

A dramatic landscape photograph of a sunset or sunrise over the ocean. The sky is filled with dark, heavy clouds, but bright sunlight is breaking through, creating a series of golden rays that fan out across the scene. The sun is positioned low on the horizon, just above the dark blue water of the sea. The overall mood is one of hope and clarity.

BFRS 9 Financial Instruments – Overview and Key Changes from Current Standard and Requirements

28 April 2016














Why is BFRS 9 Important?






- ❑ BFRS 9 will impact all entities, but especially banks, insurers and other financial companies.
- ❑ The impact will vary between industries and entities.
- ❑ Your clients and targets will want to talk about the impact on their businesses.

Overview of BFRS 9



Topic	BFRS 9	Impact	
		Financial sector 	Other corporates 
Recognition and derecognition	BAS 39 model		
Classification and measurement	New model		 
Expected credit losses (Impairment)	New model		 
Hedge accounting	Amended model		 

Legend:

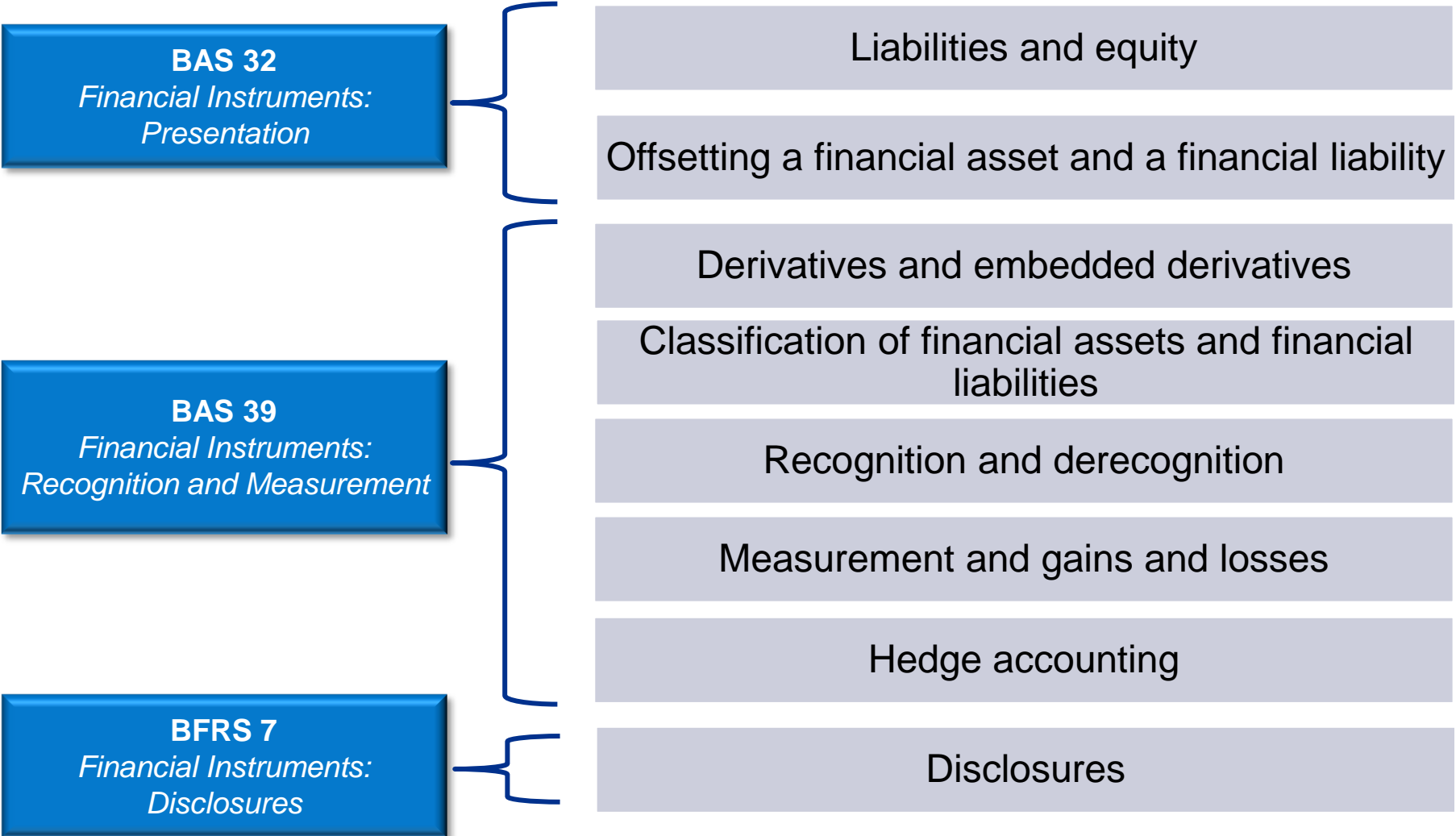
-  Low impact
-  Medium impact
-  High impact

Contents

- ❑ **Financial Instrument Standards**
- ❑ **Basics of Financial Instruments**
- ❑ **Classification and Measurement**
- ❑ **Impairment**
- ❑ **Hedge Accounting**
- ❑ **Disclosures**
- ❑ **Business Impacts, Next Steps**
- ❑ **Key Points to Remember**

Financial Instrument Standards

Overview of currently effective financial instruments standards



Background of the existing standard

BAS 39 Financial Instruments: Measurement & Recognition

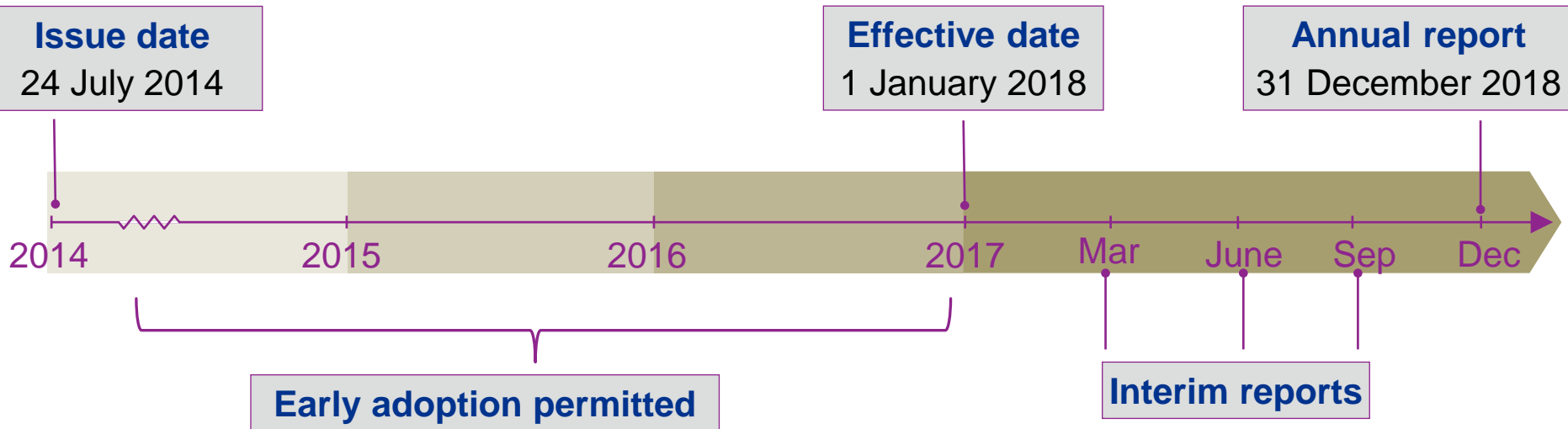
- ❑ IAS 39 which covers measurement and recognition aspects of Financial Instruments *was initially issued by the International Accounting Standards Committee (IASC) in March 1999. In November 2000 IASC issued five limited revisions to IAS 39.*
- ❑ In December 2003 the International Accounting Standard Board (IASB) issued a revised IAS 39, accompanied by Implementation Guidance.
- ❑ Since 2003, the IASB has issued a number of amendments to IAS 39. Different amendments is effective from different dates.
- ❑ IAS 39 was first effective from periods beginning on or after 1 January 2005 (IAS 39 revised in 2004).
- ❑ European Union (EU) has adopted a slightly different version of IAS 39.
- ❑ Bangladesh has adopted the original version of IAS 39 with no modification as BAS 39 which is effective from 1 January 2010.

Background of the new standard

BFRS 9 Financial Instruments

- ❑ IFRS 9 which covers recognition and derecognition, classification, measurement, impairment and hedge accounting related aspects of Financial Instruments was issued on three main phases by the International Accounting Standards Board (IASB):
 - In November 2009 IASB issued chapters related to classification and measurement
 - In November 2013 IASB added the requirements related to hedge accounting
 - In July 2014 IASB added the impairment requirements to IFRS 9
- ❑ IFRS 9 is first effective from periods beginning on or after 1 January 2018 and will replace IAS 39.
- ❑ Bangladesh has adopted the original version of IFRS 9 with no modification as BFRS 9 which is effective from 1 January 2018.

Effective Date



- Entities that initially apply a previous version of BFRS 9 by 31 January 2015 can continue to apply that version until 1 January 2018.
- Permitted to early adopt 'own credit' requirements in isolation.
- Financial instruments that are outside the scope of BFRS 9 is referred to in Appendix.

Complex Transition Provisions

- ❑ Classification and measurement and expected credit losses – retrospective application with some exemptions.
- ❑ Hedge accounting – generally prospective application.
- ❑ Restatement of prior periods not required (permitted only if information is available without the use of hindsight), except for some aspects of hedge accounting.
- ❑ Entities can choose to adopt BFRS 9 but continue hedge accounting under BAS 39 until completion of the macro hedging project.

Basics of Financial Instruments

Financial instruments (FI)

A **financial instrument** is a contract that gives rise to both:

a **financial asset**
of one entity

&

a **financial liability**
or **equity**
instrument of
another entity



Financial assets



A **financial asset** is any asset that is:

Cash

Equity
instrument of
another entity

Contractual right to receive
cash or another financial asset
or to exchange financial assets
or financial liabilities under
potentially favourable
conditions

Certain
contracts
settled in the
entity's own
equity

Financial liability



A **financial liability** is a liability that is:

Contractual obligation to deliver cash or another financial asset or to exchange instruments under potentially unfavourable conditions

Certain contracts settled in the entity's own equity

Equity instrument



An **equity instrument** is any

Contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities

Derivative

A **derivative** is a financial instruments with all three of the following characteristics:

Fair value changes in response to changes in one or more underlying variables

No or little initial net investment

Settled at a future date

Instruments with a non-financial underlying variable that is specific to a party to the contract are NOT derivatives

Derivative financial instruments are settled normally net basis, i.e., only net gain or loss as result of derivative financial instruments are settled

Examples

Examples of Traditional FI

Equity Share

Cash

Loans

Trade receivable

Trade payables

Treasury bill / bond

Bond issued

Finance lease liabilities

Financial guarantees

Examples of Derivative FI

Forward exchange contract

Interest rate swap

Commodity option

Purchased or written stock call or
put option

Classification and Measurement

Main Changes in Financial assets – Classification and Measurement



Financial asset measurement categories

- Measurement bases: Amortised Cost, FVOCI* and FVTPL* remain.
- However, criteria for classifying assets as Amortised Cost, FVOCI and FVTPL have been significantly changed.
- Derivatives embedded in a financial asset are not separated – the whole asset is assessed for classification.

Reclassification of financial assets is subject to strict conditions and expected to be very infrequent.

Financial sector		
Other Corporates		

* FVOCI – fair value through other comprehensive income / FVTPL – fair value through profit or loss

Classification of financial assets

Under BFRS 9 the classification of financial assets will be based on the measurement basis.

Categories as per BAS 39

Financial assets at fair value through profit or loss (FVTPL)

Loans and receivables (L&R)

Held to maturity (HTM)

Available for sale (AFS)

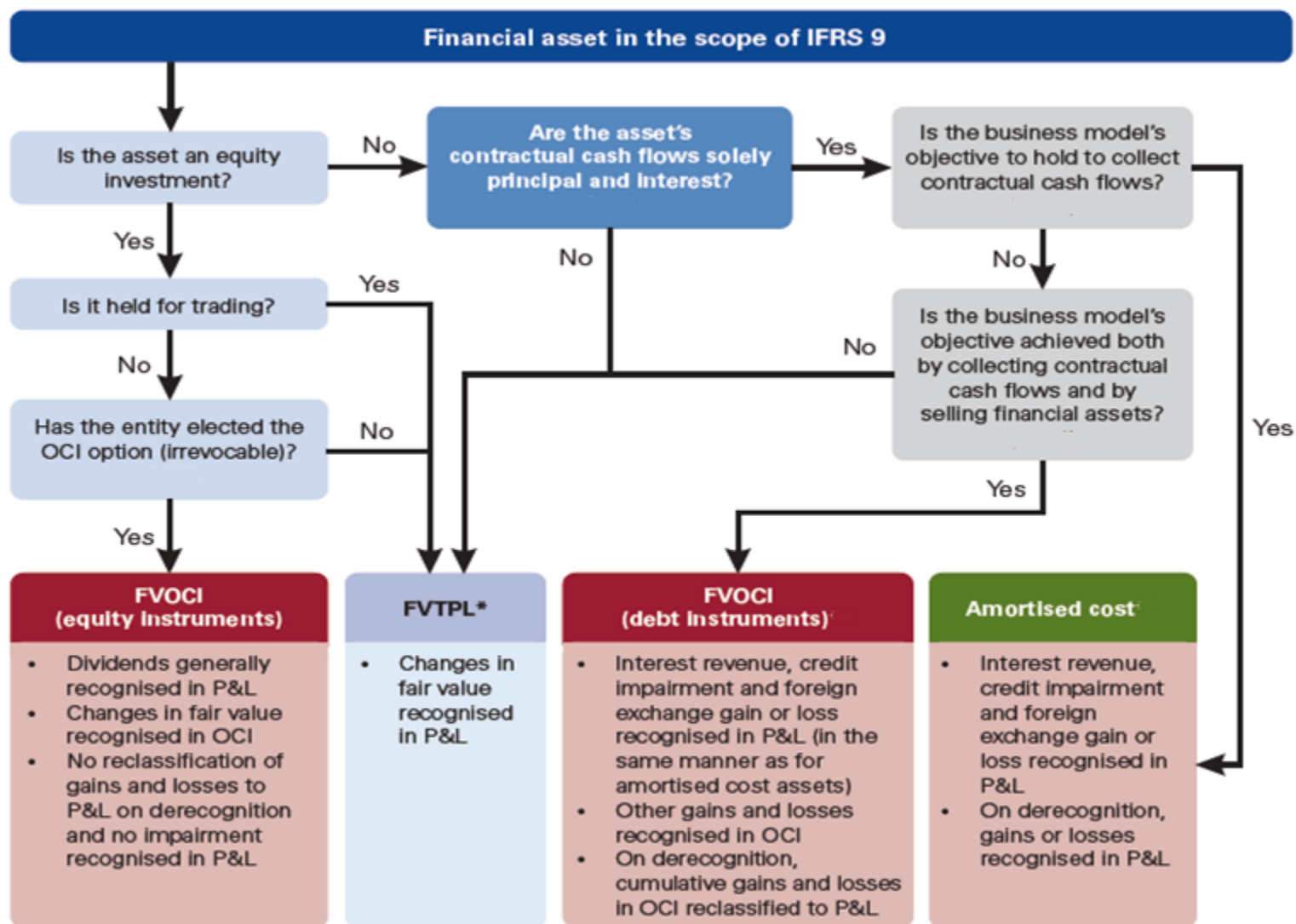
Categories as per BFRS 9

Financial assets at fair value through profit or loss (FVTPL)

Amortised Cost

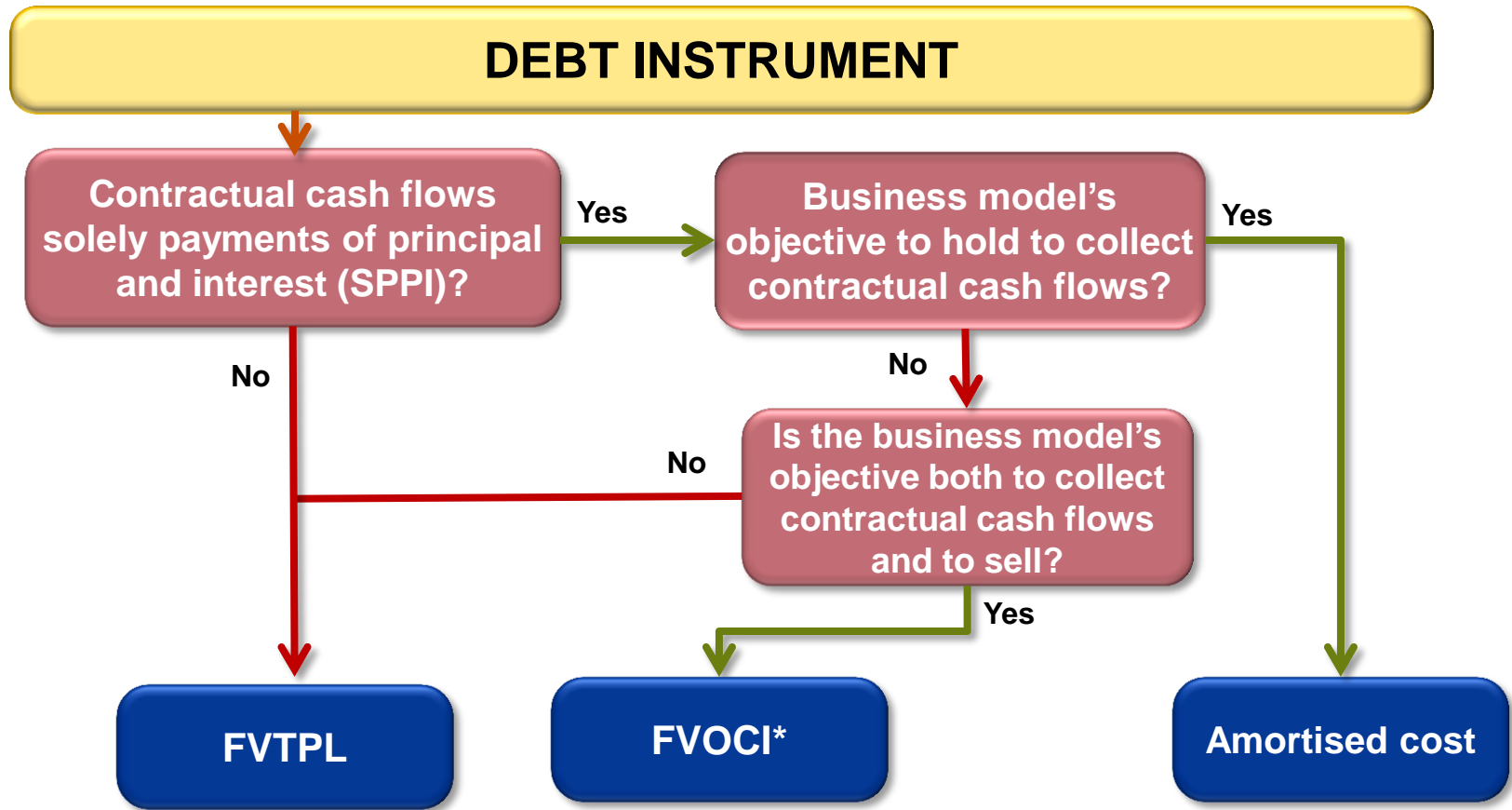
Fair Value through Other Comprehensive Income (FVOCI)

Classification of financial assets – BFRS 9



Classification of financial assets – BFRS 9

Debt Instruments



Financial sector		
Other Corporates		

* Subject to FVTPL designation option - if it reduces accounting mismatch

The Solely Payments of Principal and Interest (SPPI) Criterion – BFRS 9

Do the cash flows consist only of principal and interest?

Consistent with a basic lending arrangement.

BFRS 9 defines:

Principal	Fair value of the financial asset on initial recognition.
Interest	Consideration for time value of money, credit risk, other basic lending risks (such as liquidity risk); other associated costs (such as administrative costs); and a profit margin.

Business Model Assessment – BFRS 9

Business Models

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graph LR; BM[Business Models] --- C[Classification of financial assets – BFRS 9]; BM --- H[Hold both to collect contractual cash flows and for sale]; BM --- O[Other business models];
```

Classification of financial assets – BFRS 9

Hold both to collect contractual cash flows and for sale

Other business models

- Assessment considerations: how performance is evaluated, how risks are managed, how managers are compensated, actual and expected levels of sales, etc.
- Assessed at a level at which assets are managed, e.g. portfolios.

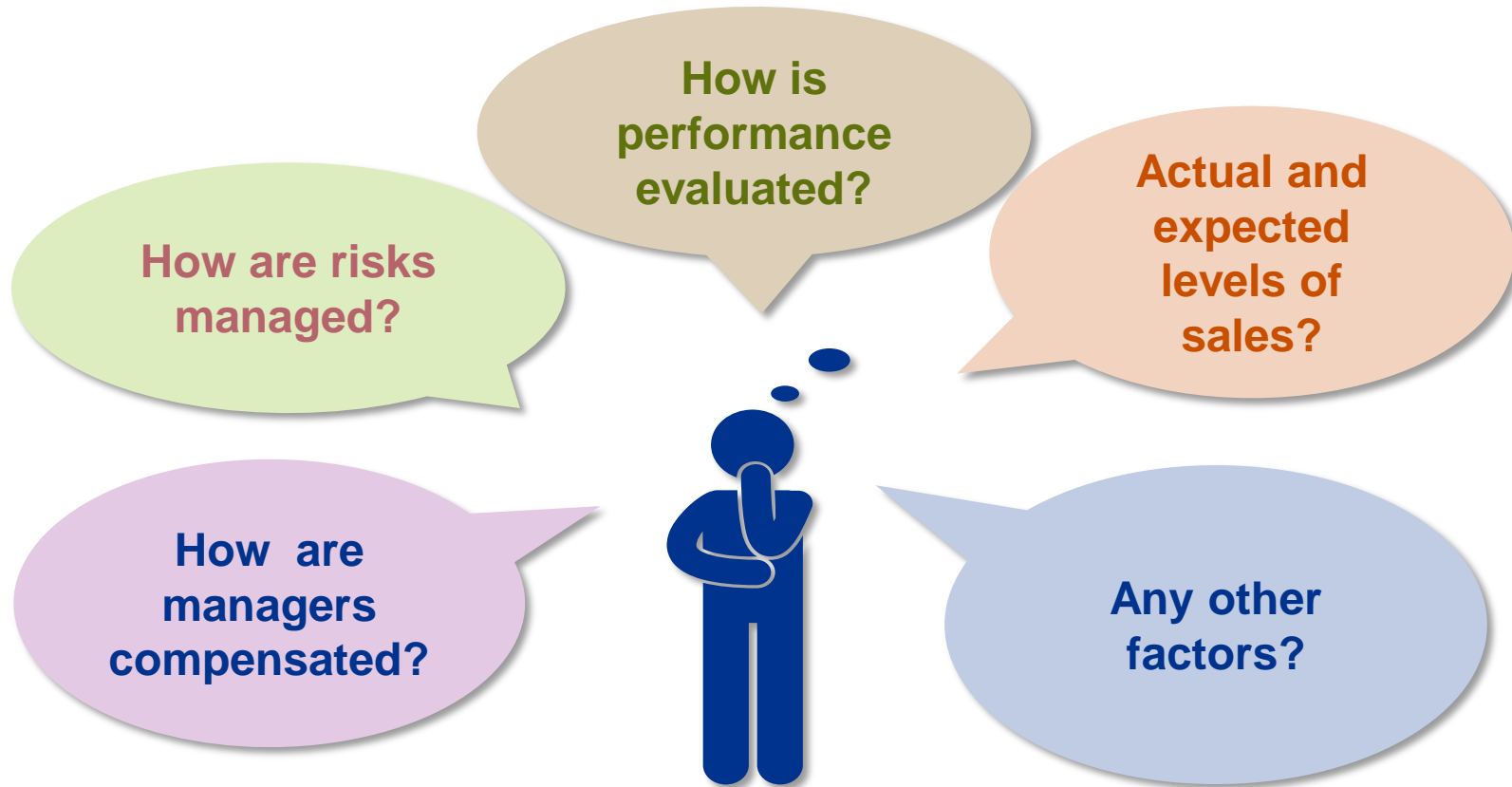
Business Models Overview – BFRS 9

Business models	Key features	Measured at
Held-to-collect contractual cash flows	<ul style="list-style-type: none">• Objective: hold assets to collect contractual cash flows.• Sales are incidental to the objective.• Typically lowest sales (in frequency and volume).	Amortised cost*
Held both to collect contractual cash flows and for sale	<ul style="list-style-type: none">• Both collecting contractual cash flows and sales are integral to achieving the objective of the business model.• Typically more sales (in frequency and volume) than held-to-collect business model.	FVOCI*
Others	<ul style="list-style-type: none">• Objective: neither held-to-collect nor held to collect and for sale.	FVTPL**

* Subject to meeting the SPPI criterion and the fair value option.

** SPPI criterion is irrelevant – assets in all such business models are measured at FVTPL.

Assessment Considerations – BFRS 9



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

Classification of Trade Receivables – BFRS 9

Classification criteria	Likely to meet?
SPPI	✓
Held-to-collect business model	✓

- Trade receivables are likely to meet both criteria:
 - Cash flows are generally fixed.
 - Generally held to collect cash flows.



Watch out for the impact of securitisation and other transactions, including factoring, and for more complex contractual terms.

Business Model Assessment Illustration – BFRS 9

- Company Z generates trade receivables that are due in 30 days after the issue of an invoice.
- Z manages cash collections, deals with customer queries and sends out reminders when amounts become overdue.
- The management focuses on monitoring the overdue status and collection teams are evaluated on the basis of the length of the cash collection period.
- When a receivable is overdue by 150 days and no payment plan has been agreed with a customer, Z's policy is to sell the receivable, at a significant discount, to a debt collection company and Z has no further involvement with that receivable. This happens rarely.

Q: What is the business model in which trade receivables are held?

Business Model Assessment: Rationale – BFRS 9

Hold to collect contractual cash flows.

- **Management of risk**
 - Focus on collection of contractual cash flows and management of overdue status.
 - The collection team evaluated with reference to the collection period.
- **Sales of assets**
 - Infrequent sales in response to deterioration in credit risk are not inconsistent with the Hold to collect model.

Trade Receivables Illustration – BFRS 9

- Entity P, a manufacturing company, has a business model that involves selling trade receivables it originates to a securitisation vehicle S.
- S issues notes to investors secured on the receivables purchased from P.
- S collects the contractual cash flows from the loans and passes them on to investors in the notes.
- P consolidates S and the trade receivables continue to be recognised in the consolidated financial statements of P.

Q: Are the trade receivables held in a held-to-collect business model?

Trade Receivables Solution – BFRS 9

In consolidated financial statements of P

- The consolidated group originated the receivables with the objective of holding them to collect the contractual cash flows.

In separate financial statements of P

- P's objective as a standalone entity is to realise cash flows on the receivables portfolio by selling the receivables to S. It is not managing the portfolio to collect the contractual cash flows.

Investments Illustration – BFRS 9

- Entity C anticipates capital expenditure in a few years.
- C invests its excess cash in short- and long-term investments so that it can fund the expenditure when the need arises.
- Many of the investments have contractual maturities that exceed C's anticipated investment period.
- Investments are held to collect the contractual cash flows but, when an opportunity arises, investments are sold to re-invest the cash in investments with a higher return.
- The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio.

Q: In what business model are the investments held?

- A. Held-to-collect.
- B. Both held-to-collect and for sale.
- C. Other.

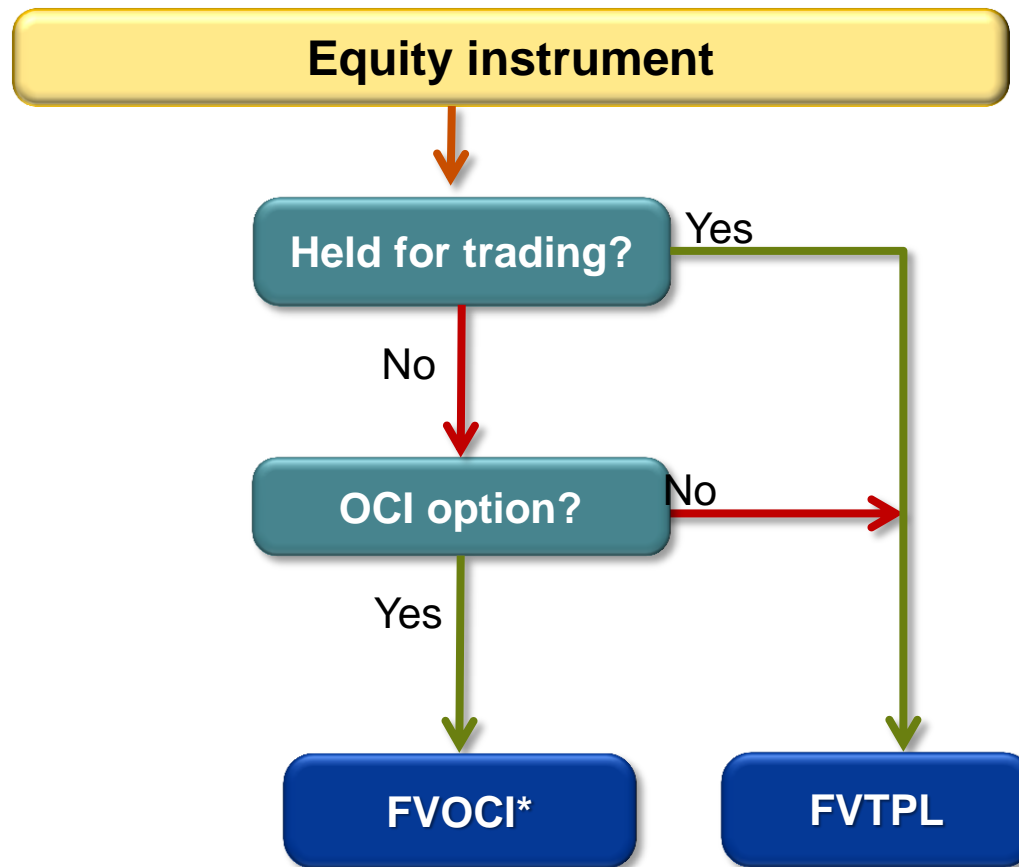
Investments Solution – BFRS 9

Business model: both held-to-collect and for sale

- The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximise the return on the portfolio until the need arises for the invested cash.

Principles of Financial Asset Classification

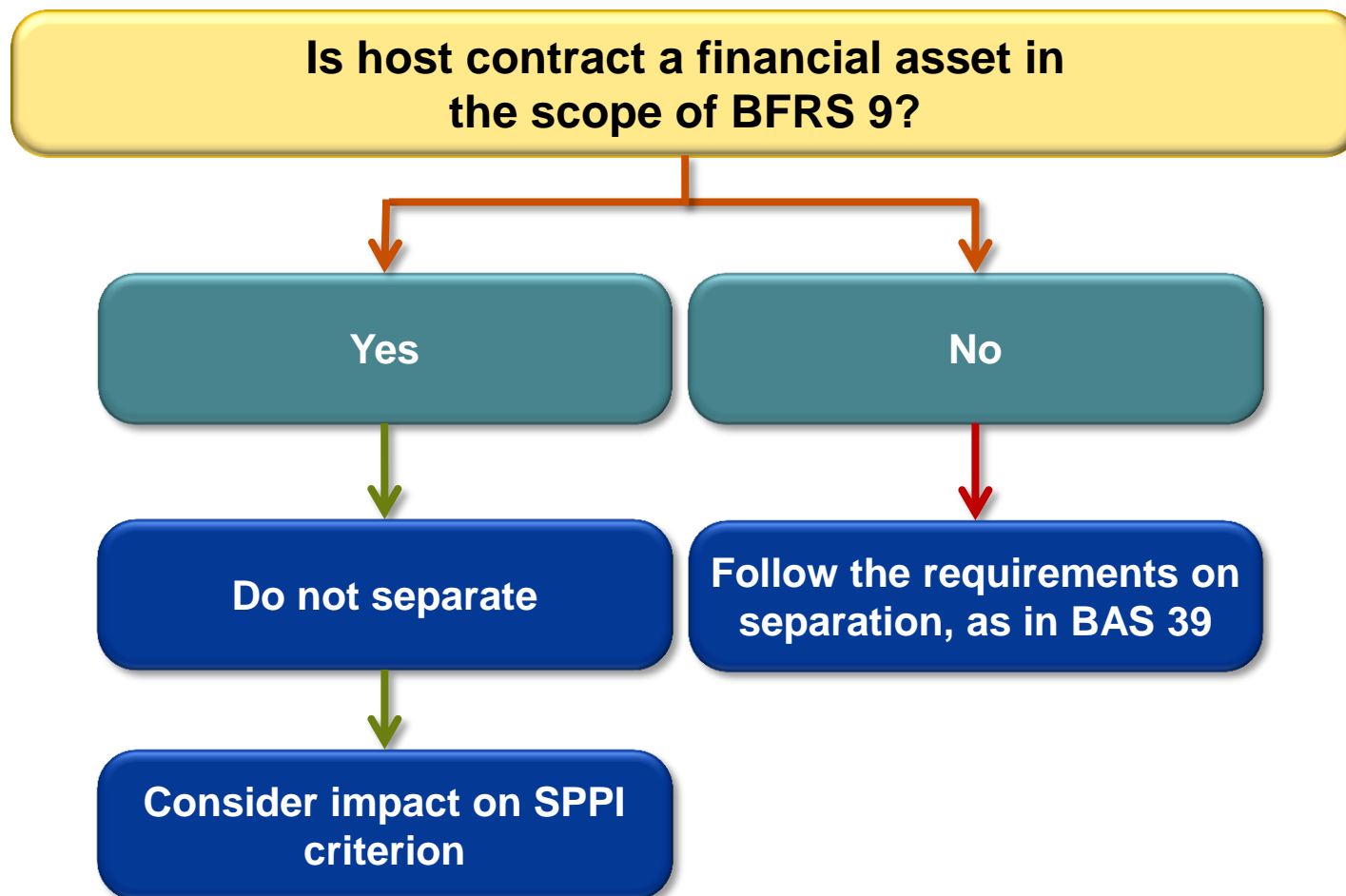
Equity Instruments – BFRS 9



Financial sector		
Other Corporates		 

* amounts recognised in OCI are not reclassified to profit or loss on derecognition and no impairment loss recognised in profit or loss.

Embedded Derivatives – BFRS 9



Classification of financial liabilities

Requirements from BAS 39 are largely retained in BFRS 9.

Categories as per BAS 39

Financial liabilities at fair value through profit or loss (FVTPL)

Other financial liabilities (OFL)

Categories as per BFRS 9

Fair value through profit or loss (FVTPL)

Amortised cost

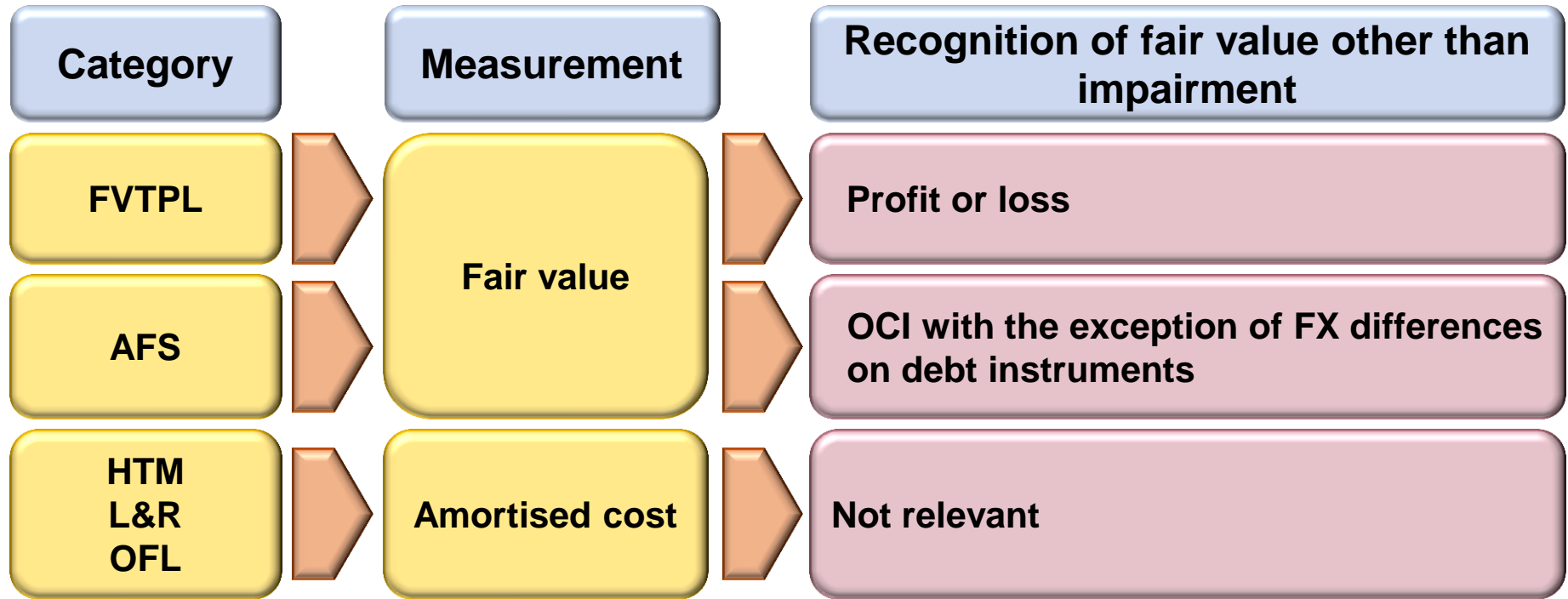
Initial Measurement – BFRS 9

- ❑ Generally, no changes from BAS 39.
- ❑ Recognise at fair value plus (minus) transaction costs# directly attributable to the acquisition (issue).
- ❑ **Exception:** trade receivables without significant financing component are recognised at transaction price* defined by BFRS 15.

Transaction costs are not adjusted for financial assets and financial liabilities measured at FVTPL.

*The amount of consideration to which an entity *expects* to be entitled.

Subsequent measurement – BAS 39



Fair value exemption: applicable in rare circumstances to investments in equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured. Also applies to derivatives that are linked to and are settled by the delivery of such equity instruments.

FX= foreign exchange

Subsequent measurement – BFRS 9

BFRS 9	Same as BAS 39?
Amortised cost	✓
FVOCI debt investments	✓
FVOCI equity instruments*	✗
FVTPL	✓



*FVOCI equity instruments

- Dividends generally recognised in profit or loss.
- Other gains and losses recognised in OCI and never reclassified to profit or loss.
- Impairment never recognised in profit or loss.
- Cost measurement no longer permitted.

Impairment

Impairment of Financial Asset (Incurred Loss Model) – BAS 39

- ❑ When there is an objective evidence that a financial asset at amortised cost or at fair value with changes recognised in equity, may be impaired, the amount of any impairment loss should be calculated and recognised in the profit and loss account (statement of comprehensive income)
- ❑ An entity should start the impairment assessment by considering whether objective evidence of impairment exists for financial assets that are individually significant.
- ❑ For financial assets that are not individually significant, the assessment can be performed on an individual or collective (portfolio) basis.

Impairment of Financial Asset – BAS 39



Is the financial asset individually significant?

Yes

Individual
assessment

Has an
impairment
been
identified
based on the
individual
assessment?

No

No

Collective assessment

- ◆ Impairment losses recognised on a collective basis represent an interim step pending the identification of impairment losses on individual assets.
- ◆ As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are no longer included in the collective impairment assessment.

BFRS 9: Main Changes From BAS 39 Guidance



- ❑ The BAS 39 incurred loss model was criticised for delaying the recognition of losses, for the complexity of having multiple impairment approaches (there are different models for assets at amortised cost, available for sale assets- debt instruments, available for sale assets – equity instruments and financial guarantees and loan commitments), and for being difficult to understand, apply and interpret.
- ❑ BFRS 9 replaces this model with an expected credit loss approach. Under the new approach, it will no longer be necessary for a loss event to occur before an impairment loss is recognised and so, generally, all financial assets will carry a loss allowance (however, certain exceptions from recognising a loss allowance are available).

BFRS 9: Main Changes From BAS 39 Guidance



Expected credit losses

- BFRS 9 changes accounting for impairment - impairment losses recognised for all amortised cost and FVOCI assets, not only those where credit loss has been incurred.

Journal Entries for amortised cost assets

Dr Impairment Loss (profit or loss)
 Cr Loss Allowance (statement of financial position)

- The model also applies to certain financial guarantees and loan commitments, but not to equity investments or instruments measured at FVTPL.
- A single set of impairment requirements applies to all instruments in the scope of BFRS 9.

Financial sector 	
Other Corporates 	 



Larger provisions with more volatility.

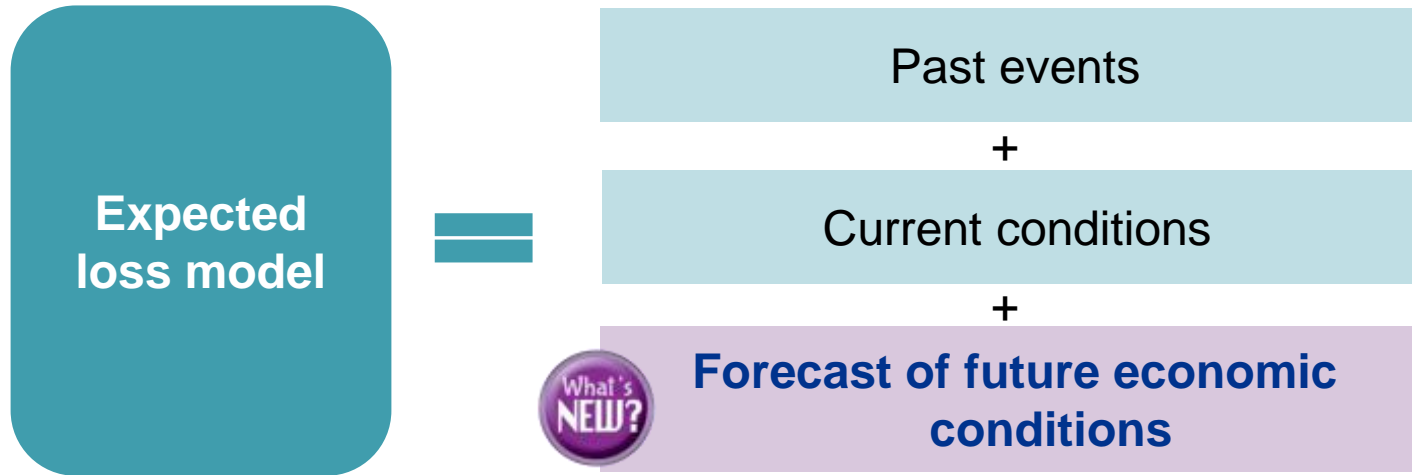
Scope of BFRS 9's impairment Requirements

In scope	Out of scope
<ul style="list-style-type: none">▪ Financial assets that are debt instruments measured at amortised cost or at FVOCI (include: trade receivables and debt securities).▪ Loan commitments issued that are not measured at FVTPL.▪ Financial guarantee contracts* issued that are in the scope of BFRS 9 and are not measured at FVTPL.▪ Lease receivables in the scope of BAS 17.▪ Contract assets in the scope of BFRS 15.	<ul style="list-style-type: none">▪ Equity investments.▪ Loan commitments and guarantees issued that are measured at FVTPL.▪ Other financial instruments measured at FVTPL.

* Unless accounted for under BFRS 4

Impairment – BFRS 9

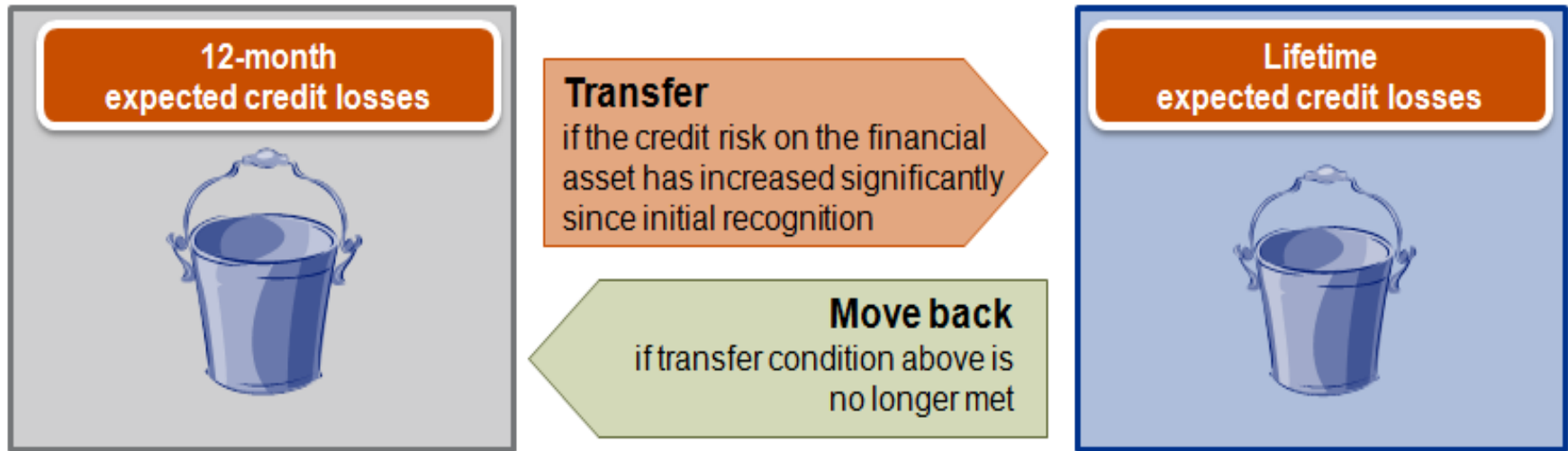
The new model



- Generally, all financial assets carry a loss allowance.
 - No trigger is required for recognising impairment
- More judgement.
- One model for financial instruments in the scope of BFRS 9.

Impairment Model - BFRS 9

Dual Measurement Approach for Impairment



- Under the general principle, one of two measurement bases will apply:
 - 12-month expected credit losses; or
 - lifetime expected credit losses.
- The measurement basis would depend on whether there has been a significant increase in credit risk since initial recognition.

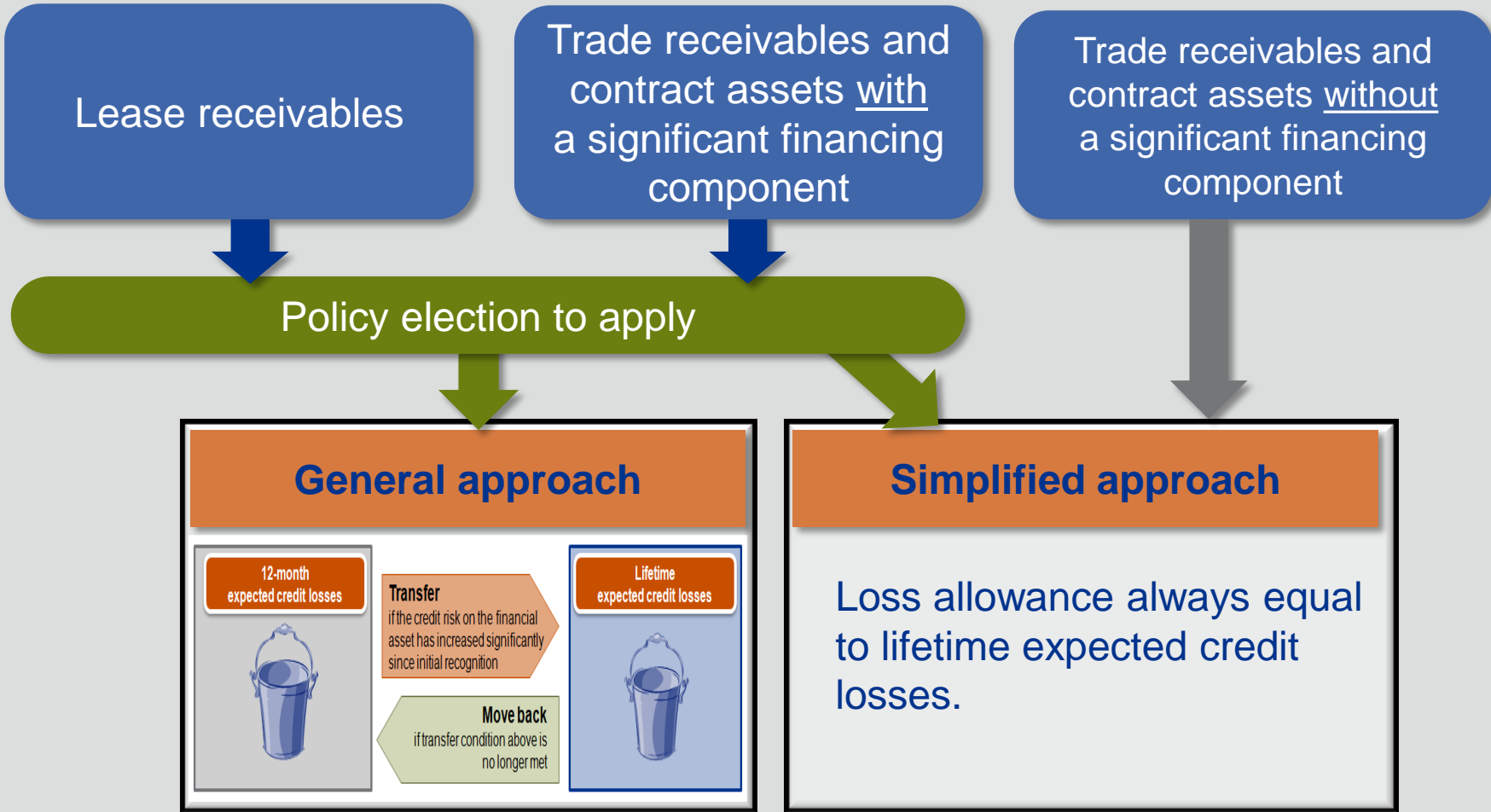
Impairment Model- BFRS 9

Key Elements

- ❑ 12-month expected credit losses – losses associated with possible default in the next 12 months.
- ❑ Lifetime expected credit losses – losses associated with possible default during life of the financial asset.
- ❑ Significant increase in credit risk – not defined.
- ❑ Default – not defined.

Impairment - BFRS 9

Trade and Lease Receivables and Contract Assets



Practical expedient to calculate expected credit losses – provision matrix.

BFRS 15 concepts in BFRS 9's impairment model

Contract assets

Right to consideration for goods or services conditional on something other than the passage of time (for example, payment for delivered product P conditional on delivery of product Q).

Significant financing component

When there is a significant benefit of financing the transfer of goods or services to the customer.

Impairment - BFRS 9

Simplifications in Impairment Model

Financial assets with low credit risk

- May assume that the credit risk on a financial instrument has not increased significantly.
- Assessment can be based on external or internal ratings.

Rebuttable presumption

- Significant increase in credit risk if financial assets >30 days past due.
- Default does not occur later than 90 days past due.

Trade Receivables: Policy Option

General Approach or Simplified Approach?



Impact of electing general approach as policy*

- Need to track changes in credit risk since initial recognition.
- More sophisticated credit risk management systems needed.
- Lower expected losses recognised.



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

**Entities should consider cost benefit analysis before electing the general approach*

Impairment - BFRS 9

Loss Allowance Recognition: Illustration

- On 31 December 20X1 Bank B grants a loan to a borrower with low credit standing, but still at an acceptable level for B.
- The price of the loan does not reflect incurred credit losses.

Q: What loss allowance should B recognise in the statement of financial position at 31 December 20X1?

- A. None.
- B. 12-month expected credit losses.
- C. Lifetime expected credit losses.

Impairment - BFRS 9

Loss Allowance Recognition: Rationale

B. 12-month expected credit losses.

- Under the general model of BFRS 9, all assets need to have a loss allowance.
- Allowance covers either 12-month or lifetime expected credit losses depending on whether the asset's credit risk has increased significantly.
- Since the loan has just been granted and there has not been a significant increase in credit risk, an allowance equal to 12-month expected credit losses is appropriate.

BFRS 9: Assessment of Significant Increase in Credit Risk: Illustration

- Bank B uses an internal credit grading system of 1 to 10.
- A drop of 2 grades represents a significant increase in credit risk.
- Bank B has a loan that was graded 2 at initial recognition, Graded 4 at the reporting date.
- B does not consider grade 4 to be a low credit risk.

Q: At the reporting date, would the loan attract a 12-month or lifetime expected credit loss allowance?

BFRS 9: Assessment of Significant Increase in Credit Risk: Rationale

Loss allowance = lifetime expected credit losses

BFRS 9: Assessment of Significant Increase in Credit Risk: Illustration

- Bank B uses an internal credit grading system of 1 to 10.
- A drop of 2 grades represents a significant increase in credit risk.
- Bank B has a loan that is graded 3 at initial recognition, Graded 4 at the reporting date.
- B does not consider grade 4 to be a low credit risk.

Q: At the reporting date, would the loan attract a 12-month or lifetime expected credit loss allowance?

BFRS 9: Assessment of Significant Increase in Credit Risk: Rationale

Loss allowance = lifetime expected credit losses

- The credit loss model in BFRS 9 is a relative rather than an absolute model which means that it focuses on the relative size of increase in credit risk.

Measuring Impairment – BFRS 9

Expected credit losses on financial assets

Probability weighted

Unbiased and probability-weighted amount (evaluate a range of possible outcomes).

Present value

Original EIR or an approximation as a discount rate.

Cash shortfalls

Difference between the cash flows due under the contract and cash flows that entity expects to receive.

Data Sources in Measuring Impairment – BFRS 9



Reasonable and supportable information that is available without undue cost or effort.

Individual Vs Collective Basis – BFRS 9

- Relevant for:
 - Assessing whether increase in credit risk is significant; and
 - Measuring impairment.

- No general guidance on when each approach is appropriate.

- However in some cases collective assessment is required:
 - To identify significant increase in credit risk, when no other borrower-specific information is available.
 - When information is not available for measurement on an individual basis.

Hedge Accounting

BFRS 9: Key features in Hedge Accounting



- More judgement needed to apply requirements.
- Hedge accounting available for broader range of hedging strategies.
- Changes for processes and systems.

Overview of Hedge Accounting – BAS 39

- Hedge Accounting allows an entity to selectively measure assets, liabilities, firm commitments etc on basis different from otherwise stipulated in BFRSs or to defer the recognition of gains or losses on derivatives
- Hedge Accounting is voluntary and the decision to apply hedge accounting is made transaction by transaction basis.
- Hence hedge accounting is only permitted when:
 - Strict documentation is met, i.e. designation of hedging instrument and hedged item must be done at the inception; and
 - Effectiveness testing requirements are met.

Overview of Hedge Accounting – BAS 39

Contains the entity's risk management objective and strategy for undertaking the hedge

Identifies clearly the hedged item and the hedging instrument



Describes the nature of the risk being hedged

Describes how hedge effectiveness will be assessed both prospectively and retrospectively

Overview of Hedge Accounting – BAS 39

Prospective effectiveness test
(At inception and at each reporting date)

Retrospective effectiveness
(At each reporting date)

Is hedge expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to hedged risk during period for which hedge is designated?

Is actual effectiveness within range of 80-125 percent?

Yes

Yes

**Hedge accounting is allowed
&
Ineffectiveness is recognised in profit or loss**

Overview of Hedge Accounting – BAS 39



BAS 39 contains 3 hedge accounting models

Cash flow hedges
of cash flow exposures

Fair value hedges
of fair value exposures

Net investment hedges
of currency exposure on
a net investment in a
foreign operation

Overview of Hedge Accounting – BAS 39

Cash flow hedge accounting

Hedged item

Regular recognition and measurement

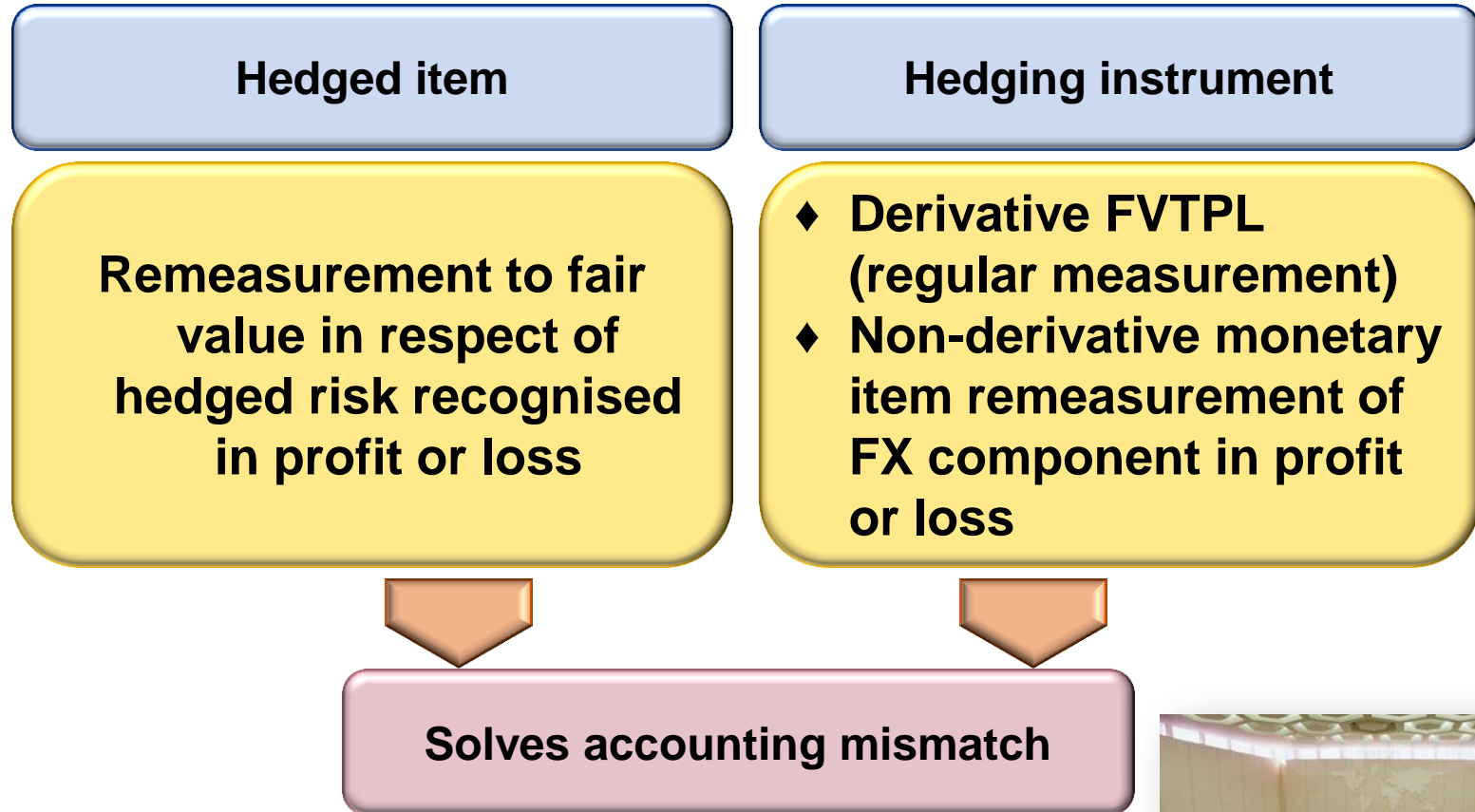
Hedging instrument

- Measured at fair value with:**
- ◆ Effective portion of changes in its fair value recognised in OCI and reclassified to profit or loss when hedged item affects profit or loss
 - ◆ Ineffective portion of changes in its fair value recognised in profit or loss

Solves accounting mismatch

Overview of Hedge Accounting – BAS 39

Fair value hedge accounting



Hedge Accounting - BFRS 9

Background of Changes

- ❑ The previous hedge accounting model under BAS 39 *Financial Instruments: Recognition and Measurement* was described as complex, not reflective of risk management activities and excessively rules-based, resulting in arbitrary outcomes. BFRS 9 aims to address these criticisms by:
 - aligning hedge accounting more closely with risk management activities, resulting in more useful information;
 - establishing a more principles-based approach to hedge accounting; and
 - addressing inconsistencies and weaknesses in the previous model.

BFRS 9: Many Existing Hedge Accounting Concepts Retained

- ❑ Three hedge accounting models:
 - Fair value hedge.
 - Cash flow Hedge.
 - Hedge of a net investment.
- ❑ Hedge documentation requirements.
- ❑ Measurement of hedged items and hedging instruments.
- ❑ Measurement of ineffectiveness.

BFRS 9: Hedge Accounting in a Nutshell

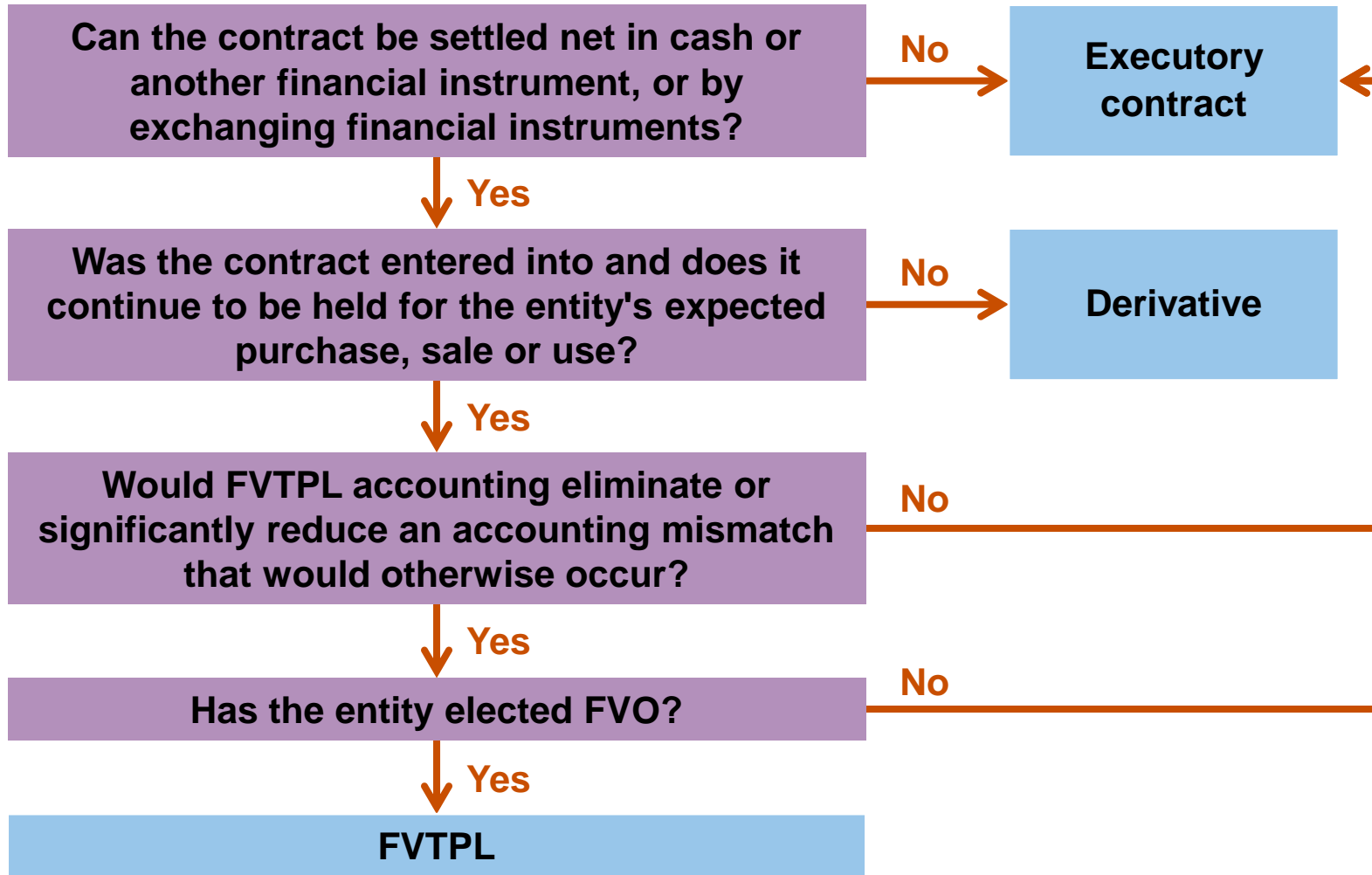
Overview

- Aligns hedge accounting with risk management.
- New requirements to achieve, continue and discontinue hedge accounting.
- Additional qualifying exposures.
- Cash instruments may be hedging instruments in additional circumstances.

Differences from Current Practice

- New fair value option model for managing credit risk.
- Alternative fair value option model for certain own-use contracts.
- Additional disclosure requirements regarding an entity's risk management and hedging activities.

BFRS 9: Own-use Contracts



FVTPL = Fair value through profit and loss

BFRS 9: Fair Value Option for Certain Credit Exposure

Matching name and seniority

Elected at initial recognition or subsequently

All or part of credit exposure

Revocable

Recognised (e.g., a loan) or unrecognised (e.g., a loan commitment)

Difference reported in profit or loss


BFRS 9: Cash Hedging Instruments

Qualifying non-derivative hedging instruments:

FVTPL financial instruments



 FVO liability with FV changes due to credit risk in OCI

 Financial asset/liability designated as FVO to reduce an accounting mismatch if hedge accounting would recreate the mismatch

For hedges other than foreign currency



Entire/proportion of a financial instrument must be designated

Prohibition on designating internal instruments retained

BFRS 9: 'Costs of hedging'

Designating a portion of a hedging instrument:

Excluded portion

Time value of a purchased option

Forward element of a forward contract

Foreign currency basis spread of a financial instrument

Accounting

Change in fair value recorded in OCI

Affects profit or loss at the same time the transaction does or amortises over time

BFRS 9: Additional Qualifying Exposures

1 Risk components of non-financial items

2 Non-contractually specified inflation

3 Group of items (including net positions)

4 Aggregated exposures

5 FVOCI equity instruments

FVOCI = Fair value through other comprehensive income

BFRS 9: Risk Components of Non-financial Items

Designation criteria (financial and non-financial risk components)

Separately identifiable



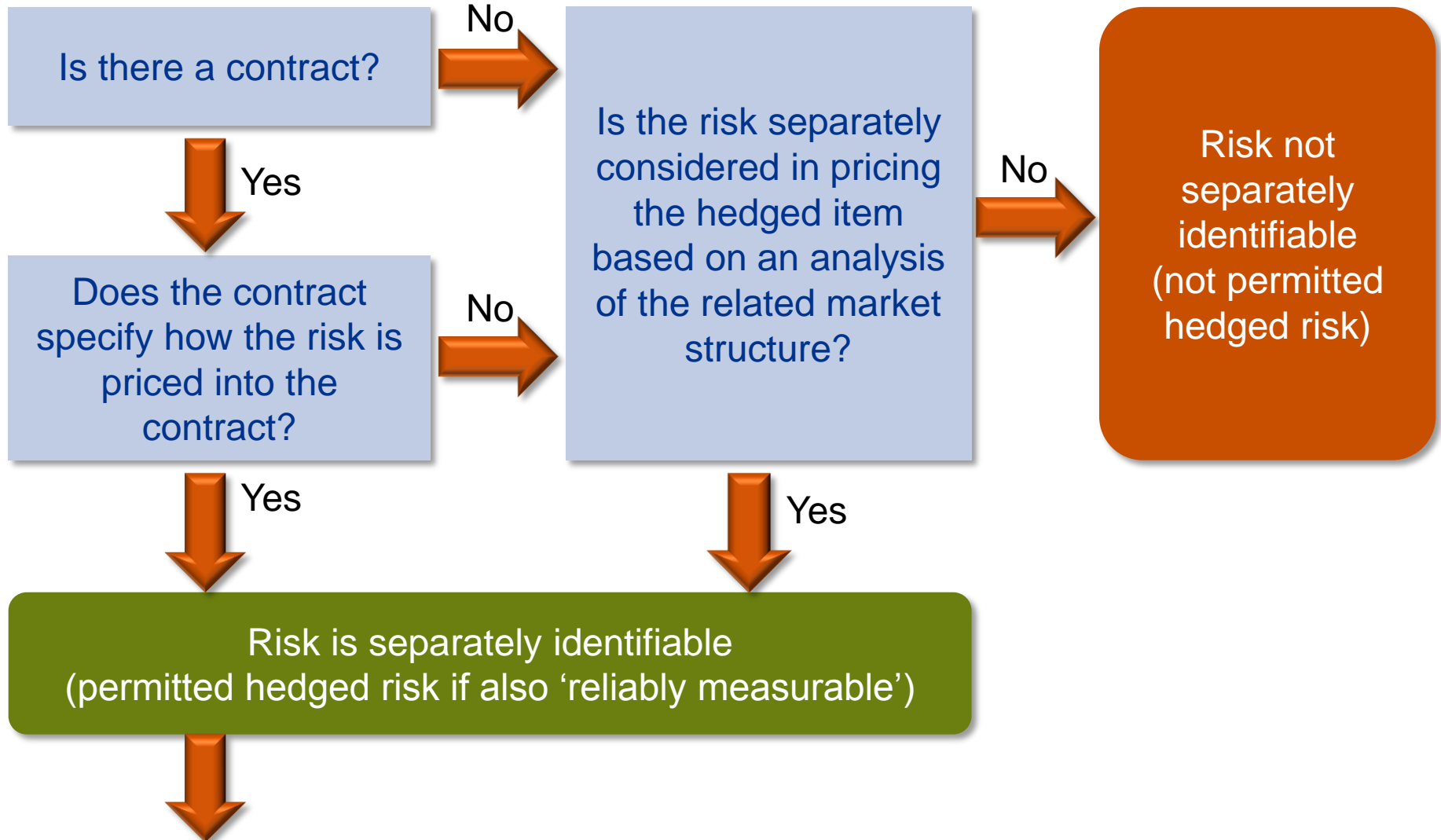
Reliably measurable

- Analyse the particular market structure to which the risk relates and in which the hedging activity takes place
- Applies to contractual and non-contractual specified risk

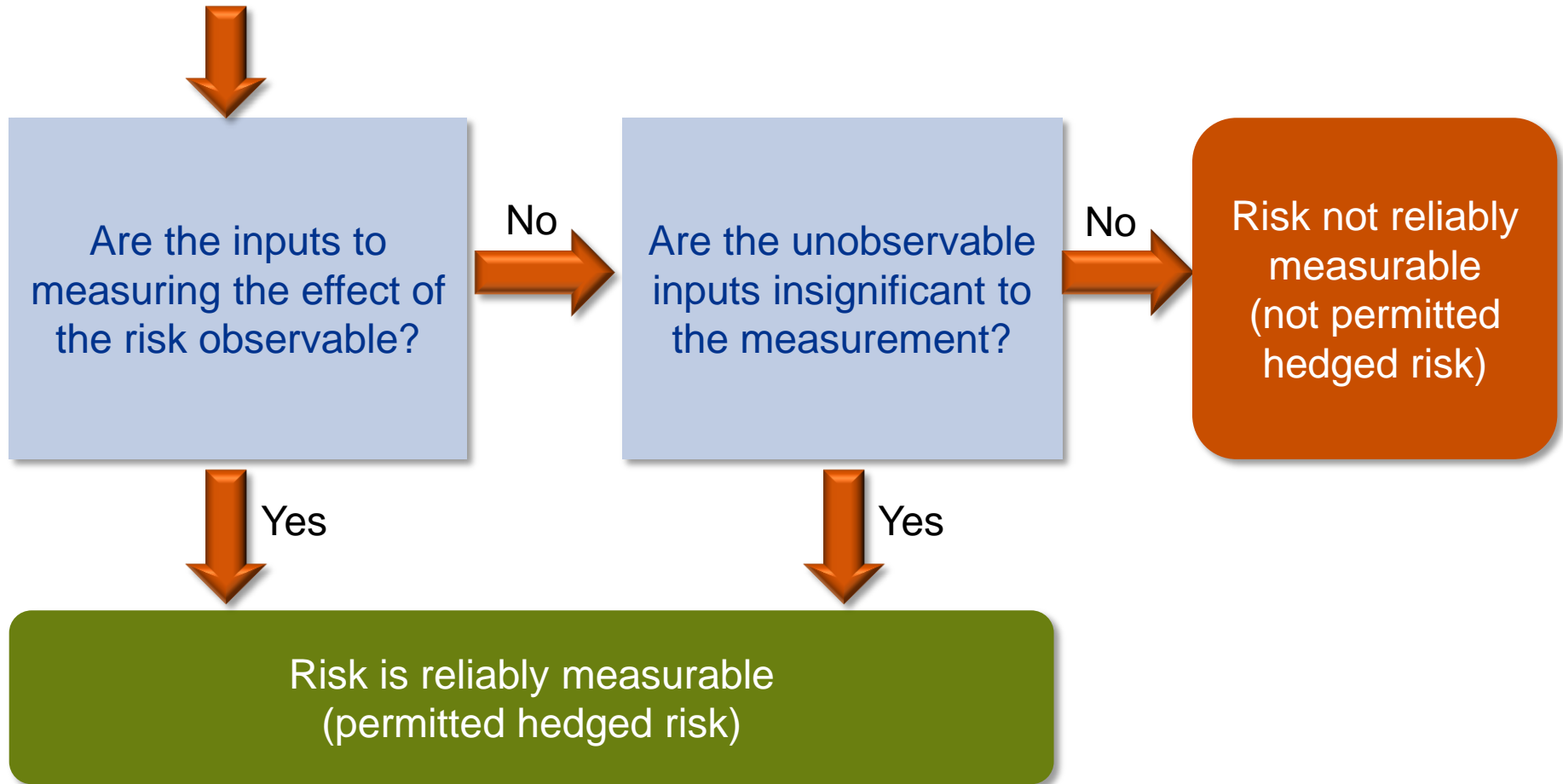
- Involves judgement
- knowledge of market is crucial



BFRS 9: Evaluating Whether a Risk is Separately Identifiable



BFRS 9: Evaluating Whether a Risk is Reliably Measurable



BFRS 9: Inflation Risk Components

Rebuttable presumption:

Non-contractually specified inflation is NOT separately identifiable and reliably measurable.

- Rebutting the presumption may be challenging
- Can the entity construct an inflation curve using real interest rates for the hedge period?

BFRS 9: Group of Items (Including Net Positions)

Eligibility criteria

- Consists of items that are eligible hedged items.
- Managed on a group basis for risk management purposes.
- In the case of a cash flow hedge of items with offsetting risk positions, it is a hedge of foreign currency risk and the designation specifies certain details about the forecast transactions.

Adequate process in place to implement, document and monitor new hedging strategies?



BFRS 9: Components of Nominal Amount

Designation requirements:

Proportion of an entire amount

or

Layer component



Separately identifiable and reliably measurable

All items within the group are exposed to the same hedged risk

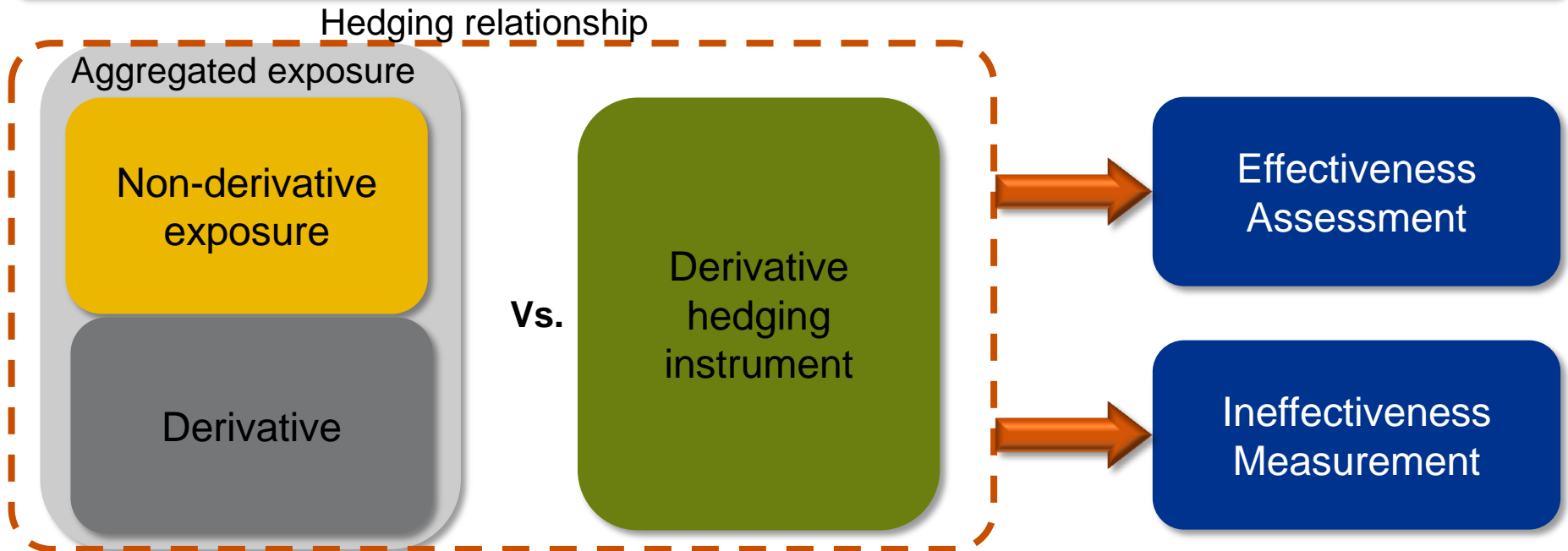
Identify and track

Fair value hedge – must consider effect of all prepayment options within the group

BFRS 9: Aggregated Exposures

Aggregated exposure = non-derivative exposure + derivative

Effectiveness assessment and ineffectiveness measurement



If aggregate exposure is a hedging relationship, assessment and measurement would be performed at that level

BFRS 9: Aggregated Exposures

- Example of an aggregated exposure:

**10 year fixed rate debt in
a foreign currency
+
10 year fixed to variable
CCIRS**

Hedged item
Aggregated exposure
10 year variable rate debt in domestic
currency

Hedging instrument
5 year domestic variable to fixed IRS

**An aggregated exposure may or may not be a hedging relationship
depending on risk management**

BFRS 9: Hedging of FVOCI Equity Investments

FVOCI equity investment hedged items – FV changes in OCI

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graph TD; A[FVOCI equity investment hedged items – FV changes in OCI] --> B[Hedging instrument – FV changes in OCI]; B --> C[Ineffectiveness in OCI]; C --> D[Amounts never reclassified from AOCI to profit or loss];
```

Hedging instrument – FV changes in OCI

Ineffectiveness in OCI

Amounts never reclassified from AOCI to profit or loss

FVOCI = Fair value through other comprehensive income

AOCI = Accumulated other comprehensive income

Hedge Effectiveness testing – BAS 39

Prospective effectiveness test
(At inception and at each reporting date)

Is hedge expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to hedged risk during period for which hedge is designated?

yes

Retrospective effectiveness
(At each reporting date)

Is actual effectiveness within range of 80-125 percent?

yes

**Hedge accounting is allowed
&
Ineffectiveness is recognised in profit or loss**

More Principles-based

- 80%-125% effectiveness bright-line removed.
- No retrospective testing of effectiveness. In some cases only qualitative prospective effectiveness test will be required.
- More items are allowed as hedged items, for example:
 - risk components of non financial items; and
 - net positions.
- More items allowed as hedging instruments, for example:
 - Non-derivative financial instruments measured at FVTPL.

In many instances hedge accounting will be less burdensome and there will be more scope to reflect internal risk management strategies

BFRS 9: Hedge Effectiveness Assessment

Out

80% – 125% test



In

Qualitative, forward-looking



- Economic relationship exists.
- Credit risk does not dominate value changes.
- Hedge ratio matches actual ratio used for risk management.

Establish link between hedging relationships and risk management objectives

BFRS 9: Hedge Effectiveness Assessment

Frequency of Assessment

- Inception; and
- On going basis:
 - Each reporting date; or
 - A significant change in the circumstances.

Qualitative or quantitative?

- Depends on facts and circumstances.
- Qualitative assessment appropriate in some circumstances.
- Risk management policy – main source of information.
- May require change in methodologies assessment.

- More judgment required.
- Changes to systems and procedures.



BFRS 9: Some New Complexities in Hedge Accounting

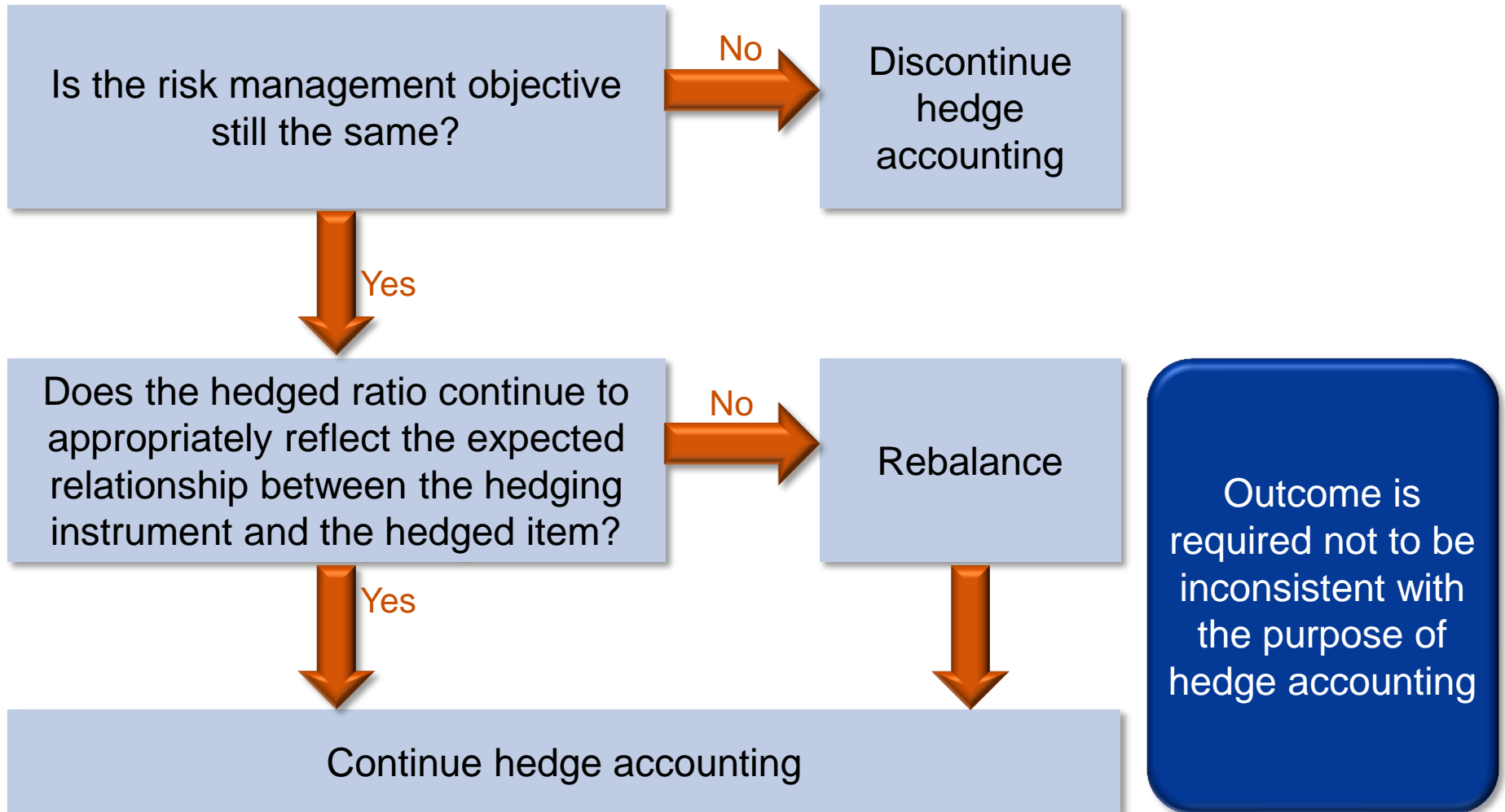
- Explicit requirements for hedge accounting to align with an entity's risk management objective.
- Hedge accounting cannot be voluntarily discontinued.
- Introduction of a concept of “rebalancing”.
- Potentially complex accounting for portions of derivatives excluded from hedging relationships (e.g. time value of an option).

BFRS 9: Rebalancing and Discontinuation in Hedge Accounting

Rebalancing - continue applying hedge accounting by adjusting hedge ratio

- Risk management strategy vs. risk management objective.
- Can be complex.
- Update hedge documentation upon rebalancing.
- Voluntary discontinuation prohibited.

BFRS 9: Rebalancing and Discontinuation in Hedge Accounting



Update on Macro Hedging project

- Potentially introducing fundamental change in how risk management is considered for financial reporting.
- A Discussion Paper (DP) *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging* has been published with a comment deadline of October 2014.
- The DP puts forward a ‘portfolio revaluation approach’, which is similar to the fair value hedge model.
- The next step in the process will be for the IASB to consider responses to the DP.

Presentation and Disclosure

Presentation and Disclosure

BFRS 9 amends BAS 1 *Presentation of Financial Statements* to require the following line items to be presented in the profit or loss section of the statement of comprehensive income or in the statement of profit or loss:

- revenue, presenting separately interest revenue calculated using the effective interest method;
 - gains or losses arising from the derecognition of financial assets measured at amortised cost;
 - impairment losses (including reversals) determined in accordance with BFRS 9;
 - gains or losses arising on reclassification of a financial asset out of the amortised cost category into the FVTPL category; and
 - if a financial asset is reclassified out of the FVOCI category into the FVTPL category, any cumulative gain or loss previously recognised in OCI that is reclassified to profit or loss.
-

Disclosures in BFRS 9

- BFRS 9 introduces extensive new disclosure requirements.
- Sourcing the additional information required could be a complex and time-consuming process that will have an impact on resources and systems.
- Designing disclosures and sourcing data should be a key part of any project for implementing BFRS 9.

Financial sector 	
Other Corporates 	 

Business Impact



- Judgements – new complexities and wider scope.
- Significant impact on systems and processes.
- New potential hedging strategies.
- Regulatory capital of banks and other financial institutions may be affected.
- Impact on equity and KPIs.

Next Steps – Communications with Audit Committees and Stakeholders

- Initial Discussion Points
 - Highlight most relevant areas of BFRS 9 and differences from current practice.
 - Discuss initial thoughts on the expected impact of BFRS 9.
 - Highlight non-accounting areas potentially affected.
 - Planned communications with external stakeholders.

Next steps



Start impact
assessment

Early
adoption?

Key Points to Remember!

- BFRS 9 will impact entities in different ways:
 - Banks, insurers and other financial sector entities are likely to be significantly impacted.
 - Impact on other corporates may be less.
- Process of assessing impact should start now.
- This overview covers BFRS 9 at a very high level – in reality there are many detailed and complex requirements; these will be subject to more detailed training.



Thank you

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

Appendix

Specific exemption from financial instruments standards

	BAS 32	BAS 39	BFRS 7	APPLICABLE STANDARD
Interests in subsidiaries	x	x	x	BFRS 10 BAS 27
Interest in associates and joint ventures	x	x	x	BAS 28 BAS 27
Employers' rights and obligations under employee benefit plans	x	x	x	BAS 19
Financial instruments, contracts and obligations under share-based payment transactions	x	x	x	BFRS 2
Rights and obligations under insurance contracts (Except embedded derivatives and certain financial guarantees)	x	x	x	BFRS 4 ⁽²⁾
Financial instruments with a discretionary participation feature (except embedded derivatives)	x	x		BFRS 4
Rights and obligations under leases		x		BAS 17 ⁽⁴⁾
Rights to reimbursement payments in relation to provisions		x		BAS 37

Specific exemption from financial instruments standards

	BAS 32	BAS 39	BFRS 7	APPLICABLE STANDARD
Equity instruments issued by the entity, including warrants and options that meet the definition of an equity instrument (for the issuer)		✘		BAS 32
Financial instruments issued by the entity that are classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16 C and 16D of BAS 32 (for the issuer)		✘	✘	BAS 32
Forward contracts between an acquirer and a selling shareholder for the sale/acquisition of an acquire that will result in a business combination at a future date of acquisition		✘		BFRS 3
Loan commitments that cannot be settled net in cash or another financial instrument (except for those loan commitments that are designated as at FVTPL or are to provide loans at below market interest)		✘		BAS 37

✘ Indicates a specific exclusion from the standard