

## Gearing up on your IFRS 9 readiness

*I am in charge for the accounting and financial reporting function at a bank. We are currently preparing for the IFRS 9 implementation and in need of an advice on how to make this process simpler, and what should be our area of concern?*

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IFRS 9 Financial Instruments was issued on 2014 and has a mandatory effective date of 1 January 2018.

IFRS 9 introduces a new methodology for financial instruments classification and the incurred loss impairment model is replaced with a more forward looking expected loss model. This is all in addition to the major new requirements on hedge accounting. These fundamental changes however, call for careful planning. The planning for IFRS 9 implementation is going to be an important issue. An assessment phase is recommended as a starting point of the IFRS 9 journey and entities should focus on understanding the IFRS 9 financial and operational implications. With the implementation of IFRS 9, you will need to assess people, processes, technology and controls that will be necessary to drive an effective implementation.

**Classification & Measurement.** IFRS 9 contains three classification categories for financial assets: Measured at amortized cost (AC); Measured at fair value through other comprehensive income (FVOCI); and Measured at fair value through profit or loss (FVTPL).

IFRS 9 uses a simple approach to determine whether a financial asset is measured at AC or FV. The assessment of the new

measurement is based on how a company manages its financial instruments (its business model); and the contractual cash flow characteristics of the financial assets. IFRS 9 requires financial asset to be classified at AC if the objective of the company's business model is to hold the financial assets to collect the contractual cash flows; and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. When these two requirements are not met, the financial asset has to be measured at fair value.

There are three criteria that need to be considered for classification and measurement: Business model criterion, as entity may have separate business models for portfolios of investments that are managed in different ways; Cash flow characteristics criterion; and No accounting mismatch.

**Impairment.** As a result of that new classification model, the only financial assets subject to impairment will be instruments measured at AC. Impairment do not apply for equity investments.

IFRS 9 has redesigned the provisioning model for financial assets, financial guarantees, loan commitment, and lease receivables. The incurred loss model has been

changed to an expected loss model. This is what we call as 'forward-looking impairment model'. The impairment process will look at twelve-months expected credit losses, lifetime expected credit losses (gross carrying amount), and lifetime expected credit losses (net carrying amount).

**Hedge Accounting.** IFRS 9 incorporates new hedge accounting requirements that represent a major overhaul of hedge accounting and introduce significant improvements, principally by aligning the accounting more closely with risk management.

There are three criteria to apply hedge accounting: Hedging relationship; Designation and documentation; and Hedge effectiveness requirements.

**IT Systems.** To be IFRS 9 compliant, impairment systems will require further adjustments. You need to identify the gaps in the tools currently used to meet the needs. Information required for both accounting and disclosure purposes needs to be captured and assessed appropriately. It is important that your company have an integrated, cross-functional application to avoid manual interventions. You should also consider the capacity of current system, as the volume of data can be challenging.

### KEY POINTS

- Implementation of IFRS 9 will bring an integration of functions and skills, i.e. accounting, finance, risk management
- Identify what models need to change, and understand the complexity and volume of data needed for IFRS 9
- Check your readiness for IFRS 9 implementation and identify how long will it need to be fully compliant
- Develop implementation plan and discuss it with your board of directors



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