial items (e.g. greater ability to hedge commodity or other risk exposures)• Flexibility in hedging groups of items (i.e. net positions)• Separate (ongoing) project to address open portfolio (macro) hedging

With less than two years remaining, what should audit committees and boards of directors be asking about the transition to IFRS 9?

- 1.** What is our current state of implementation? In particular,
 - Do we have a steering committee, which functions are represented on it, who is leading the initiative (e.g. accounting policy, credit or other) and why?
 - What's our transition timeline, key milestones, and are we on track?
- 2.** How do budget and plans compare to our competitors and do we understand any differences between what we and our peers are expecting to spend?
- 3.** What's our plan to win the 'War on Talent'? Our competitors and service organizations will all be seeking to secure specialized skills and knowledge; what will we do?
- 4.** What is our process to manage the IFRS 9 story? The market will be comparing how we are doing versus our competitors; how will we be prepared and proactive in this space?
- 5.** How will we validate the appropriateness of new models in time for transition and thereafter; and what governance process will we put in place?
- 6.** What key new data elements are being introduced to the financial reporting process and how will they be vetted?
- 7.** What are our plans for parallel testing and disclosures during the transition period?
- 8.** Have we considered whether we can use this change to enhance our existing credit risk, systems, or data management?
- 9.** How have we assessed the:
 - impact to our regulatory capital position
 - expectations of regulators
 - consequences to our financial performance, and
 - potential for unintended consequences?
- 10.** What are our top three risks for the implementation and how are we addressing them?

What are the next steps?

2016 ▶▶▶▶▶ 2016 ▶▶▶▶▶ 2016 / 2017 ▶▶ 2017 ▶▶▶▶▶ 2018



- Program governance
- Financial impact assessment
- Gap analysis and impact on downstream systems
- Implementation roadmap

- Target operating model
- Roles and responsibilities
- Methodology build
- Data, systems, and controls build or integration
- Consider other impacts on the business

- Implement target operating model
- Model testing
- Data, systems, and controls testing
- Systems integration
- Reporting and disclosure

- Parallel run
- Impact analysis
- Reporting
- Deployment into full production starting 2018

Training

Stakeholder Management/Develop Communication Plan to the Market

Program Management

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