Sesiones paralelas:

Break-out sessions:

Implementando la NIIF 9 *Instrumentos Financieros*: instituciones no financieras

Implementing IFRS 9 *Financial Instruments*: other than financial institutions

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International Financial Reporting Standards

IFRS 9
Financial Instruments (other than financial institutions)

IFRS Conference

Mexico, October 2014

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

Financial Instruments – a comprehensive new standard

IAS 39

Classification & Measurement
IFRS 9 (2010) + Limited amendments
Final limited amendments July 2014

Impairment
Final July 2014

General Hedge accounting
New requirements published 2013

IFRS 9

International Financial Reporting Standards

Classification and measurement

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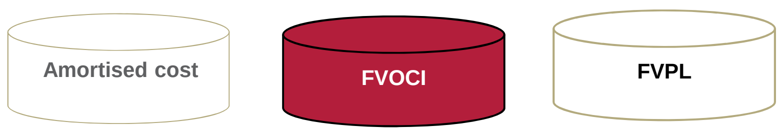
IFRS

C&M – Limited amendments to IFRS 9 (2009)



- Introduces new business model
- Assets managed with the objective of both:
  - Collecting contractual cash flows; and
  - Selling financial assets
- Addresses a business model some felt was missing
- Addresses potential accounting mismatches due to interaction with accounting for insurance contract liabilities

IFRS

The IFRS 9 classification model for assets

	Business model is hold to collect	Business model is hold to collect and sell	Other business models
Cash flows are solely payments of principal and interest (P&I)	Amortised cost	FVOCI NEW	FVPL
Other types of cash flows	FVPL	FVPL	FVPL

*Excludes equity investments. Can elect to present in OCI.

IFRS

Financial liabilities – ‘own credit’

designated under fair value option (FVO)

Financial statements – IFRS 9			
Balance sheet		*P&L*	
Financial liabilities – FVO	Full FV	Gain or loss	all FV Δ except own credit
		OCI	
		Gain or loss	FV Δ due to ‘own credit’*

* Not recycled

The ‘own credit’ requirements can be adopted before the rest of IFRS 9

IFRS

International Financial Reporting Standards

Impairment

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IFRS®

Overview of the finalised model

Change in credit quality since initial recognition

Expected credit losses ('ECL') recognised	12-month ECL	Lifetime ECL	Lifetime ECL
Interest revenue	Gross basis	Gross basis	Net basis
	Stage 1 *Performing*	Stage 2 *Under-performing*	Stage 3 *Non-performing*

IFRS™

The basis for the model

- The yield on financial instruments reflects initial credit loss expectations
- When expected credit losses exceed those initially expected an economic loss is suffered
- This was best reflected in the 2009 ED

Model reflects this in a more cost effective way by:

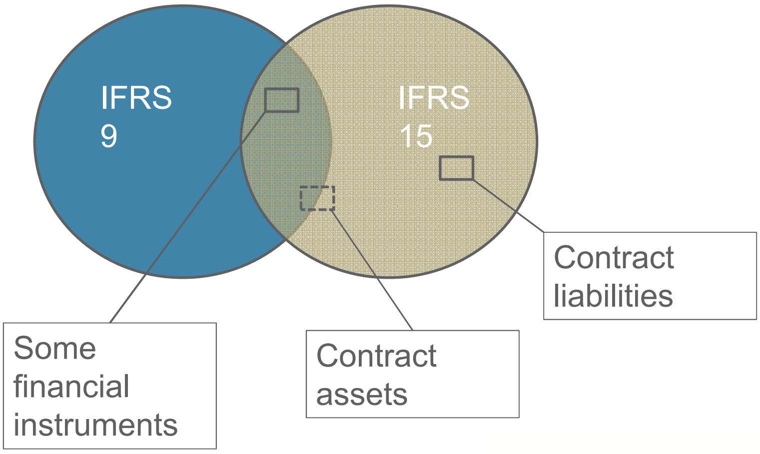
- Recognising a portion of expected credit losses initially
- Recognising lifetime expected credit losses when significant increase in credit risk occurs

Exceptions to the general model

- Simplified approach for trade and lease receivables
  - Measure short-term trade receivables at lifetime expected losses
  - Policy election for trade receivables with significant financing and lease receivables
- Assets credit-impaired on initial recognition
  - Use credit-adjusted effective interest rate
  - Allowance balance represents changes since origination in lifetime losses

Exceptions designed to achieve a better balance between the benefits and costs

IFRS 9 meets IFRS 15



International Financial Reporting Standards

Hedge accounting

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A better link between accounting and risk management

Feedback on IAS 39: *Recognition and Measurement*

- Lack of an overarching principle; complex and rule-based
- Difficult for **preparers** to reflect hedges in financial statements
- Hard for **users** to understand risk management practices

Solutions in IFRS 9: *Financial Instruments*

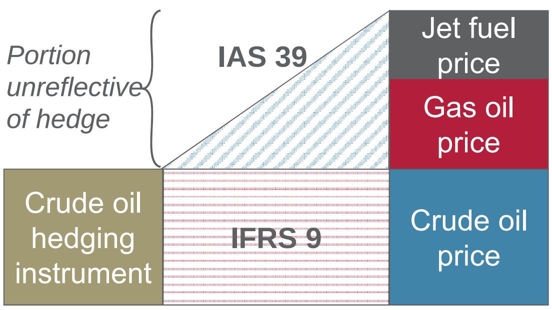
- Align accounting treatment with risk management activity
- Enable **preparers** to better reflect hedging in financial statements
- Provide disclosures to help **users** understand risk management and its impact on the financial statements

Key changes from current accounting

This has been a comprehensive review of hedge accounting

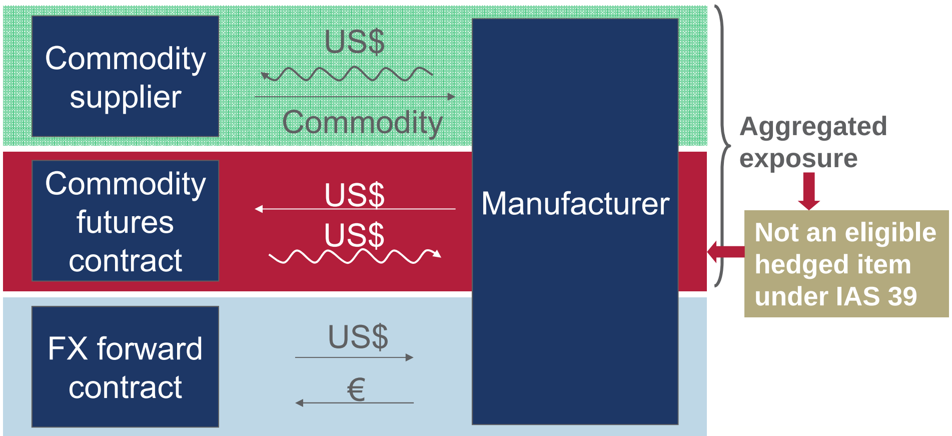
- Links economics of risk management with accounting treatment
- Significantly reduces accounting considerations that affect risk management decisions
- Ability to account for more hedges of non-financial items

Example: Measuring the success of hedging jet fuel contracts with crude oil futures



Superior hedging for 'aggregate exposures'

Example: hedging commodity price & FX risk



Other core improvements

Hedge effectiveness testing

1. Economic relationship
2. Effect of credit risk
3. Hedge ratio

Costs of hedging

Improves the transparency around some hedging instruments:
- time value of options
- forward element of foreign currency
- basis risk for hedges of foreign exchange risk

Disclosures

To understand risks being hedged; how those risks are managed; and the effect of hedging those risks on the financial statements.

Project doesn't address macro hedging

Even if apply IFRS 9 can still use specific portfolio hedge accounting requirements in IAS 39

For now entities can choose to keep using IAS 39

IAS 39 hedge accounting

Accounting policy choice

IFRS 9 hedge accounting

Some banks may not make any changes to their hedge accounting at this time

- The IASB is working on a project to consider accounting for macro hedges (Discussion Paper published)

IFRS™

International Financial Reporting Standards

Conclusion

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IFRS™

When will IFRS 9 be effective?

Annual periods beginning on or after 1 January 2018

- A mandatory effective date consistent with stakeholder requests (a 3-year lead time)
- Entities permitted to early apply the completed (whole) version of IFRS 9
- Previous versions of IFRS 9 phased out:
  - Not permitted to early apply a previous version if date of initial application is more than 6 months after completed IFRS 9 is issued
- 'Own credit' requirements have been available for early application, in isolation, since the publication of IFRS 9 (2013)

Convergence with the FASB

The lack of convergence has been disappointing for all of us.

Strong attempts have been made, but the starting points were already different.

We developed limited amendments to the existing IFRS 9 C&M model, whereas for the FASB it was an entirely new model

Multiple attempts to converge on various impairment models

Hedge accounting has been an IASB-only project

Questions and comments

Implementing IFRS 9
Financial Instruments:
other than financial institutions

Raúl González Lima
October 7, 2014

IASB's response to the global financial crisis

- **Classification and remeasurement**: a single classification approach driven by cash flow characteristics and how it's managed
- **Impairment**: a forward-looking "expected loss" model
- **Hedge accounting**: a model that better aligns accounting with risk management

When?

- **Annual periods beginning on January 1, 2018**
- 2018, 2017 and 2016 (retrospective with certain exceptions)
- A stakeholders request
- Early application allowed for the **whole** version of IFRS 9

IFRS 9 Classification model for assets

Each financial asset is classified into one of the three main classifications categories:

- **Amortized cost**
- **Fair value through other comprehensive income** (FVTOCI)
- **Fair value through profit or loss** (FVTPL)

IFRS 9 Classification model for assets (excludes equity investments)

	Business model is hold to collect	Business model is hold to collect and sell	Other business models
Cash flows are solely payments of principal and interest	**Amortized cost**	**FVTOCI**	**FVTPL**
Other types of cash flows	**FVTPL**	**FVTPL**	**FVTPL**

FVTOCI

- New business model
- Assets managed with the objective of both:

(i) collecting contractual cash flows; **and**

(ii) selling financial assets

Impairment
Key changes from current accounting

- A responsive, forward-looking expected credit loss ("ECL") model
- Meets the calls of the G20 and others
- Responds to delayed recognition concerns and provides timely information about ECL
- Single model reduces the complexity of multiple approaches in IAS 39
- Robust disclosures to understand changes in ECL and credit risk

Forward-looking expected credit loss model

A responsive, forward-looking expected credit loss model	As information emerges over time – entity is able to distinguish credit quality of loans
Stage 1	Origination of a portfolio of loans
Stage 2	Entity observes deteriorating economic conditions
Stage 3	More information enables entity to identify specific deteriorated loans

Hedge accounting

Feedback on IAS 39	Solutions in IFRS 39
• Lack of an overarching principle; complex and rule-based	• Align accounting treatment with risk management activity
• Inability for preparers to reflect hedges in financial statements	• Enable preparers to better reflect hedging in financial statements
• Hard for users to understand risk management practices	• Provide disclosures to help users understand risk management and its impact on the financial statements

Classification and measurement: Impact to processes and systems

- Define business models for various portfolios (e.g. current and non-current)
- Evaluation of solely payments of principal and interest
- Changes in the chart of accounts including remapping of the new reclassification requirements

Classification and measurement: Impact to financial statements

- New presentation and disclosure requirements
- No recycling of gains or losses upon disposal for equity instruments classified as fair value through OCI
- Retrospective aplication of IFRS 9 with certain exceptions

Classification and measurement: Assurance considerations

- Adequacy of documentation of business model
- Assessment of changes in business model
- Assessment of frequency of sales to evaluate the business model test
- Evaluation of cash flows to fulfil the solely payments of principal and interest and availability of data

Impairment:
Implementation challenges

Components	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
Maturity	• Contractual term vs behavioral • Consideration of prepayment and others
Expected loss modeling	• Determination of models for 12 months and lifetime expected loss • Discount rate
Forward-looking data	• Economic overlay

Impairment:
Assurance considerations

	Technical analysis and interpretation	
Corporate governance	Modelling assumptions /inputs, validation and outputs	Controls considerations
	Disclosures	
	Lack of comparability / benchmarks	
	Views of regulators	

Hedge accounting:
Impact to processes and systems

- Linking hedge accounting with risk management
- Develop a process to rebalance and determine the frequency
- Additional need for information due to new diclosure requirements
- Voluntary de-designation is not permitted

Hedge accounting:
Impact to financial statements

- Reduced volatility in profit and loss due to treatment of time value of purchased options
- Reduced inefectiveness due to separation of risk components in case of non-financial items
- Reduced volatility in profit and loss as swap differential and FX basis risk is considered as costs of hedging

Hedge accounting:
Assurance considerations

- Assessing the effectiveness of the hedge without the bright line of 80% to 125%
- Validating market data for hedge effectiveness testing including rebalancing and basis risk
- Identifying risk components that are separately identifiable and reliably measurable if no specific criteria explicitly stated in the contract
- Controls and governance over availability of data to comply with additional disclosure requirements regarding an entity's risk management and hedging activities

Other Implementation Considerations

- Preliminary understanding and advice
- Adoption and reporting dates
- Options and exceptions
- Training
- Differences with current IFRS (analysis, calculation and assessment)
- Accounting policies to be amended / adopted
- Preparation of financial statements

Training on IFRS 9

- **Comprehensive understanding**: preparers, controllers, financing, investment, treasury, finance planning and CFOs
- **Basic understanding**: tax, other accountants, investor relations, information technology and legal

IFRS 9

Financial Instruments
(Non-Financial Institutions Experiences)

Mexico City, October 2014

Building a better working world

The views expressed in this presentation are those of the presenter, not necessarily those of EY

IFRS 9 – Financial Instruments

- New standard that replaces current IAS 39.
- Deals with:
  - Classification & Measurement.
  - Impairment
  - General Hedge Accounting.
- Adoption:
  - In 2009 covered Classification and measurement of financial assets.
  - In 2010 incorporated new requirements on accounting for financial liabilities and carried over requirements for derecognition.
  - Mandatory effective date change from 2013 to 2015 and modified the relief from restating comparative periods and the associated disclosures in IFRS 7.
  - In 2013 issued the General Hedge Accounting model, early adoption of the requirement to present FV changes due to own credit on liabilities designated as at FVTPL to be presented in OCI. Removed the 2015 effective date.
  - July 2014, completed standard; introduces the new expected loss impairment model; limited changes to the classification and measurement requirements for financial assets. Effective on January 1, 2018, early adoption permitted.

IFRS 9 – Financial Instruments: Main Changes

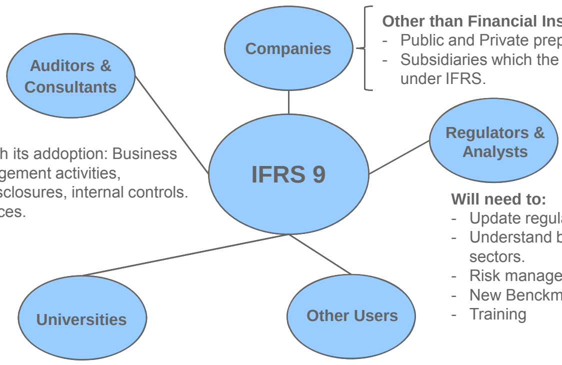
- IFRS 9 does not change substantially the definitions and main terms that apply to financial instruments contained in IAS 32, *Financial Instruments: Presentation* and the scope of financial instruments that fall within IAS 32, IAS 39 and IFRS 7.
  - Some concepts remain complex to understand.
  - Several transactions are scope out but not the resulting financial assets or liabilities.

But…

- Introduces/Changes:
  - Business Model
  - Fair value through other comprehensive income for financial assets
  - Expected credit loss model vs Incurred credit loss model.
  - Embedded derivatives bifurcation
  - Own credit on liabilities designated at FVTPL presented in OCI
  - Effectiveness test ?
  - Other…

IFRS 9 – Financial Instruments: Impact Overview

- Implementation of IFRS 9 is impacting different entities…



Other than Financial Institutions:
- Public and Private preparing under IFRS
- Subsidiaries which the parent prepares under IFRS.

Will need to: (Auditors & Consultants)
- Review/Assist with its addoption: Business model, risk management activities, measurement, disclosures, internal controls.
- Share best practices.
- Training.

Will need to:
- Update regulation.
- Understand business models in different sectors.
- Risk management in different countries.
- New Benckmarks and KPIs?
- Training

Will need to:
- Link learning with new practices in business.
- Training.

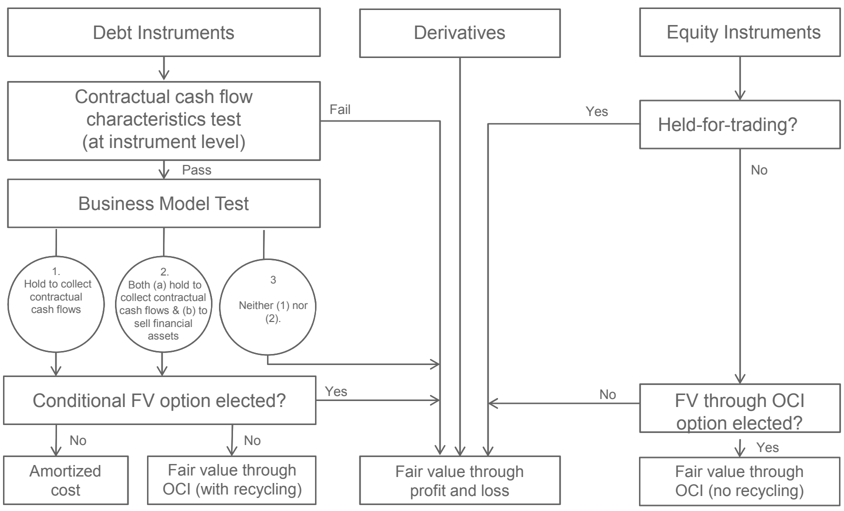
Will need to:
- Understand business model and new accounting policies.
- Risk management
- Etc.

IFRS 9 – Financial Instruments: Financial Assets Impact

- Implementation of IFRS 9 will require to the Companies to:
  - Evaluating its business model used in financial assets
    - May appear different models in group of entities (consolidating entities):
      - Aggregation
      - Documentation of judgment applied
  - Documentation of the business model test
    - Need to be involved the key management personnel
    - Collecting contractual cash flows and realize it upon maturity vs selling the financial asset.
  - Documentation of the cash flow characteristics test
    - Solely payments of principal and interest on the principal amount?

- Other impacts:
  - Discussion with stakeholders meaning of new concepts of FVTOCI and its impact in equity.
  - Review its accounting policies and disclosures.
  - Assess internal controls in different areas such as legal, treasury, accounting, taxes, etc.
  - Changes in systems and general ledger

IFRS 9 – Financial Instruments: Financial Assets Accounting



IFRS 9 – Financial Instruments: Embedded Derivatives

- Embedded derivatives:
  - Included in hybrid contracts that also includes a non-derivative host.
  - The cash flows of the combined instrument vary in a way similar to a stand-alone derivative.
- The embedded derivative concept in IAS 39 was carried over in IAS 39 to apply only to host contracts that are not financial assets within the scope of IFRS 9.
- Consequently, embedded derivatives that under IAS 39 would have been bifurcated and accounted for at FVTPL, because they were not closely related to the host financial asset will no longer be bifurcated.
- Instead, the contractual cash flows of the financial asset are assessed in their entirety and the asset as a whole is measured at FVTPL when the contractual cash flow characteristics does not pass the test

Companies will need to reassess contracts with embedded derivatives and its accounting (i.e. leasing contracts, insurance contracts, contracts for the purchase or sale of a non-financial item).

IFRS 9 – Financial Instruments: Financial Liabilities

- Implementation of IFRS 9 does not change the basic model for measuring the Financial Liabilities included in IAS 39. Categories remain as follows:
  - Held for trading -> FVTPL
  - All other -> Amortized Cost
- However, IFRS 9 contains an option to designate a financial liability as measured at FVTPL if it meets certain requirements.
- When a financial liability contains and embedded derivative that modifies the cash flows of the liability and it is not clearly closely related, the financial liability may be designated as measured at FVTPL.
- Gain or losses on financial liabilities designated as at FVTPL need to be split into the amount of change in FV attributable to changes in credit risk of the liability in order for it be presented in OCI, and the remaining amount in P&L.

IFRS 9 – Financial Instruments: Hedge Accounting - Risk Management

- The new hedge accounting model aims to provide a better link between the entity's risk management strategy, the rationale for hedging and the impact of hedging on the financial statements.
- One of the key challenges is to differentiate between the risk management strategy and the risk management objective. This is critical for assessing whether to continue applying hedge accounting for a particular hedging relationship is appropriated.
  - The *risk management strategy* is established at the highest level of an entity and identifies the risks to which the entity is exposed and whether and how the risk management activities should address those risks.
  - The *risk management objective*, on contrary, is set at the level of an individual hedging relationship and defines how a particular hedging instrument is designated to hedge a particular hedged item.

Small and medium-sized entities with limited risk management activities that use financial instruments may not have formal written document outlining their overall risk management strategy in place. Those entities will need to incorporate the risk management strategy in their hedge documentation directly.

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IFRS 9 – Financial Instruments: Hedge Accounting

- Expands the range of eligible hedged items by including aggregated exposures. This expansion, however, comes with some necessary complexity in the accounting for that type of hedge designation.
- IFRS 9 now permits an entity to designate a risk component of a non-financial item in a hedging relationship, provided the risk component is separately identifiable and reliably measurable.
- Uses a new approach to the effectiveness assessment that is only prospective, does not involve any bright lines and, depending on the circumstances, may be qualitative.
  - Required on an ongoing basis, as a minimum at each reporting date.
- Rebalancing under IFRS 9 allows entities to refine their hedge ratio without discontinuing the hedging relationship.
  - Operationally more complex than adjusting the hedging instrument because of the need to track the history of different quantities that were designated during the term of the hedging relationship.
- New qualitative disclosures over the description of the risk management strategy of the entity when hedge accounting is applied.

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IFRS 9 – Financial Instruments: Impairment

- Impairment model in IFRS 9 is based on the premise of providing for expected losses rather than on incurred losses.
- Linkage with IFRS 15 - > No financial transactions.
- Need to monitor credit risk changes during the life of a financial instrument.
  - Collect market data.
  - Compile detailed historical to measure the performance of the asset and monitoring for non performing. Document on an individual basis / groups or portions of portfolios.
- Estimate the risk of default occurring on the financial instrument during its expected life.
  - Companies need to incorporate reasonable and supportable information at the reporting date.
- Need to reflect the time value using the effective interest rate of the asset.
- Relief for short term trade receivables that **do not** constitute a finance transactions (i.e. retail, car dealers, construction, etc.).

➡ Companies are reviewing the implication of recording interest on a net basis vs. gross basis. Reviewing impact in budgets and impacts in coventants

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IFRS 9 vs. Mexican FRS

- Mexican Financial Reporting Standards (FRS) are in process of being developed to converge.
  - Guidance on financial instruments are included in several Mexican FRS
- Differences identified between IFRS 9 and Mexican FRS are:
  - Option to measure at FVTOCI the Equity Instruments not held for trading
    - Mexican FRS requires these equity investments to be measure at cost.
  - Reclassification of financial assets is done on the first day of the first reporting period following the change in business model.
    - Mexican FRS considers that it is appropriate to have evidence. Public companies may require to change in the following quarter; non-public the following reporting year.
  - Option to use transaction date and settlement date to recognize financial instruments.
    - Mexican FRS considers only transaction date.

➡ Other differences are being analyzed, the convergence requires a substantial change in the Mexican FRS framework such as the definition of Fair Value.

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