TRANSITION TO IFRS 9 *FINANCIAL INSTRUMENTS*

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OUTLINE OF THIS WEBINAR

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- Are you ready for IFRS 9?
- New Categories of Financial Assets
- Overview of Transitional Requirements - Classification and Measurement
- Transitional Requirements – Financial Assets that are Debt Instruments
- Financial Assets with Embedded Derivatives

ARE YOU READY FOR IFRS 9?

FOR-PROFIT ENTITIES

The Triple Threat Accounting Standards

Australian Accounting Standard	Effective Date - Years Beginning on or after …	30 June Year-end	31 December Year-end
AASB 15 *Revenue from Contracts with Customers*	1 January 2018	30 June 2019	31 December 2018
AASB 9 *Financial Instruments*	1 January 2018	30 June 2019	31 December 2018
AASB 16 Leases	1 January 2019	30 June 2020	31 December 2019

NOT-FOR-PROFIT ENTITIES

Four New Accounting Standards

Australian Accounting Standard	Effective Date - Years Beginning on or after …	30 June Year-end	31 December Year-end
AASB 15 *Revenue from Contracts with Customers*	1 January 2019	30 June 2020	31 December 2019
AASB 1058 *Income of Not-for-Profit Entities*	1 January 2019	30 June 2020	31 December 2019
AASB 9 *Financial Instruments*	1 January 2018	30 June 2019	31 December 2018
AASB 16 *Leases*, including peppercorn leases	1 January 2019	30 June 2020	31 December 2019

NEW CATEGORIES OF FINANCIAL ASSETS

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IFRS 9

- IFRS 9 Categories of Financial Assets
  - Amortised Cost
  - FVTOCI (Equity Instruments & No Recycling)
  - FVTOCI (Debt Instruments & Recycling)
  - FVTPL (Fair Value Through Profit or Loss)

Determining the AASB 9 Categories of Financial Assets

Step 1 - Determine whether you have a:

- derivative;
- equity instrument; or
- debt instrument

Step 2 - Use the appropriate decision tree

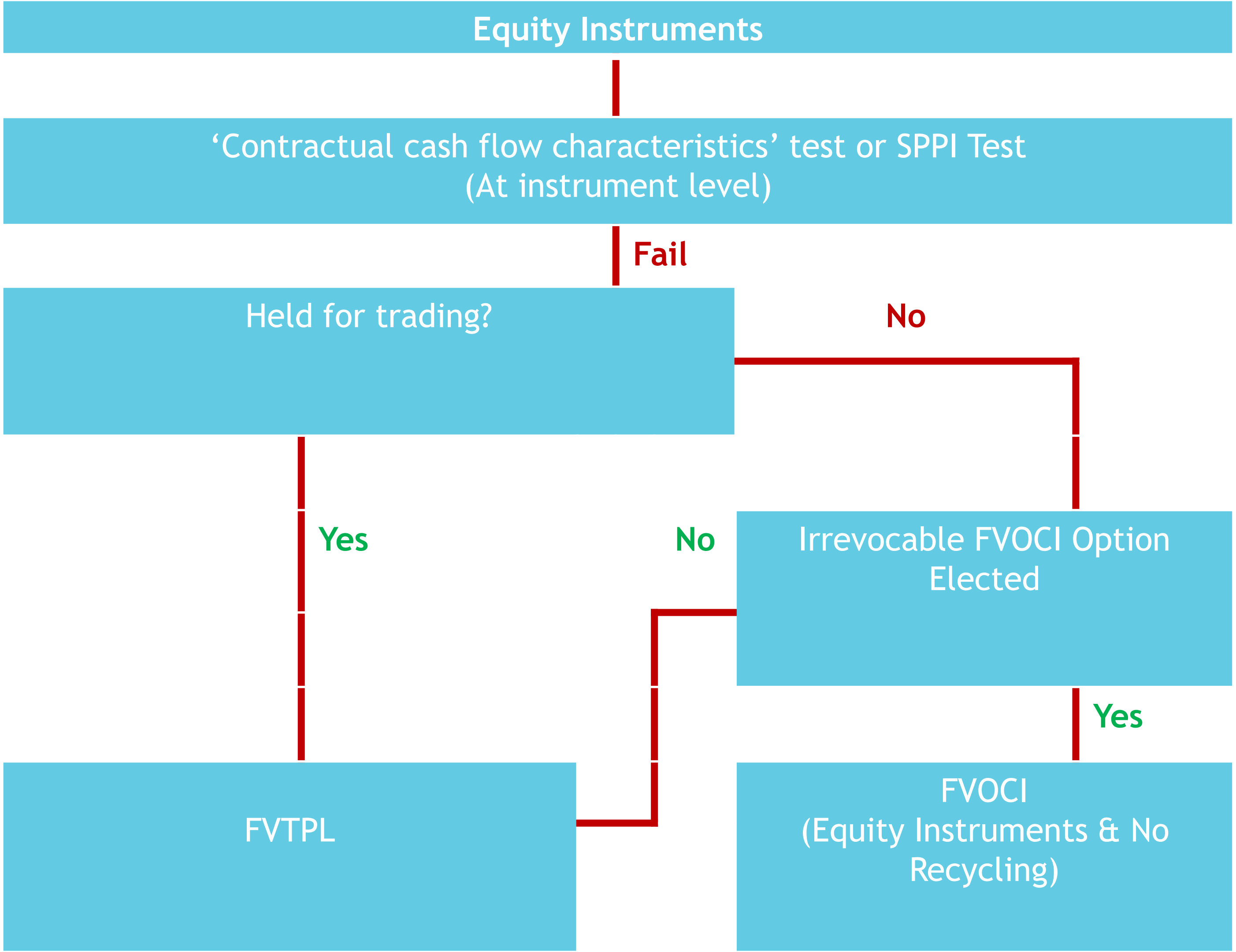
Determining the AASB 9 Categories of Financial Instruments - Decision Tree for Derivatives

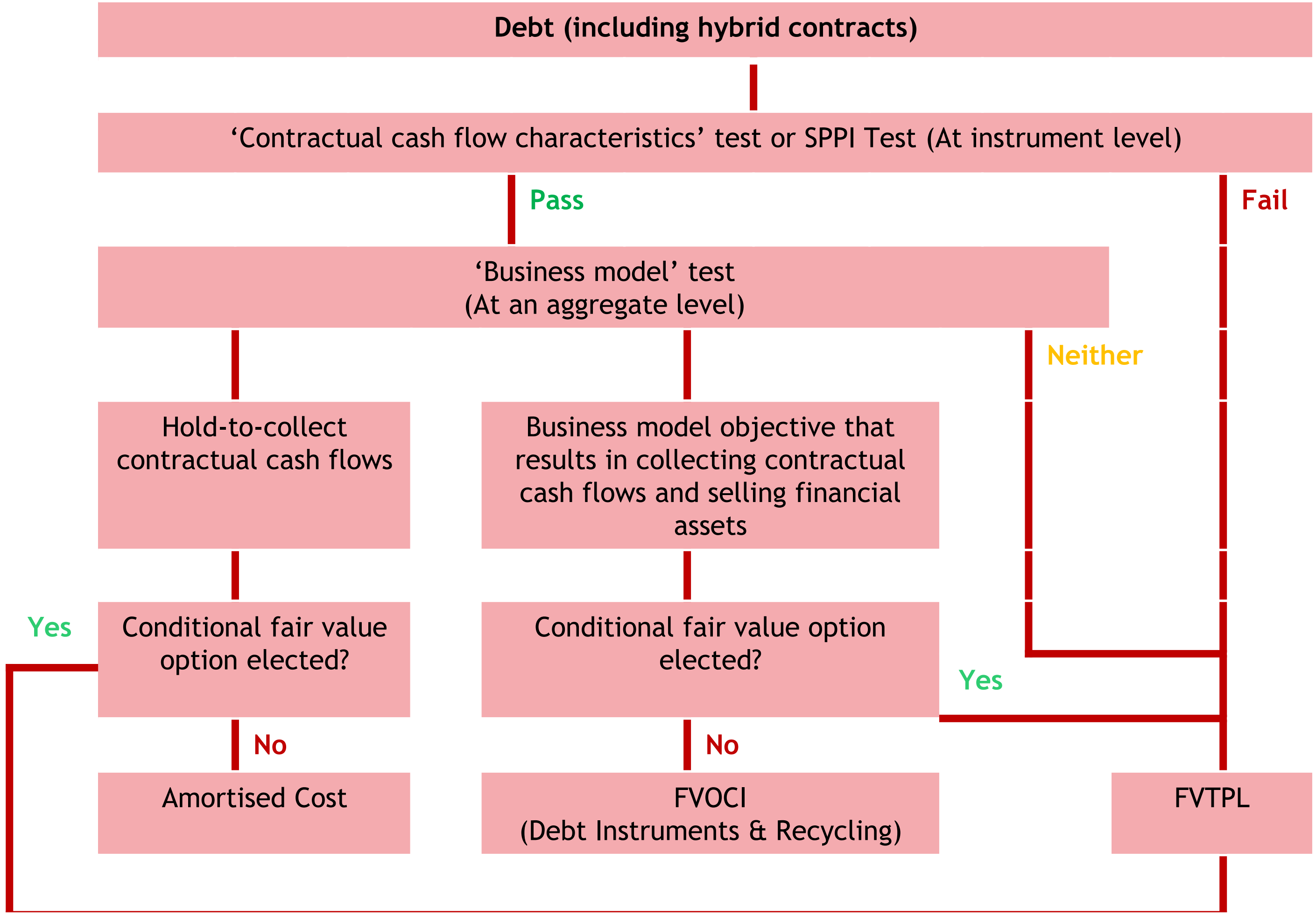
Derivative

‘Contractual cash flow characteristics’ test
or SPPI Test
(At instrument level)

Fail

FVTPL


Equity Instruments
'Contractual cash flow characteristics' test or SPPI Test
(At instrument level)
Fail
Held for trading?
No
Yes
No
Irrevocable FVOCI Option Elected
Yes
FVTPL
FVOCI
(Equity Instruments & No Recycling)


Debt (including hybrid contracts)
'Contractual cash flow characteristics' test or SPPI Test (At instrument level)
Pass
Fail
'Business model' test
(At an aggregate level)
Neither
Hold-to-collect contractual cash flows
Business model objective that results in collecting contractual cash flows and selling financial assets
Yes
Conditional fair value option elected?
Conditional fair value option elected?
Yes
No
No
Amortised Cost
FVOCI
(Debt Instruments & Recycling)
FVTPL

OVERVIEW OF THE TRANSITIONAL REQUIREMENTS - CLASSIFICATION AND MEASUREMENT

OVERVIEW OF TRANSITIONAL REQUIREMENTS

Classification and measurement

Retrospective

Impairment

Retrospective

Hedge accounting

Prospective (with certain exceptions)

Focus of this presentation

IFRS 9 TRANSITION APPROACH

Must apply all requirements of IFRS 9 at the same time subject to 3 exceptions

Exceptions

Requirement to present changes in fair value related to credit risk in OCI for liabilities designated at FVTPL	→	Can be early adopted in isolation
Hedge accounting requirements	→	Choice to continue applying IAS 39 hedge accounting requirements
Entities that have adopted previous versions of IFRS 9	→	Special transitional provisions apply

DATE OF INITIAL APPLICATION (DIA)

- Beginning of the first reporting period in which an entity first applies IFRS 9
- Example: An entity applies IFRS 9 for its annual reporting periods beginning 1 January 2018
  Therefore: Date of initial application is 1 January 2018
- Example: An entity applies IFRS 9 for its annual reporting periods beginning 1 July 2018
  Therefore: Date of initial application is 1 July 2018
- The DIA is relevant to a number of assessments that relate to the classification and measurement of financial assets

TRANSITION REQUIREMENTS

Classification and measurement

Phase	Transition requirements	Summary
Classification and measurement	Retrospective	• Not <u>required</u> to restate comparatives • May restate i.e. choice to restate • Must provide the disclosures set out in IFRS 7

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TRANSITION REQUIREMENTS

Classification and measurement

- Accounting policy choice
  - Restate comparatives
  - Do **not** restate comparatives

COMPARATIVES

IFRS 9 paragraphs 7.2.15

No restatement

- Adjustment to opening retained earnings at DIA
- Difference between:
  - Carrying amounts before adoption of IFRS 9
  - New carrying amounts on the DIA

Restatement

- Only available if possible without the use of hindsight
- Restate for classification and measurement based on IFRS 9 transitional provisions at DIA
- No restatement permitted for financial assets and financial liabilities already derecognised at DIA

EXAMPLE 1

Background

- Entity A applies IFRS 9 with a DIA of 1 January 2018
- On 30 September 2017, Entity A sold an available-for-sale equity investment and recognised a gain of $30 which included the effect of reclassifying the related amount from the available-for-sale reserve to profit or loss

Question

Are there any adjustments required on transition?

EXAMPLE 1 (CONT)

Question

Are there any adjustments required on transition?

Answer

- No
- The date of initial application is 1 January 2018
- IFRS 9 does not apply to financial instruments that have already been derecognised by the date of initial application

EXAMPLE 2

Background

- Entity B bought an equity investment in an unlisted company on 1 January 2017 $100
- The equity investment was measured at cost under IAS 39/AASB 139
- On 31 December 2017 Entity B recognised an impairment loss of $60
- Entity B applies IFRS 9 for the first time in the annual reporting period ending 31 December 2018
- It elects to measure the equity investment at FVTOCI
- Fair value of the investment on 1 January 2018 is $50
- Fair value of the investment at 31 December 2018 is $90

Question

How should Entity B account for the investment on

a) Transition, and

b) At 31 December 2018?

EXAMPLE 2 (CONT)

Question (a): How should Entity B account for the investment on transition?

Answer (a)

- Date of initial application of IFRS 9 is 1 January 2018
- Carrying value of the investment as at 31 December 2017 under IAS 39/AASB 139 is $40
- Fair value under IFRS 9 on 1 January 2018 is $50
- Recognise difference of $10 in opening retained earnings at 1 January 2018
- Journal to record initial adjustment at 1 January 2018

Dr	Equity investment (financial asset)	$10
Cr	Opening retained earnings	$10

EXAMPLE 2 (CONT)

Question (b): How should Entity B account for the investment as at 31 December 2018?

Answer (b)

- Entity B elects to measure the equity investment at FVTOCI
- At 31 December 2018, recognise the CU40 fair value gain in OCI ($90-$50)
- Journal to record FV gain 31 December 2018

DR	Equity investment (financial asset)	$40
CR	Revaluation reserve re shares (OCI)	$40

EXAMPLE 3

Background

- Same facts as Example 2
- Except that Entity B decides to classify the equity investment at FVTPL

Question

How should Entity B account for the investment

a) On transition, and

b) At 31 December 2018?

EXAMPLE 3 (CONT)

Question (a): How should Entity B account for the investment on transition?

Answer (a)

- Date of initial application is 1 January 2018
- Carrying value of the investment as at 31 December 2017 under IAS 39 is $40
- Fair value under IFRS 9 on 1 January 2018 is $50
- Recognise difference of CU10 in opening retained earnings at 1 January 2018
- Journal to record initial adjustment at 1 January 2018

DR	Equity investment (financial asset)	$10
CR	Opening retained earnings	$10

EXAMPLE 3 (CONT)

Question (b): How should Entity B account for the investment as at 31 December 2018?

Answer (b)

- Entity B elects to measure the equity investment at FVTPL
- At 31 December 2018, recognise the C$0 fair value gain in profit or loss ($90-$50)
- Journal to record FV gain 31 December 2018

DR	Equity investment (financial asset)	$40
CR	Profit or loss	$40

TRANSITIONAL REQUIREMENTS - FINANCIAL ASSETS THAT ARE DEBT INSTRUMENTS

TRANSITION REQUIREMENTS

Financial assets that are debt instruments

Phase	Transition requirements	Summary

Classification and measurement	SPPI test (para 7.2.3)	• Apply SPPI contractual cash flows characteristics test based on facts and circumstances that exist on initial recognition
		• Resulting classification is applied retrospectively
		• Transitional requirements when impracticable:
		    • Assess a modified time value of money element (para 7.2.4)
		    • Assess whether the fair value of a prepayment feature was insignificant (para 7.2.5)

TRANSITION REQUIREMENTS

Financial assets that are debt instruments

Phase	Transition requirements	Summary

Classification and measurement	Business model test
	(para 7.2.3)
		• Business model assessment carried out as at the DIA
		  • Hold to collect
		  • Hold to collect and sell
		• Resulting classification is applied retrospectively
		• No adjustment for different business model in prior period(s)

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EXAMPLE 4
IFRS 9 paragraph 7.2.15

Background

- On 1 January 2016, Entity C lent Developer Co CU500 million for 5 years at a fixed rate of 5% (CU500m repayment due on 31 December 2020)
- Developer Co uses the funds to buy a piece of land and construct residential apartments for sale
- In addition to the 5% fixed rate of interest, Entity C will be entitled to 10% of the net profit from the project
- Under IAS 39, Entity C had accounted for the loan as an available for sale financial asset (measured at FVTOCI)
- Entity C applies IFRS 9 for the first time in its annual reporting period ending 31 December 2018
- Fair value of the loan at 1 January 2018 is CU490 million
- Fair value of the loan at 31 December 2018 is CU530 million

Questions

a) What adjustments are required on transition (if any)?

b) What is the journal entry for 31 December 2018?

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EXAMPLE 4 (CONT)

IFRS 9 paragraph 7.2.15

Question (a): What 'measurement' adjustments are required on transition (if any)?

Answer (a)

- Under IFRS 9, the terms of this 'loan' do not meet the solely payments of principal and interest contractual cash flow test, meaning that it is required to be measured at FVTPL
- Under IAS 39 the loan was classified as available for sale and measured at fair value
- No measurement adjustments are required on transition to IFRS 9

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EXAMPLE 4 (CONT)

IFRS 9 paragraph 7.2.15

Question (b): What is the journal entry at 31 December 2018?

Answer (b)

Journal entry for the year ending 31 December 2018

DR Financial asset	$40 million
CR Profit or loss	$40 million

FINANCIAL ASSETS WITH EMBEDDED DERIVATIVES

FINANCIAL ASSETS WITH EMBEDDED DERIVATIVES

IFRS 9 paragraph 7.2.6 & 7.2.7

IAS 39 requires ‘hybrid’ instruments to be assessed to determine whether they are to be separated into components

- ‘Host’ contract
- Embedded derivative(s)

IFRS 9 requires hybrid instruments to be assessed in their entirety

- In many cases hybrid instruments will be measured at FVTPL
- Use IFRS 7 fair value disclosures for host component for prior periods
- Calculate the fair value of the instrument at the DIA
- Difference between total for components and fair value as a whole, to be recorded in retained earnings

EXAMPLE 5

Background

- Entity Z holds a hybrid instrument, originally acquired in 2017
- At 31 December 2017, the instrument was separated into (under requirements IAS 39):
  - Host contract – amortised cost
  - Carrying value = $5 million
- IFRS 7 fair value disclosed = $5.5 million
- Embedded derivative asset recognised at FVTPL and FV = $200,000
- Entity Z's DIA of IFRS 9 is 1 January 2018
- Fair value of hybrid instrument at 1 January 2018 is $5.75 million

Question

How should Entity Z measure the hybrid instrument at the DIA if

a) Comparatives are restated

b) Comparatives are not restated

EXAMPLE 5 (CONT)

Question (a)

How should Entity Z measure the hybrid instrument at the DIA if comparatives are restated?

Answer (a)

- Determine fair value of hybrid instrument at 31 December 2017

Component	FV ($)
Host contract	5,500,000
Embedded derivative asset	200,000
FV of hybrid instrument (para 7.2.6)	**5,700,000**

- Journal entry to adjust carrying amount of hybrid instrument in comparative periods (year-ended 31 December 2017)

DR	Hybrid contract	$5,700,000
CR	Host contract	$5,000,000
CR	Embedded derivative asset	$200,000
CR	Opening retained earnings	$500,000

EXAMPLE 5 (CONT)

Question (a)

How should Entity Z measure the hybrid instrument at the DIA if comparatives are restated?

Answer (a)

- Adjustment to opening retained earnings at DIA
- Calculate difference between FV of entire instrument at DIA & FV calculated in accordance with para 7.2.6

Value of instrument	($)
FV of hybrid instrument on DIA	5,750,000
FV of hybrid instrument (para 7.2.6)	5,700,000
Difference	**50,000**

- Journal on 1 January 2018 to adjust opening retained earnings on DIA

DR	Hybrid contract	$50,000
CR	Opening retained earnings	$50,000

EXAMPLE 5 (CONT)

Question (b)

How should Entity Z measure the hybrid instrument at the DIA if comparatives are not restated?

Answer (b)

- Adjustment to opening retained earnings at DIA
- Calculate difference between FV of entire instrument at DIA & carrying value of instrument on DIA

Component	($)
FV of hybrid instrument on DIA	5,750,000
CV of hybrid instrument – DIA	5,200,000
Difference	**550,000**

EXAMPLE 5 (CONT)

Question (b)

How should Entity Z measure the hybrid instrument at the DIA if comparatives are not restated?

Answer (b)

- Journal on 1 January 2018 to adjust opening retained earnings (or another component of equity) on DIA

DR	Hybrid contract	$5,750,000
CR	Host contract	$5,000,000
CR	Embedded derivative asset	$200,000
CR	Opening retained earnings	$550,000

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MONTHLY FINANCIAL REPORTING WEBINARS

- https://www.bdo.com.au/en-au/insights/audit-assurance/webinars/2018-financial-reporting-accounting-standards

- Next month's Webinar (25 July 2018)
  - IFRS 9 – Risk Assessment

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