KPMG

AASB 9: *Financial Instruments* Transition

Tuesday 20 June 2017

Your facilitators are

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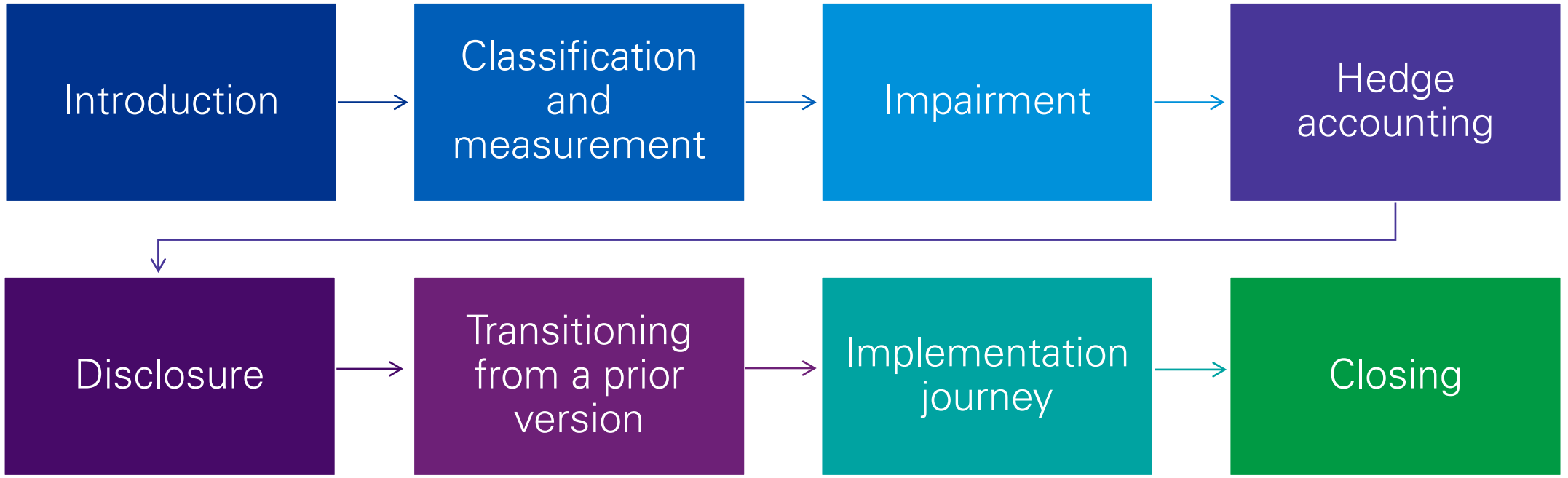
Agenda



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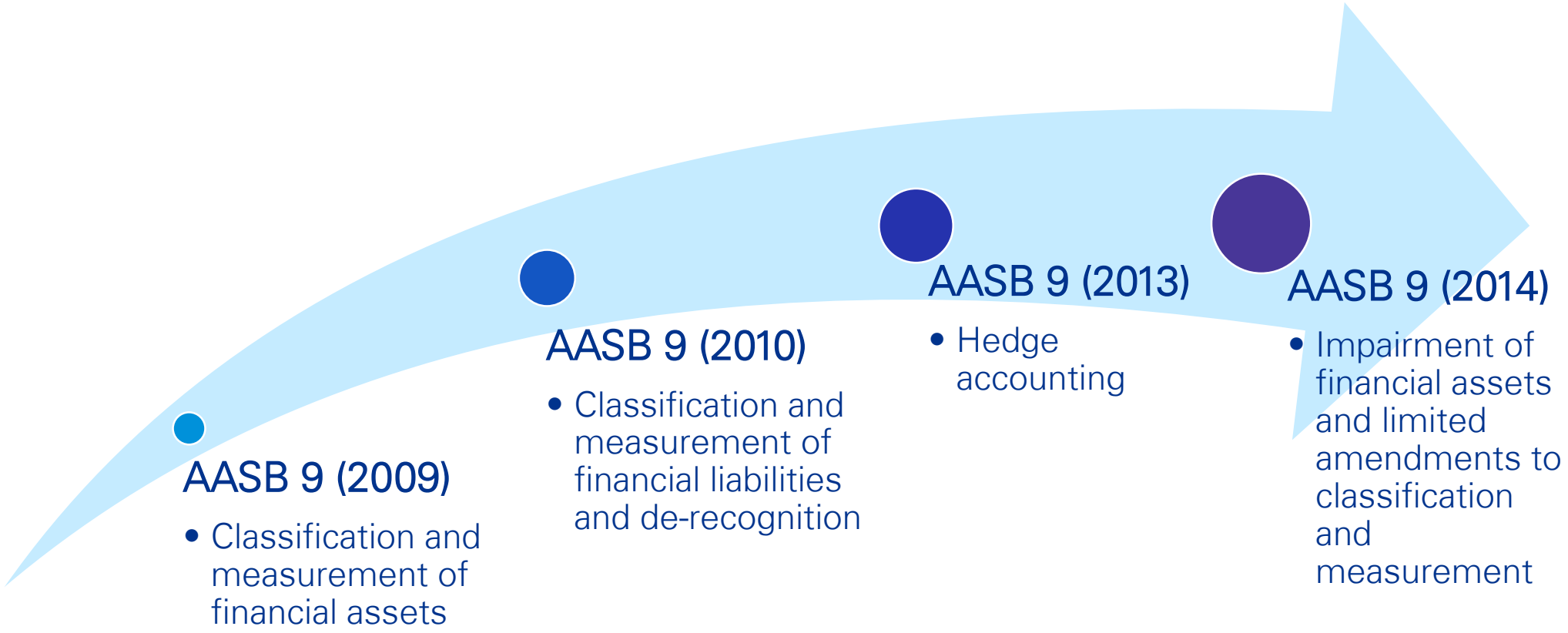
Introduction

The story so far...



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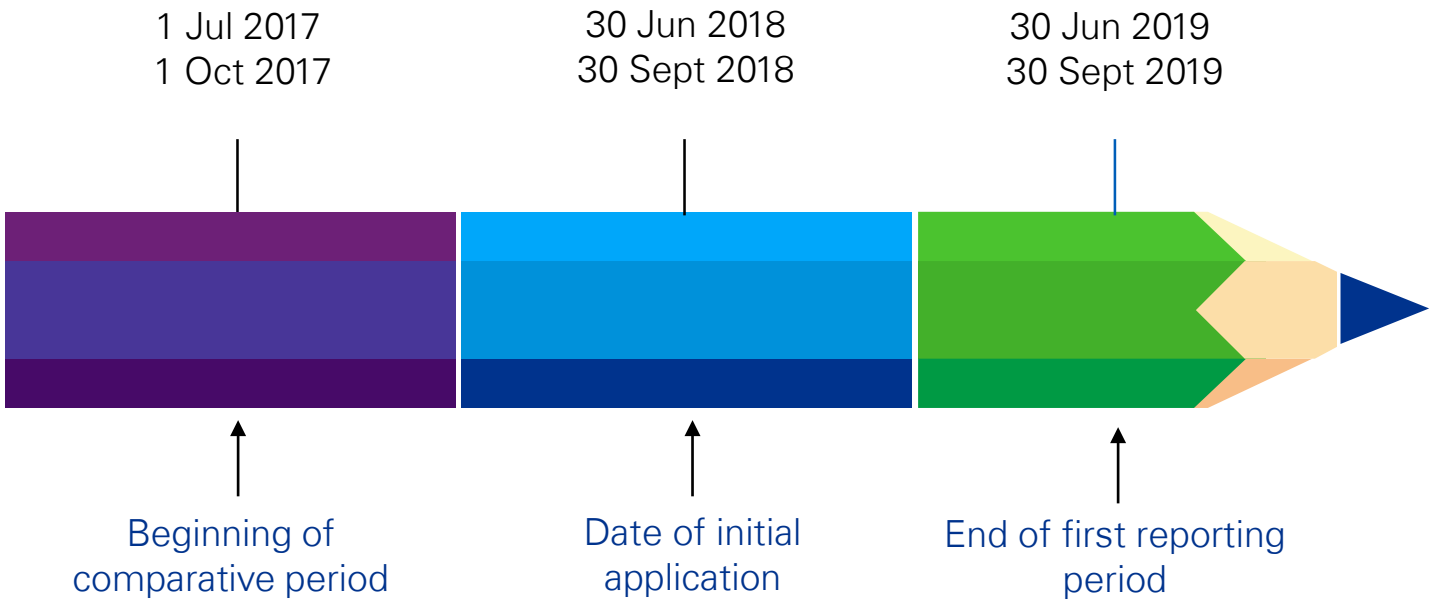
Where are we at?

Applicable years beginning on or after 1 Jan 2018



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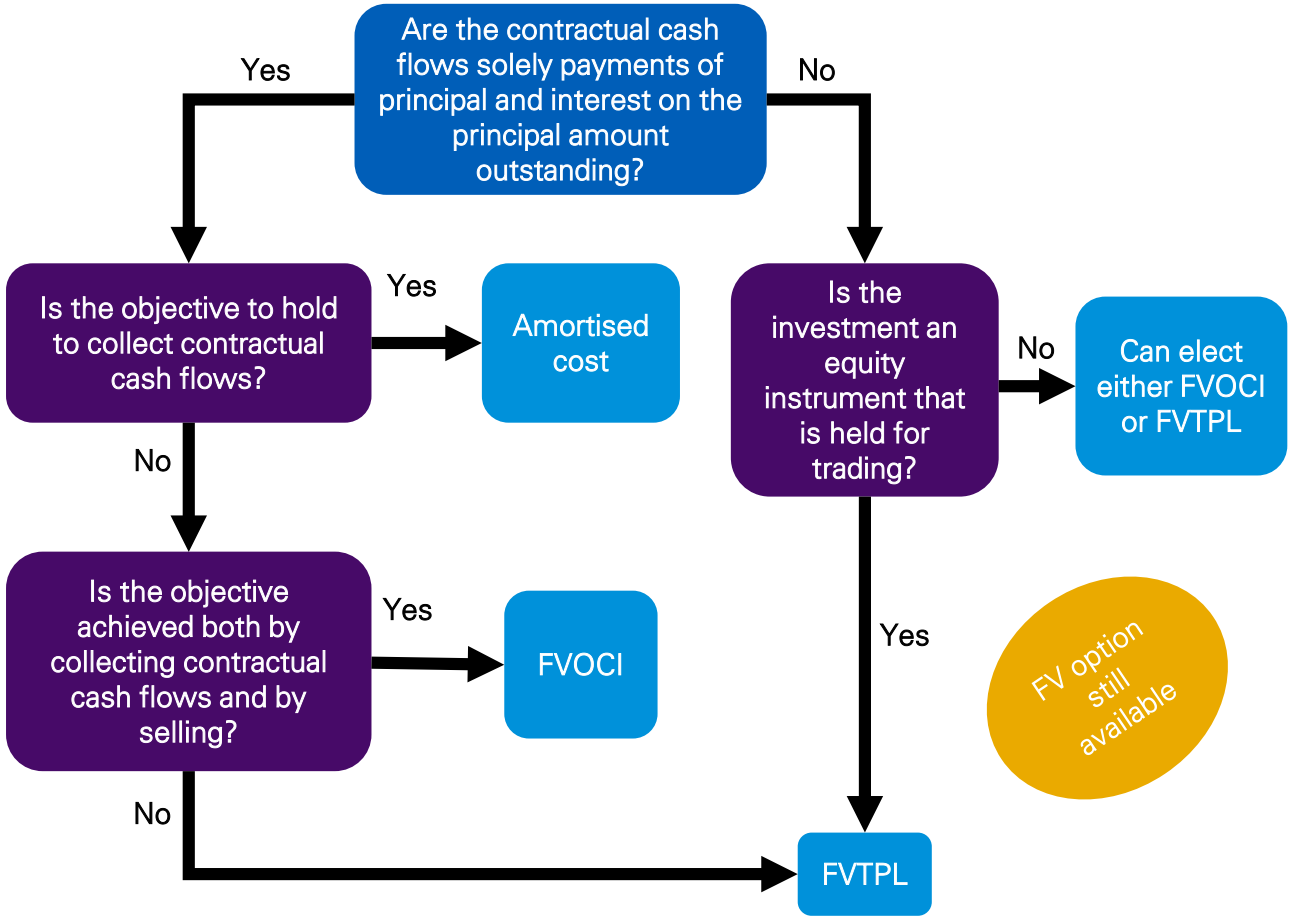
Classification and measurement

Classification of financial assets



Different rules for amortised cost measurement

Need to assess the contractual cash flows of the instrument in its entirety

FVOCI only available for certain debt instruments and equity investments that are not held for trading

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The SPPI criterion example

An entity has a loan receivable with interest payments based on BBSW + a margin reflecting the borrower's credit risk. The loan also entitles the entity to a 0.1% share of the borrower's revenue in excess of a pre-determined threshold.

Do the cash flows consist only of principal and interest?

Is it consistent with a basic lending arrangement?

Principal	Fair value of asset on initial recognition	
Interest	Consideration for: • Time value of money; • Credit risk associated with the principal amount;	Can also include consideration for: • Other basic lending risks – liquidity risk; – other associated costs (such as administrative costs). • A profit margin

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Impact of classification

Category	Initial recognition	Subsequent measurement	Impairment requirements apply?	Examples
Amortised cost	Fair value plus transaction costs	Amortised cost	Yes	Trade receivables Loans
FVTPL	Fair value	Fair value through P&L	No	Shares held for trading Puttable units Derivatives
FVOCI - debt	Fair value plus transaction costs	• P&L: Interest, impairment and FX • OCI: Other gains and losses • Gains and losses reclassified to P&L on de-recognition	Yes	Government debt securities held for liquidity purposes
FVOCI - equity	Fair value plus transaction costs	• P&L: Dividends • OCI: Other gains and losses • No reclassification of gains and losses from OCI	No	Shares not held for trading

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Additional considerations

Prepayment options

- Exception permits amortised cost for certain options
- IASB ED for prepayment with negative compensation

Specific rules

- Contractually linked instruments
- Non-recourse loans
- Modified time value

Contracts to buy or sell non-financial items

- Certain executory contracts can be designated at FVTPL
- Designation made at inception and is irrevocable

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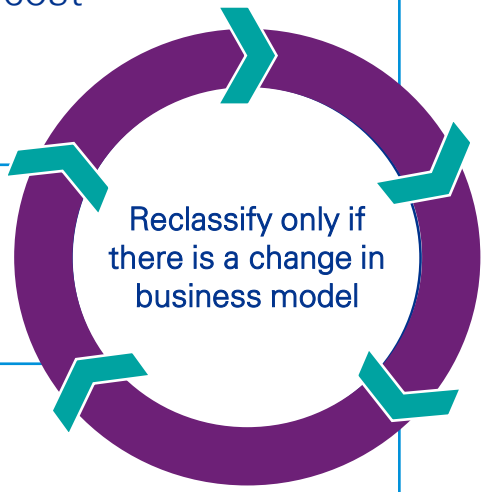
Business model assessment

Assessed at a level at which groups of assets are managed, e.g. a portfolio

Business Models	Key features	Measure at
Held-to-collect	• Business holds assets to collect contractual cash flows • Sales are incidental to the objective	Amortised cost
Held both to collect and for sale	• Both collecting contractual cash flows and sales are integral to achieving the objective of the business model	FVOCI
Others	• Assets are neither held-to-collect nor held to collect and for sale	FVTPL



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Business model assessment

Finance company loan portfolios

Originating entity

- Originates loans with customers
- Accumulates loans for sale to SPV

Special Purpose Vehicle

- Finances the purchase of loans through issue of notes to investors

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Polling question 5

Trade receivables for Big Corporate Ltd

Trade receivables ledger:

Year ending 30 June 2019

Customer	Balance owed
Customer A	$10,500
Customer B	$12,400
Customer C	$11,300
Customer D	$15,000
Customer E	$14,150

Receivables that may be accepted by Bank under off-balance sheet securitisation or debt factoring agreement.

What is the appropriate business model?

Q: What is the appropriate business model for receivables from Entity B, C and D?

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Classification of financial liabilities

Measurement categories

- Financial liabilities held for trading or derivatives – at FVTPL
- Continue to separate any embedded derivatives
- Other financial liabilities – at amortised cost
  - Fair value option available to reduce or avoid an accounting mismatch

No change from AASB 139

For all financial liabilities designated at FVTPL – own credit

- Fair value change attributable to changes in own credit risk must be presented in OCI unless doing so creates or enlarges an accounting mismatch.

New requirement

Reclassification of financial liabilities is not permitted

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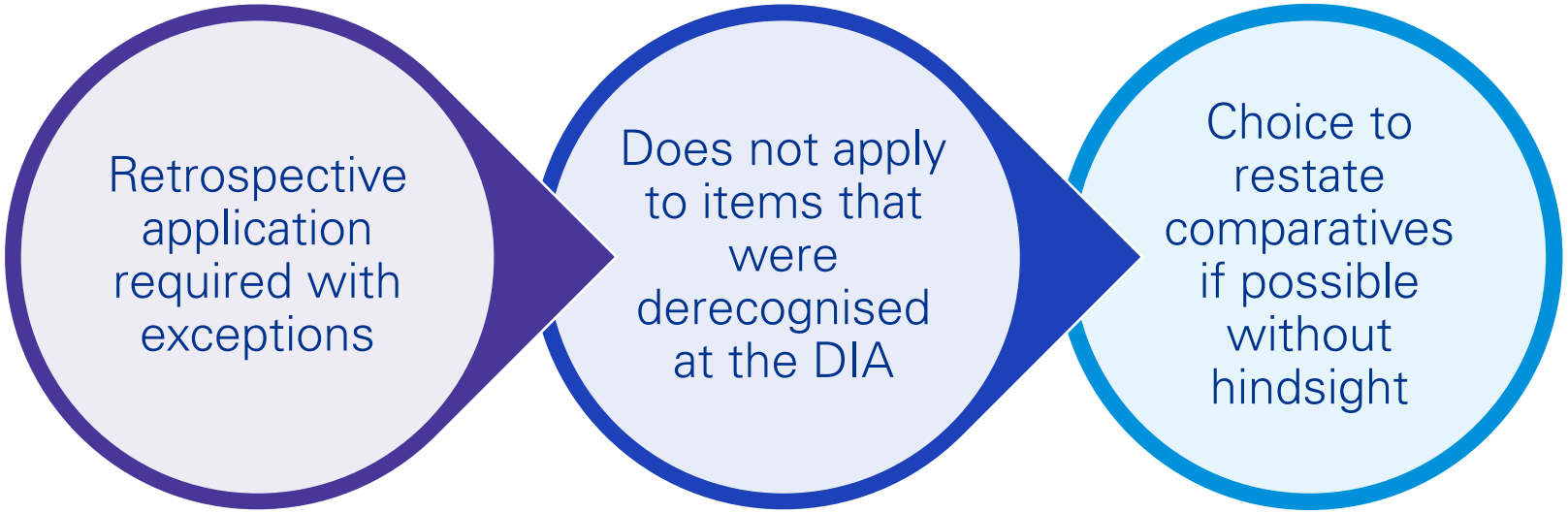
Transition

Principles of transition



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Summary of transitional considerations

1. Assess nature of cash flows for financial assets
2. Identify business models for financial assets
3. Any FVOCI designations for eligible equity investments
4. Assess FVTPL designations

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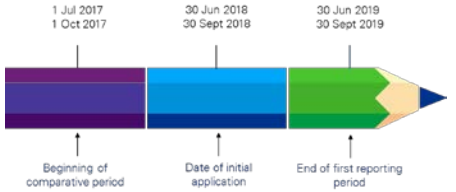
Pertinent dates for transition assessments



At initial recognition

1 July 2017

Date of initial application
1 July 2018

30 June 2019

Prior periods

Comparative period

First year

- SPPI assessment
- Effective interest rate calculation

- Business model assessment
- FVOCI elections for equity investments not held for trading
- FVTPL designations and revocations

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Transition - assessment at initial recognition

For interest-bearing assets

SPPI assessment

- Based on facts and circumstances existing at initial recognition of the financial asset
- Application of available impracticability exceptions would mean more restrictive application of SPPI criterion

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Transition - assessment at DIA

Business model assessment

- Based on facts and circumstances at the DIA
- Not required to consider business models that may have applied in previous periods
- Consider accounting policy in relation to debt factoring and/or securitisation arrangements

FVOCI designations for equity investments

- All equity investments must be fair valued
- May elect to designate equity investments that are not held for trading as FVOCI
- Determine whether an asset is held for trading as if it were acquired on the DIA

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Transition - assessment at DIA

FVTPL designations

- Only if designation eliminates or significantly reduces an accounting mismatch
- Reassess any prior FVTPL designations to ensure compliance with AASB 9 requirements
- Can choose not to continue with any existing FVTPL designations
- Entities can choose to apply to new or previously undesignated instruments where the criteria is met
- Assess whether presenting the effects of changes in a financial liability's credit risk in OCI would create or enlarge an accounting mismatch in P&L as at DIA
- Own use contracts resulting in an accounting mismatch. Must designate all similar contracts

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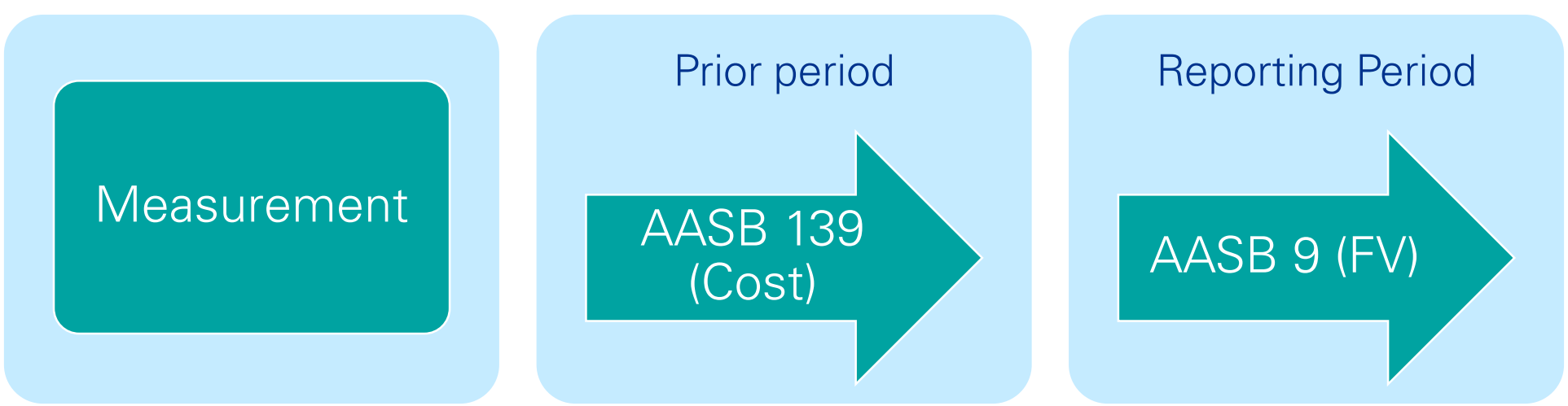
Transition - assessment at DIA

Unquoted equity investments previously at cost



- Difference between the fair value and the previous carrying amount = Adjustment to the opening retained earnings at the DIA.
- No retrospective application permitted.

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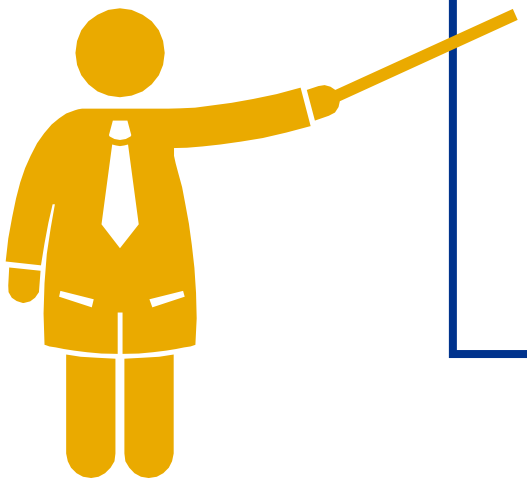
Question



"How would an organisation retrospectively apply the standard given that it is only applicable to instruments that exist at the DIA and it is at this date that the various elections and designations need to be made?"

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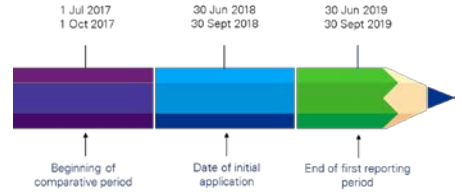
Items already derecognised at date of initial application



Date of initial application

1 July 2017 | 1 July 2018 | 30 June 2019

Prior periods | Comparative period | First year

Equity A: $100 → Impairment loss of $30 → $70 → Further loss of $10 → $60 → $80 Disposal of equity A

Equity B: $80 → $80 → $120 Disposal of equity B, P/L impact of $40

Restating comparatives

Equity A	Transfer $30 from RE to FVOCI reserve	Restate P/L by $10 Adjust FVOCI reserve	No gain or loss on disposal. Recognise $20 gain through OCI
Equity B	No adjustment	Does not exist at DIA	

Not restating comparatives

Equity A		Transfer $40 from RE to FVOCI reserve	No gain or loss on disposal. Recognise $20 gain through OCI

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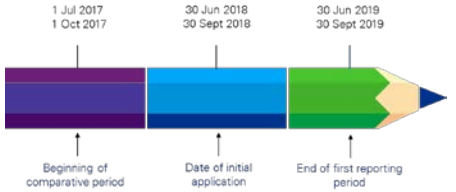
Retrospective application



Example instrument:

8 % interest only loan on a principal of $100.

Classified as:

- AFS under AASB 139, and
- Amortised cost under AASB 9.

30/11/2010
Initial recognition of loan receivable
SPPI assessment

1/7/2017
Start of comparative period

1/7/2018
Date of initial application (DIA)
Business model assessment

Prior periods | Comparative period | First year

Fair value $100

Fair value $103

Amortised cost $100

Fair value $102

Amortised cost $100

Restating comparatives

Restate carrying amount by 3

Recognise provision for impairment

Recognise interest income of 8

Recognise provision for impairment

Not restating comparatives

Decrease carrying amount by 2

Recognise provision for impairment

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Practical expedients (PEs)

Investments in hybrid contracts	If restating comparatives, PE for fair value in comparative year
Financial assets with modified time value	If impracticable to assess at initial recognition, SPPI assessment is made without taking into account specific related exemption
Financial assets with prepayment features	
Retrospective application of EIR method	If impracticable to apply EIR method retrospectively then the fair value at end of comparative period = gross carrying amount

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Impact of change in measurement category

From AASB 139	To AASB 9	Impact
Amortised cost	FVTPL or FVOCI	• Measure FV at DIA.
FVTPL FVOCI	Amortised cost	• Recalculate gross carrying amount by retrospectively applying EIR method. • If impracticable, FV at DIA = new gross carrying amount.
FVTPL	FVOCI	• No change in gross carrying amount. • Retrospectively apply the EIR method. • If impracticable, calculate EIR based on FV at DIA.
FVOCI	FVTPL	• No change at DIA.

Any change in carrying amount recognised in opening retained earnings

Table above assumes comparatives will not be restated.
If you are restating the relevant date becomes start of comparative period, rather than DIA.

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Impairment

Headlines of the new impairment model

Expected loss model means impairment generally recognised for performing assets

Receivables will effectively have an impairment provision booked on initial recognition

Provisions for impairment expected to be larger and more volatile

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Scope

Financial assets (including trade receivables)

- Debt instruments measured at amortised cost or FVOCI

Financial guarantee contracts

- Only those that are in scope of AASB 9 and not measured at FVTPL

Loan commitments

- Even if otherwise outside the scope of AASB 9

Lease receivables

Contract Assets (AASB 15)

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Trade and lease receivables and contract assets

Trade receivables and contract assets **without** a significant financing component

Trade receivables and contract assets **with** a significant financing component

Lease receivables

All other financial instruments in-scope of impairment requirements

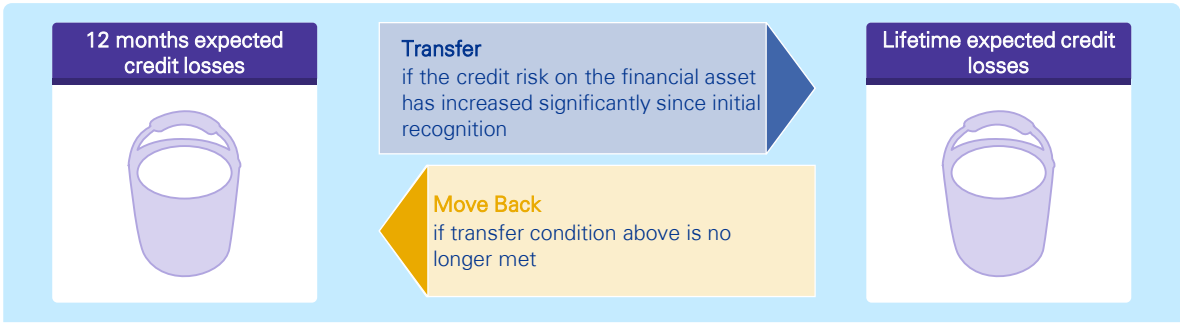
Policy election to apply

Simplified approach

Loss allowance always equal to lifetime expected credit losses

For short-term receivables, both approaches would lead to the same result

General approach



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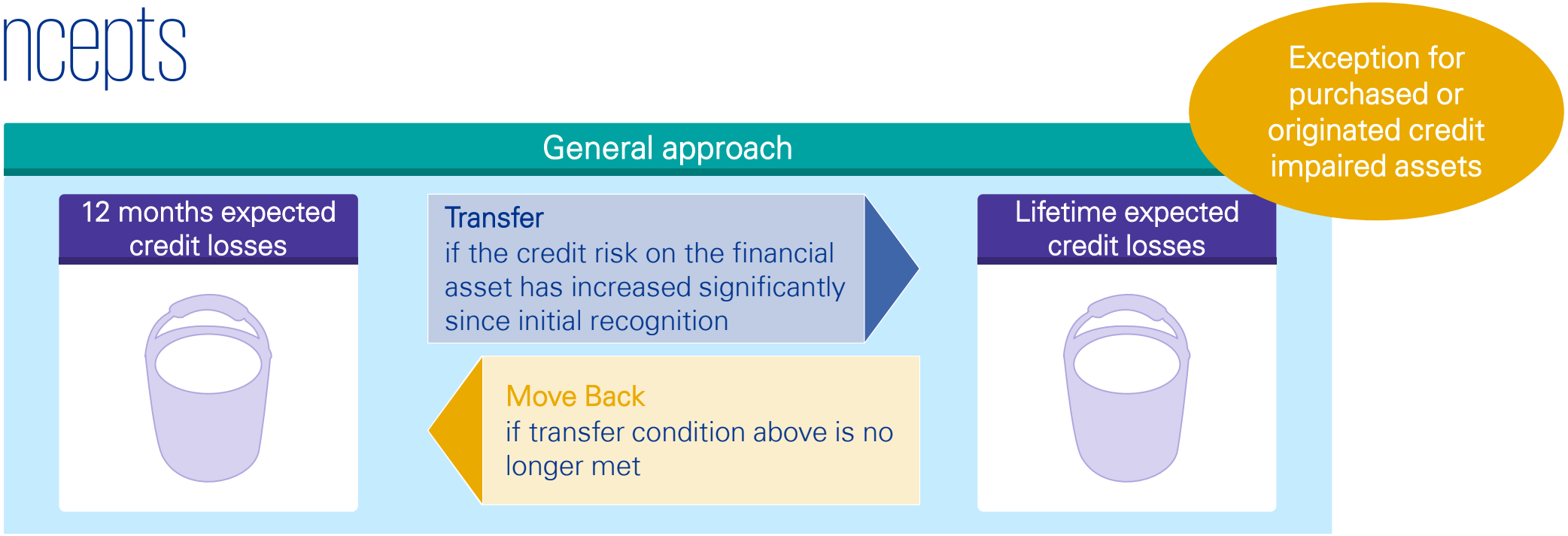
Key concepts



12-month expected loss — The amount an entity expects to lose due to default events that are possible within 12 months of the reporting date.

Lifetime expected loss — The amount an entity expects to lose due to default events that are possible over the life of the financial instrument.

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Implementation issues

Areas of significant judgment

Significant increase in credit risk

- Need to track relative changes in credit risk since initial recognition
- Not defined in the standard however rebuttable presumption that no later than 30 days past due

Measurement of expected losses

- No methodology specified for calculation thus judgement involved
- Must incorporate reasonable and supportable forward looking information
- Specific rules apply to revolving facilities

Default

- Not defined but needs to be consistent with risk management processes
- Rebuttable presumption that no later than 90 days past due

Specialist involvement is often required

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Practical expedient - Provision matrix

Scenario

Manufacturer M operates only in one geographical location, and has a portfolio of short term trade receivables with similar risk characteristics of $30 million on 30 June 201X.

Calculation of impairment using the provision matrix:

	Gross carrying amount (A)	Lifetime expected credit loss rate (B)	Lifetime expected credit loss allowance (A x B)
Current	$15,000,000	0.3%	$45,000
1–30 days past due	$7,500,000	1.6%	$120,000
31–60 days past due	$4,000,000	3.6%	$144,000
61–90 days past due	$2,500,000	6.6%	$165,000
>90 days past due	$1,000,000	10.6%	$106,000
	$30,000,000		**$580,000**

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Transition

Transition

General approach: assess whether there has been a significant increase in credit risk between initial recognition and the DIA

- No = 12-month ECL
- Yes = Lifetime ECL

If unable to determine whether there has been a significant increase in credit risk must book lifetime ECL until the asset is derecognised

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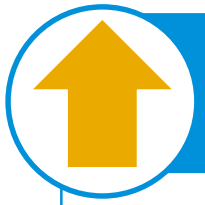
Modifications of terms

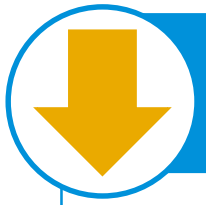
Modification of terms

What is the accounting consequence under AASB 9 when the terms and conditions of a financial asset or liability are modified?



Substantial modification

- De-recognise existing asset or liability
- Recognise new asset or liability and calculate a new effective interest rate
- Recognise any gain or loss in P&L
- Previous costs and fees recognised immediately in P&L



Non-substantial modification

- Re-calculate the gross carrying amount by discounting the modified cash flows using the original effective interest rate
- Recognise any gain or loss in P&L
- Amortise costs and fees over the remaining life

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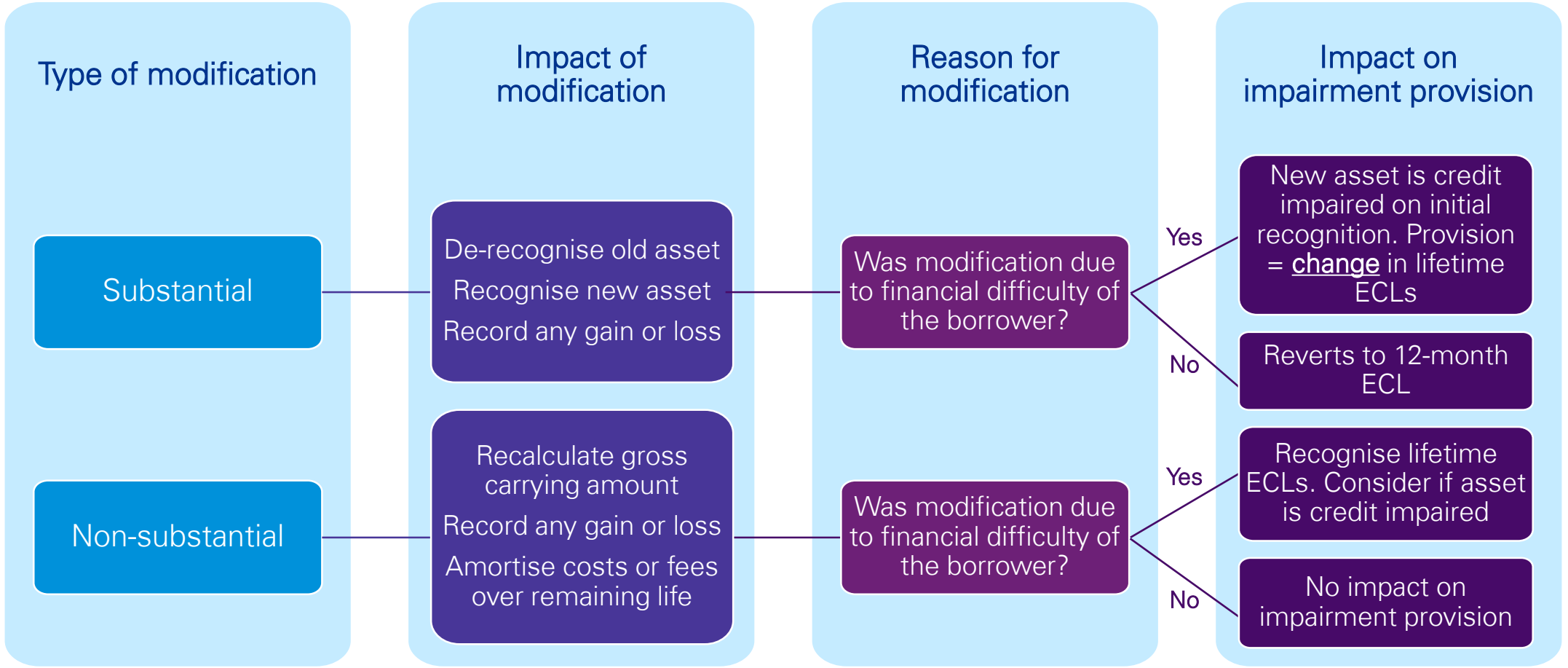
Modification of financial assets: impairment impacts

Modifications have an impact on impairment for amortised cost and FVOCI debt instruments



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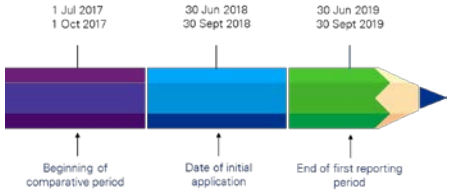
Modification of terms: transition impacts



Currently, no immediate gain or loss under AASB 139 if the modification is not substantial

AASB 9 requires retrospective application

Apply requirements of AASB 9 to prior period modification.
Reflect any gain or loss in opening retained earnings.

1 July 2017

1 July 2018

30 June 2019

Prior periods

Comparative period

First year

Initial recognition of loan payable.

Non-substantial modification. No immediate gain or loss under AASB 139.

Loan still outstanding at date of transition to AASB 9

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Hedge accounting

Key changes in a nutshell

Reducing Volatility

- Aligns hedge accounting with risk management
  - Hedge accounting can be applied to a broader range of hedging objectives
  - More allowable hedged risks and hedging instruments (i.e. aggregated/synthetic exposures)
- Simplified effectiveness testing
  - 80-125% bright line test removed
- Cost of hedging concept introduced
  - Will reduce volatility for entities with options

Documentation is still crucial

Complexity still exists

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Hedge accounting

Entities can make an accounting policy choice to either:

In either case entities must apply the new AASB 7 hedge accounting disclosure requirements

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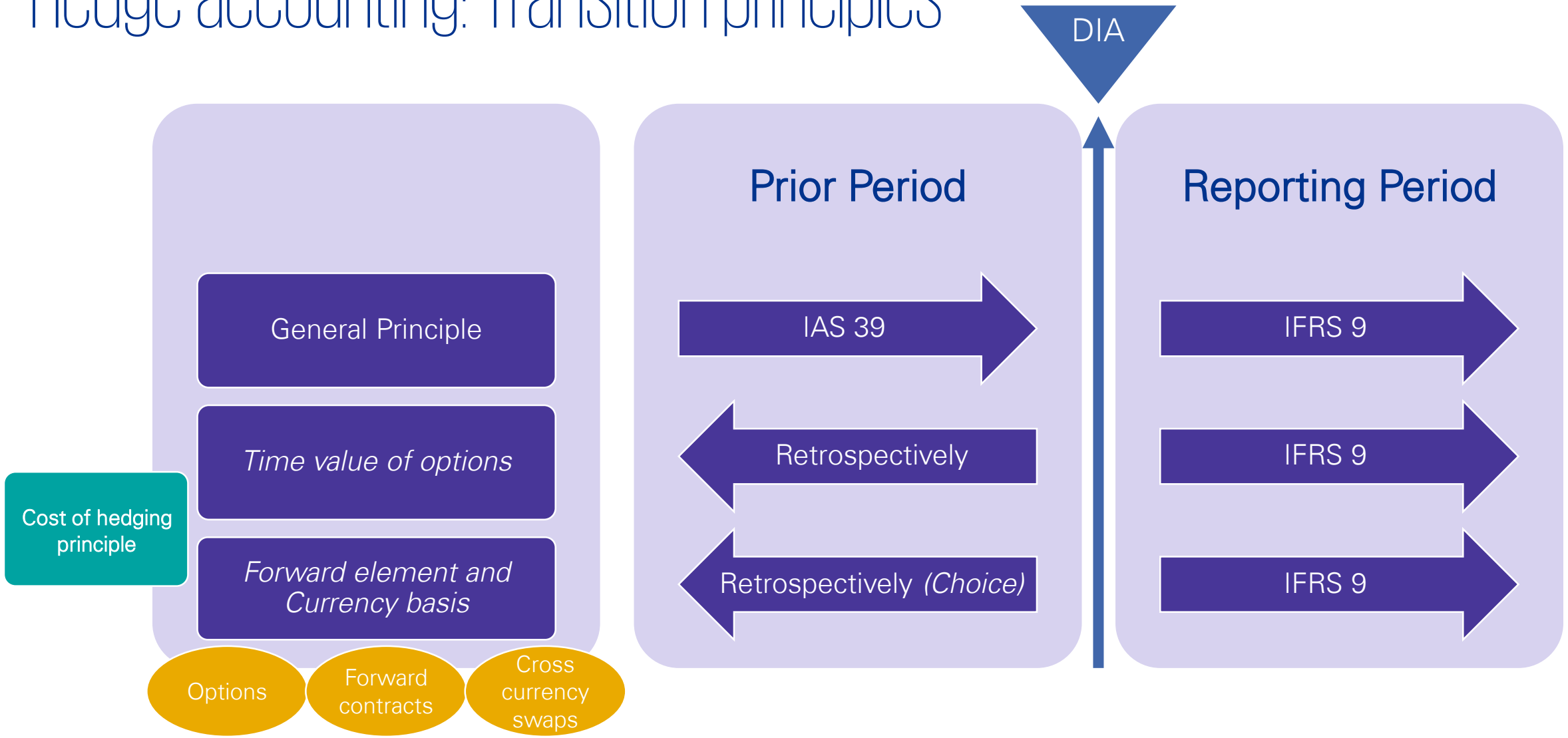
Hedge accounting: Transition principles



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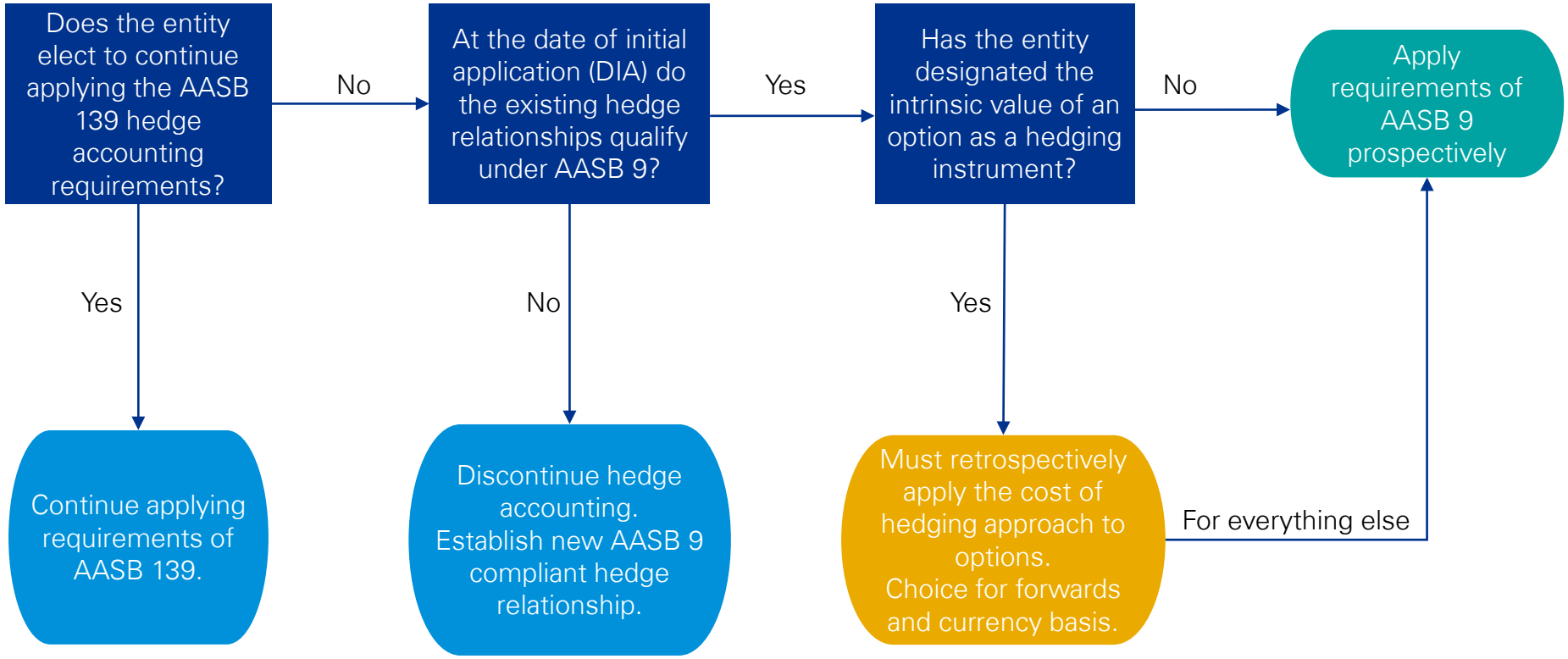
Hedge accounting: Summary Transition decision tree



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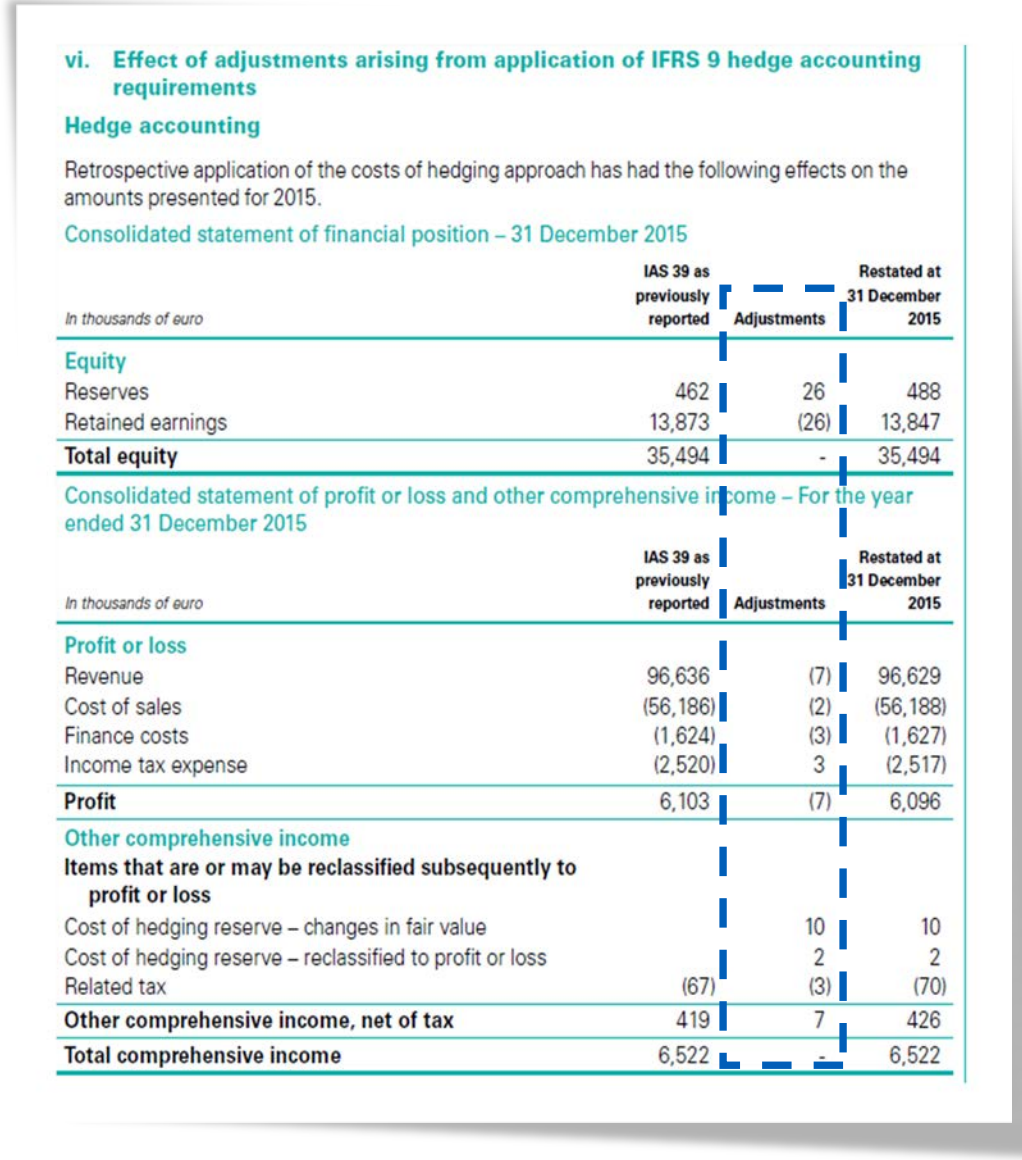
Disclosures

Transitional disclosure - financial statement lines affected



vi. Effect of adjustments arising from application of IFRS 9 hedge accounting requirements

Hedge accounting

Retrospective application of the costs of hedging approach has had the following effects on the amounts presented for 2015.

Consolidated statement of financial position – 31 December 2015

In thousands of euro	IAS 39 as previously reported	Adjustments	Restated at 31 December 2015
Equity			
Reserves	462	26	488
Retained earnings	13,873	(26)	13,847
Total equity	35,494	-	35,494

Consolidated statement of profit or loss and other comprehensive income – For the year ended 31 December 2015

In thousands of euro	IAS 39 as previously reported	Adjustments	Restated at 31 December 2015
Profit or loss			
Revenue	96,636	(7)	96,629
Cost of sales	(56,186)	(2)	(56,188)
Finance costs	(1,624)	(3)	(1,627)
Income tax expense	(2,520)	3	(2,517)
Profit	6,103	(7)	6,096
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss			
Cost of hedging reserve – changes in fair value		10	10
Cost of hedging reserve – reclassified to profit or loss		2	2
Related tax	(67)	(3)	(70)
Other comprehensive income, net of tax	419	7	426
Total comprehensive income	6,522	-	6,522

AASB 7 disclosures amended for AASB 9

AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors

Disclose

Nature of change

Adjustment - each financial statement line (if applicable)

Adjustment - AASB 133 *Earnings per Share*

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Transitional disclosure - classification and measurement

v. Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Group's financial assets and financial liabilities as at 1 January 2016.

In millions of euro	*Note*	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial assets					
Interest rate swaps used for hedging	*24*	Fair value – hedging instrument	Fair value – hedging instrument	131	131
Forward exchange contracts used for hedging	*24*	Fair value – hedging instrument	Fair value – hedging instrument	352	352
Other forward exchange contracts	*24*	Held-for-trading	Mandatorily at FVTPL	89	89
Sovereign debt securities	*24*	Held-for-trading	Mandatorily at FVTPL	591	591
Corporate debt securities	*24, X(v)(a)*	Available-for-sale	FVOCI – debt instrument	373	373
Equity securities	*24, X(v)(b)*	Available-for-sale	FVOCI – equity instrument	511	511
Equity securities	*24, X(v)(c)*	Designated as at FVTPL	Mandatorily at FVTPL	254	254
Trade and other receivables	*17, 24, X(v)(d)*	Loans and receivables	Amortised cost	22,485	22,325
Cash and cash equivalents	*18*	Loans and receivables	Amortised cost	1,850	1,849
Corporate debt securities	*24, X(v)(e)*	Held to maturity	Amortised cost	2,256	2,243
Total financial assets				28,892	28,718

AASB 7 Financial Instruments: Disclosures

Disclose

New category & amount – AASB 9

Original category & amount – AASB 139

Qualitative information – changes in classification

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Transitional disclosure - classification and measurement

v. Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table reconciles the carrying amounts of financial assets under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2016.

In millions of euro	IAS 39 carrying amount 31 December 2015	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2016
Financial assets				
Amortised cost				
Cash and cash equivalents:				
Opening balance: *Loans and receivables*	1,850			
Remeasurement			(1)	
Closing balance				1,849
Trade and other receivables:				
Opening balance: *Loans and receivables*	22,485			
Remeasurement			(160)	
Closing balance				22,325

v. Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

In millions of euro	IAS 39 carrying amount 31 December 2015	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2016
Financial assets				
Available-for-sale				
Opening balance:	884			
To FVOCI – debt		(373)		
To FVOCI – equity		(511)		
Closing balance				

AASB 7 Financial Instruments: Disclosures

Disclose changes, showing separately:

1) Measurement changes

Re-measurement relates to application of new impairment requirements.

2) Category changes

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Transitional disclosure - Impairment

Trade receivables and contract assets (continued)

Movements in the allowance for impairment in respect of trade receivables and contract assets

The movement in the allowance for impairment in respect of trade receivables and contract assets during the year was as follows. Comparative amounts for 2015 represent the allowance account for impairment losses under IAS 39.

	2016	2015	
In thousands of euro		Individual impairments	Collective impairments
Balance at 1 January per IAS 39	54	6	20
Adjustment on initial application of IFRS 9	160		
Balance at 1 January per IFRS 9	214		

AASB 7 Financial Instruments: Disclosures

Disclose reconciliation of provisions

AASB 139 to AASB 9

AASB 137 to AASB 9

I.e. Applicable for entities with financial guarantee contracts or loan commitments

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On-going - Hedge accounting

Cash flow hedges[a, b]

At 31 December 2016, the Group held the following instruments to hedge exposures to changes in foreign currency and interest rates.

	Maturity		
	1–6 months	6–12 months	More than one year
Foreign currency risk			
Forward exchange contracts			
Net exposure (in thousands of euro)	253	63	-
Average EUR:USD forward contract rate	0.91	0.87	0.83
Average EUR:GBP forward contract rate	1.27	1.23	1.20
Average EUR:CHF forward contract rate	0.92	0.91	0.90
Interest rate risk			
Interest rate swaps			
Net exposure (in thousands of euro)	-	41	78
Average fixed interest rate	2.2%	2.4%	2.8%

New disclosures will apply regardless…

AASB 7 Financial Instruments: Disclosures

Disclose

- Timing of notional amount
- Average price or rate of the hedging instrument.

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On-going - Impairment

Trade receivables and contract assets (continued)

Expected credit loss assessment for corporate customers as at 1 January and 31 December 2016 (continued)

The following table provides information about the exposure to credit risk and ECLs for trade receivables and contract assets for corporate customers as at 31 December 2016.

31 December 2016 *In thousands of euro*	Equivalent to external credit rating *[Agency Y]*	Weighted-average loss rate	Gross carrying amount	Impairment loss allowance	Credit-impaired
Grades 1–6: *Low risk*	BBB- to AAA	0.2%	5,576	(11)	No
Grades 7–9: *Fair risk*	BB- to BB+	0.7%	17,823	(125)	No
Grade 10: *Substandard*	B- to B+	3.1%	1,289	(40)	No
Grade 11: *Doubtful*	C to CCC+	7.1%	144	(10)	Yes
Grade 12: *Loss*	D	52.0%	8	(4)	Yes
			24,840	(190)	

31 December 2016 *In thousands of euro*	Gross carrying amount	Weighted-average loss rate	Loss allowance	Credit-impaired
Current (not past due)	6,242	0.3%	(19)	No
1–30 days past due	1,298	2.1%	(27)	No
31–60 days past due	244	18.4%	(45)	No
61–90 days past due	96	38.0%	(36)	No
More than 90 days past due	5	61.0%	(3)	Yes
	7,885		(130)	

AASB 7 Financial Instruments: Disclosures

Disclose

- Exposure to Credit Risk
- Judgments used in determining expected credit loss

AASB 101 Presentation of Financial Statements considerations

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On-going - Classification and measurement

Impact of modification on ECL

Assets with lifetime ECL

- Modify terms
- Concluded not substantial

Assets that *had* lifetime ECL

- Modified terms since initial recognition
- Changed to 12 month ECL during the year

Disclose gain / loss and Amortised Cost before modification

Modified financial assets

The following table provides information on financial assets that were modified while they had a loss allowance measured at an amount equal to lifetime ECL.

In millions of euro	2015
Financial assets modified during the period	
Amortised cost before modification	450
Net modification loss	17
Financial assets modified since initial recognition	
Gross carrying amount at 31 December of financial assets for which loss allowance has changed to 12-month measurement during the period	14

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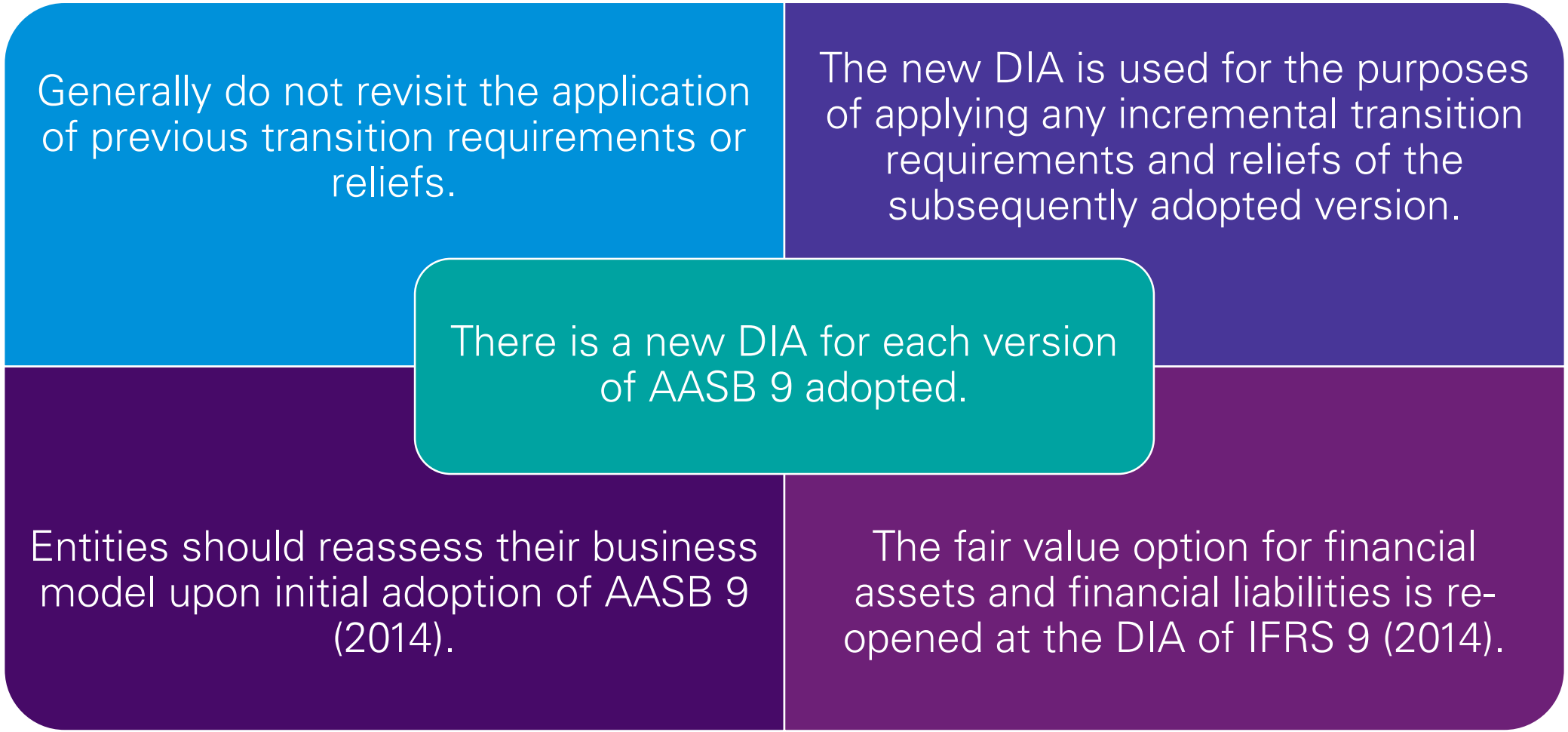
Transitioning from prior versions

Transitioning from prior versions of AASB 9



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Implementation journey

Key challenges

AASB 9 will impact several business areas

- Selection of transition options
- Establish new accounting policies
- Impairment methodology changes
- Increased disclosure requirements

- Manage communication of impact to financial metrics (e.g., KPIs)

- Education of new requirements
- Embed new classification requirements into existing processes

- Consider updating risk management strategies/policies
- Consider new eligible hedged items and accounting for hedging instruments

- Complete and accurate data collection
- Establish new processes and controls

- Loan restructuring / refinancing considerations (substantial / not substantial modification)

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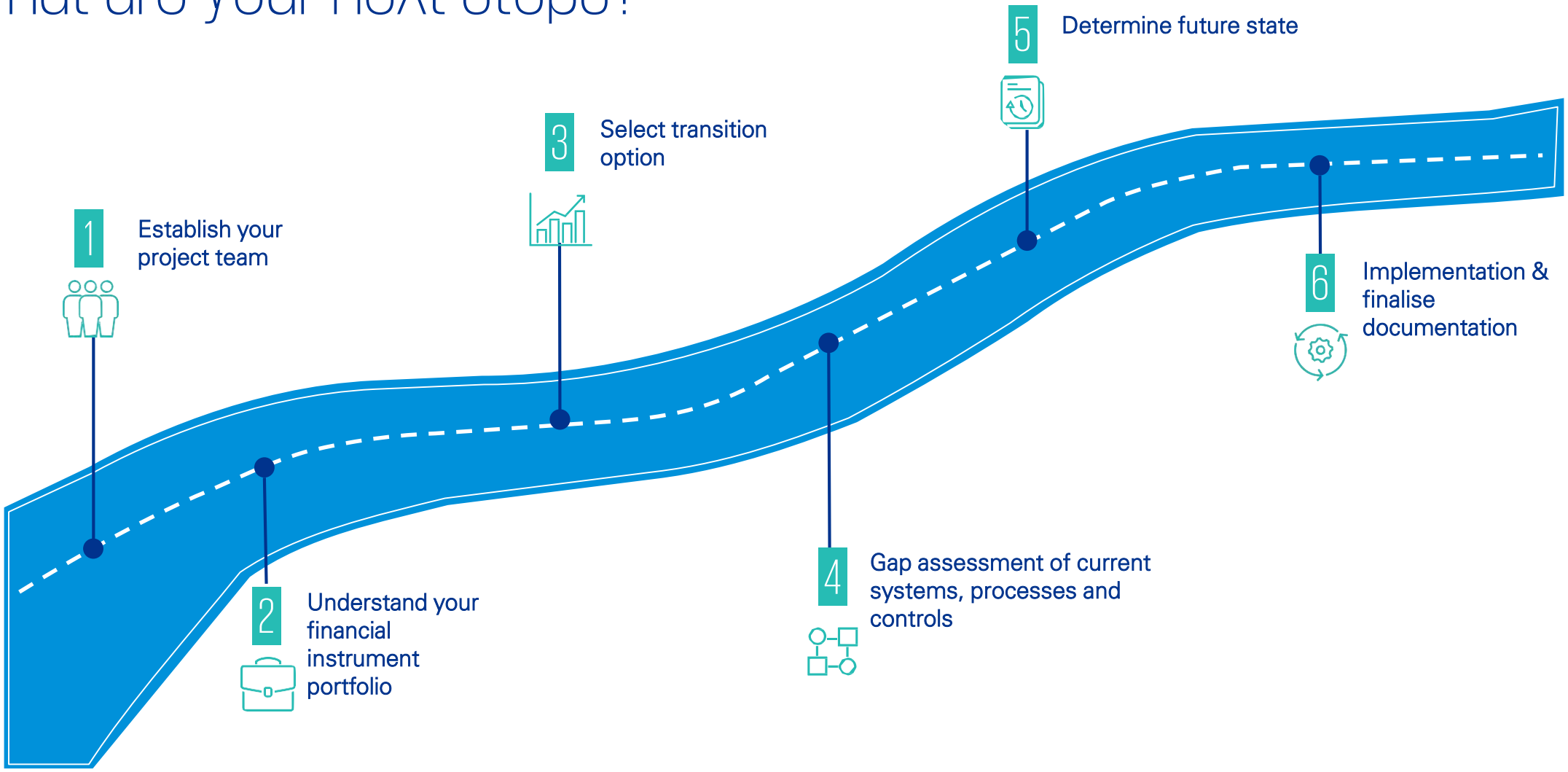
What are your next steps?



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How we can help

Run or support implementation projects

- Full service solution using KPMG global methodologies & tools to assist you with gap analysis, understanding transition options, impact assessment for key financial metrics, analysis of changes required to processes, systems or disclosures, training and overall project management support.

Accounting advice

- Support the finance team with their implementation projects by providing advice over any key judgments and assumptions required under AASB 9.

Transition impact assessment

- KPMG can help you determine the most appropriate transition option by quantifying the impacts to the balance sheet, profit or loss and key reported metrics to assist with communicating the change to key stakeholders.

Treasury systems and hedge accounting

- Perform systems and derivative set up assessments and/or configuration services to ensure the changes to the hedge accounting model are appropriately reflected.
- Aligning treasury/risk management/accounting policies and hedge documentation to reflect AASB 9.

Classification and measurement

- Review existing financial assets/liabilities classifications including business models assessing their classification under AASB 9.
- Perform or review valuations for financial assets/liabilities previously accounted for under amortised cost, now required to be at fair value.

Impairment

- Identify modifications to current impairment processes and controls.
- Support the company to build a framework and methodology to collate data and quantitatively calculate impairment under the new expected losses model.

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Closing

Key takeaways: Broader business impacts

Financial and operational system changes

- Existing systems may not capture required data
- Dual systems for certain transition options
- Transition options
- Debt covenants

Internal control assessment

- Processes re-designed
- New controls vs modify existing controls
- Identify new risk points

Governance and change

- Training (accounting, sales, etc)
- Effect on management compensation metrics
- Impact on forecasting and budgeting processes
- Liquidity strategy

Communication with stakeholders

- Identify relevant stakeholders
- Messaging
- Timing of communication
- Comparability of data communicated
- Credit rating

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Resources from KPMG

Resources

For access to KPMG's insights on evolving accounting practice, including access to our Example Public and Example Bank financial statements go to: http://www.kpmg.com/ifrs

Access previous Accounting & Reporting Webinars: http://www.kpmg.com/au/accountingreporting

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