Deloitte.

IFRS 9 Seminar

Tbilisi, 15 June 2017

რა უნდა იცოდეთ
ახალი კანონი ბუღალტრული აღრიცხვის, ანგარიშგებისა და აუდიტის შესახებ

ზოგადი ინფორმაცია

საქართველოს ახალი კანონი ბუღალტრული აღრიცხვის, ანგარიშგებისა და აუდიტის შესახებ ძალაშია **2016** წლის ივნისიდან**.**

კანონის თანახმად შეიქმნა საქართველოს ფინანსთა სამინისტროს სისტემაში შემავალი სახელმწიფო საქვეუწყებო დაწესებულება - ბუღალტრული აღრიცხვის**,** ანგარიშგებისა და აუდიტის ზედამხედველობის სამსახური**.**

კანონი კომპანიებს **4** ძირითად კატეგორიად და საზოგადოებრივი დაინტერესების პირად ყოფს.

ეს კანონი, მოგების გადასახადის ცვლილებებთან ერთად, მნიშვნელოვან გავლენას მოახდენს საქართველოში არსებულ ბიზნეს გარემოზე.

ფინანსური აღრიცხვისა და ანგარიშგების მოთხოვნები

კატეგორია	ანგარიშგების საფუძველი	ფინანსური ანგარიშგებების მომზადებისა და წარდგენის ვალდებულება	აუდიტის ჩატარების ვალდებულება	მმართველობის ანგარიშგების მომზადების ვალდებულება**
სდპ	ფასს	დიახ	დიახ	დიახ*
I	ფასს	დიახ	დიახ	დიახ*
II	ფასს მცირე და საშუალო საწარმოებისთვის	დიახ	დიახ	დიახ*
III	ფასს მცირე და საშუალო საწარმოებისთვის	დიახ	არა	არა
IV	განსაზღვრავს სამსახური	დიახ	არა	არა

* სდპ-მ, I და II კატეგორიის საწარმოებმა უნდა წარმოადგინონ აუდიტორის დასკვნა მმართველობის ანგარიშგებაზე.

** მმართველობის ანგარიშგების ინფორმაცია შესაძლოა მოცემული იყოს საწარმოს ფინანსურ ანგარიშგებაში.

საზოგადოებრივი დაინტერესების პირი (სდპ) – იურიდიული პირი, რომელიც არის:

ყ.გ) მიკროსაფინანსო ორგანიზაცია „მიკროსაფინანსო ორგანიზაციების შესახებ" საქართველოს კანონის შესაბამისად;

მნიშვნელოვანი თარიღები

რეგულაციის ძალაში შესვლა

კატეგორია I, II და სდპ

- 2017 წლის 31 დეკემბრით დასრულებული საანგარიშგებო პერიოდისთვის.

ანგარიშგებების წარდგენა და გამოქვეყნება

საანგარიშგებო პერიოდის დასრულების შემდგომ არაუგვიანეს 1 ოქტომბრისა შესაბამისმა საწარმოებმა უნდა წარმოადგინონ შემდეგი ანგარიშგებები:

- ფინანსური ანგარიშგება
- მმართველობის ანგარიშგება
- აუდიტორული დასკვნა

სამსახური ვალდებულია ეს ანგარიშგებები და აუდიტორული დასკვნები გამოაქვეყნოს მათი წარდგენიდან 1 თვის ვადაში.

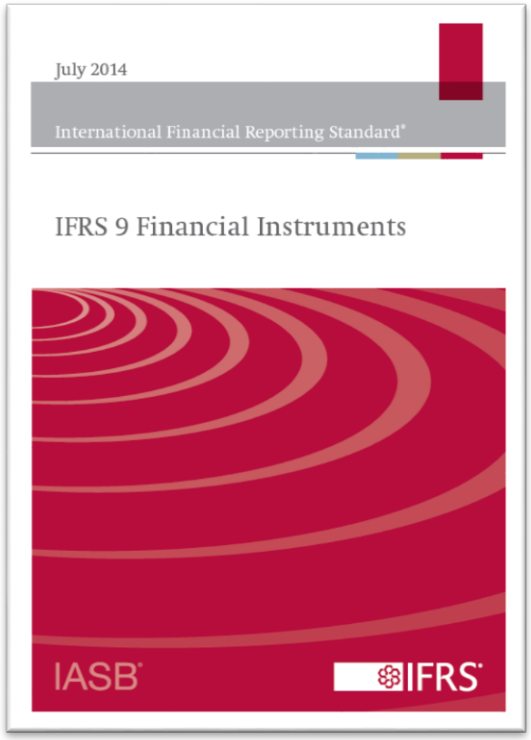
Overview

The IASB has issued the final version of **IFRS 9 Financial Instruments** on 24 July 2014 – Mandatory application **2018**

Classification and Measurement

Impairment

General Hedge Accounting



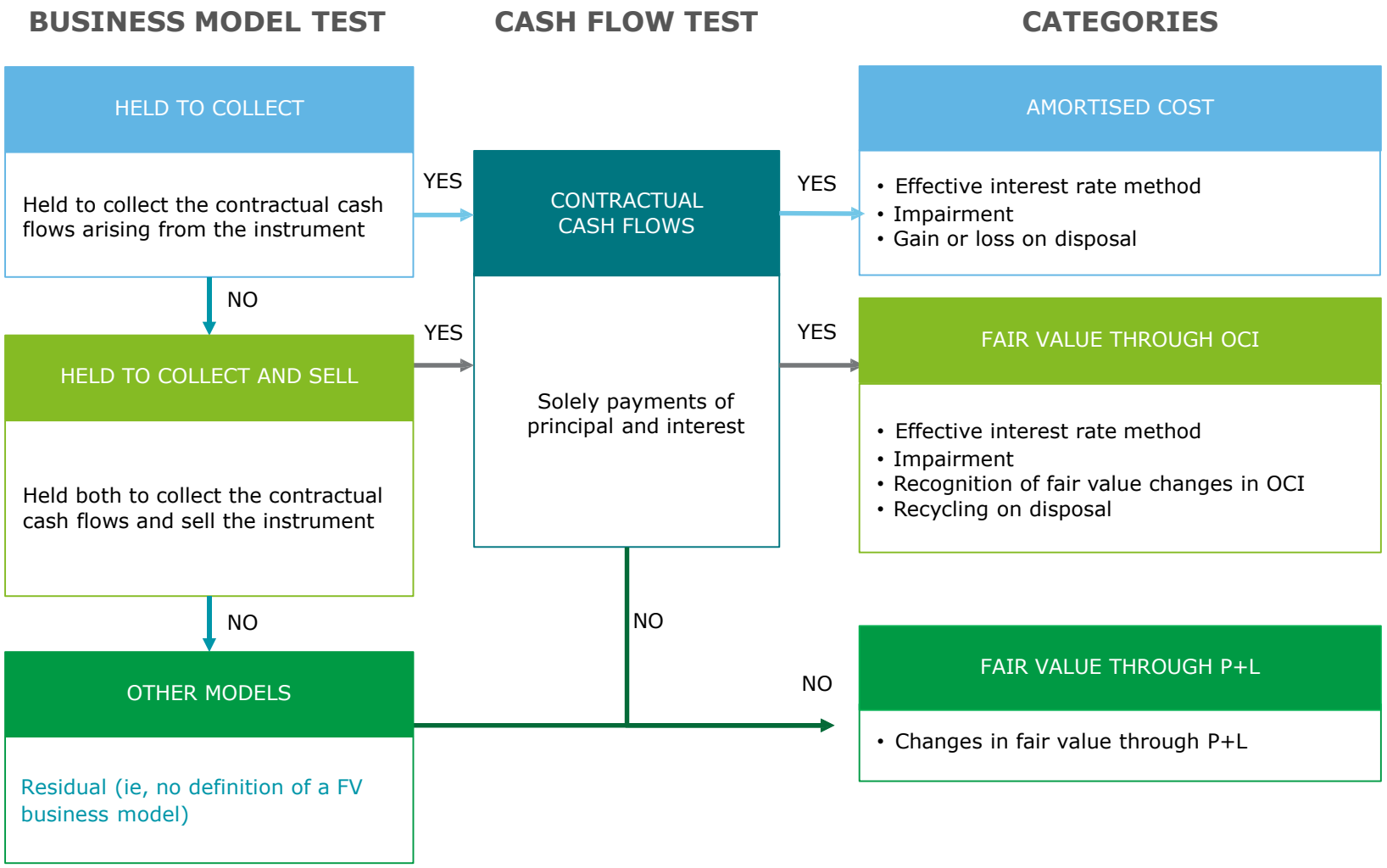
Macro Hedge Accounting

Separate project

Overview
Major changes introduced by IFRS 9

	Changes compared to IAS 39?
Scope	None (minor extensions, e.g. impairment of issued loan commitments not measured at FVTPL)
Recognition & derecognition	None
Classification and measurement of financial assets	New model regarding the classification and measurement based on : • The entity's business model (portfolio perspective) and • The contractual cash flow characteristics (CCC criterion) of the individual financial asset
Classification and measurement of financial liabilities	• No amendments regarding classification • New requirements for the accounting of changes in the fair value of an entity's own debt where the FVO has been applied („own credit issue")
Embedded derivatives	Bifurcation of embedded derivatives needs to be assessed for hybrid contracts containing a host that is a financial liability or a host that is not an asset within the scope of IFRS 9 (hybrid contracts with a financial asset as a host contract are classified in their entirety based on the CCC criterion)
Amortised cost measurement	None
Impairment	Significant change to expected loss model

Classification of financial assets – IFRS 9 model



Approach to classification and measurement of financial assets

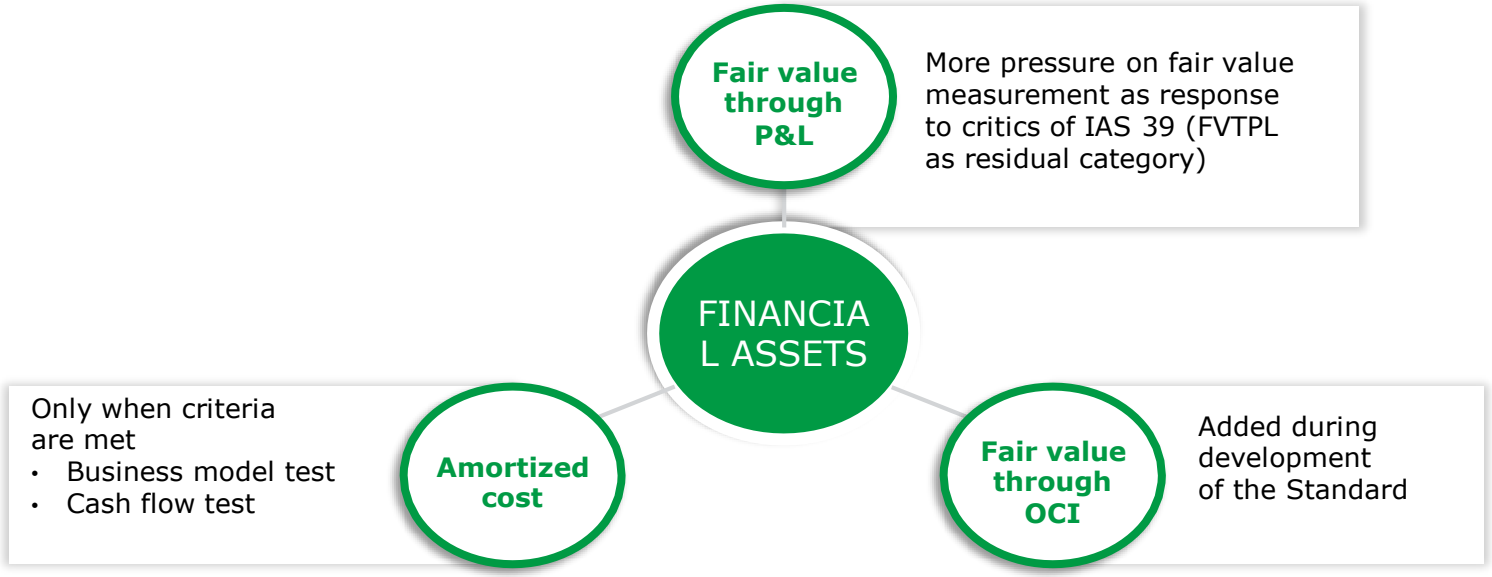
1. Identify business model(s) — C&M session I

2. Identify cash flows characteristics (if needed) — C&M session II

3. Apply measurement options (if available)

Example of classification of financial assets in new measurement category

Loan Products	Business model	Will pass SPPI test?	Classification under IFRS 9
Consumer loans	Held to collect	Yes	Amortized cost
Express loans/Online loans	Held to collect	Depends	Fair value through Profit and loss/Amortized Cost
Residential mortgage loans	Held to collect	Yes	Amortized cost
Gold – pawn loans	Held to collect	Depends	Amortized cost/Fair value through Profit and loss



IFRS 9 Impairment concept

Definition of Impairment

In IFRS 9 impairment is referred as change in expected credit losses are required to be measured through a loss allowance at an amount equal to:

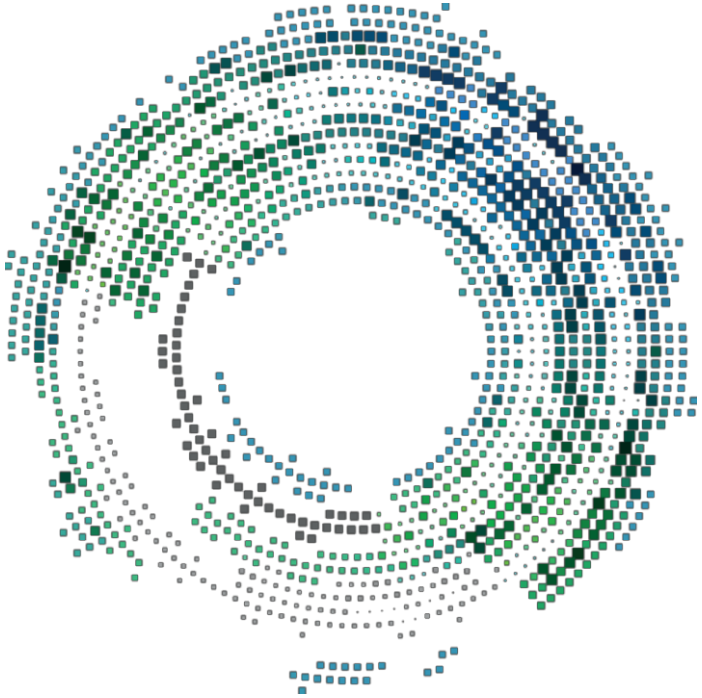
[IFRS 9 paragraphs 5.5.3 and 5.5.5]

- the 12-month expected credit losses (expected credit losses that result from those default events on the financial instrument that are possible within 12 months after the reporting date); or
- full lifetime expected credit losses (expected credit losses that result from all possible default events over the life of the financial instrument).

Credit Risk Assessment:

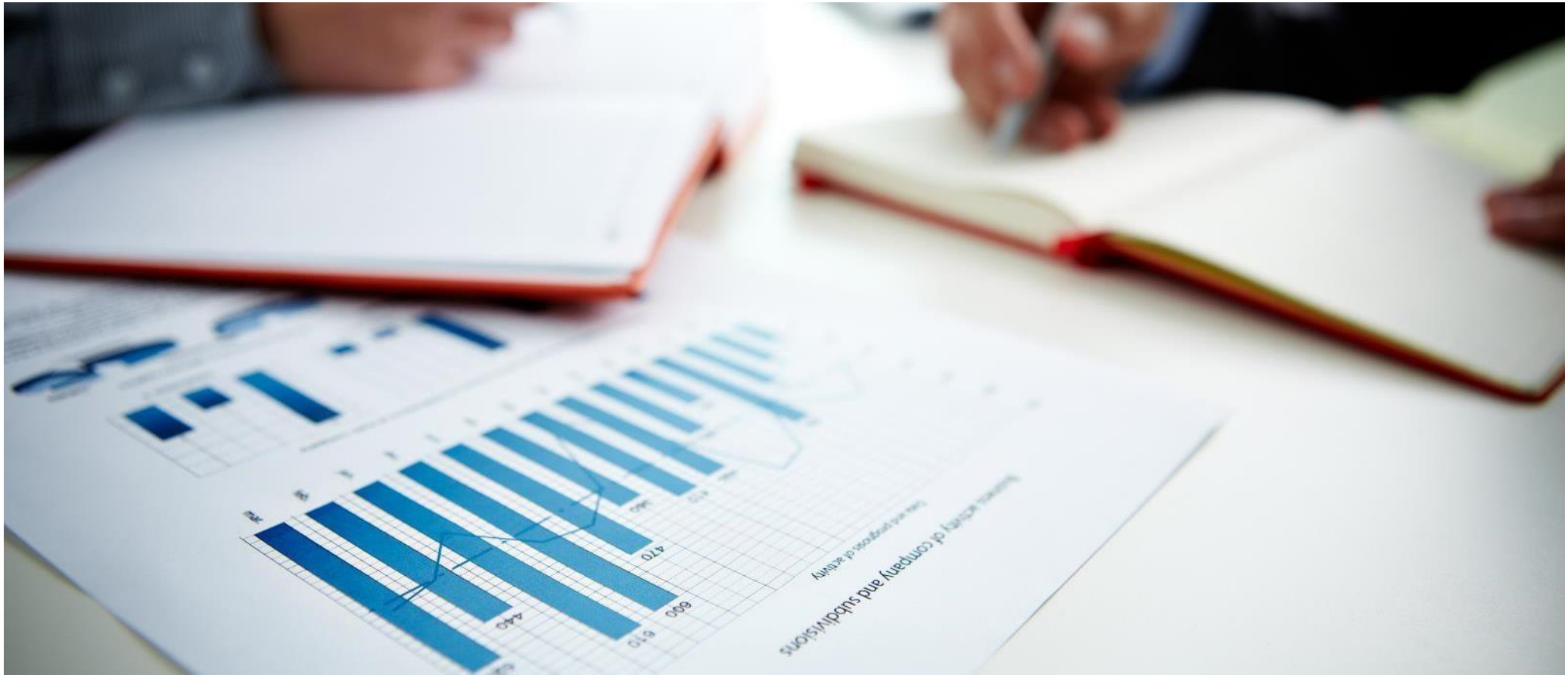
✓ Individual assessment

✓ Collective assessment



Challenge – Historical data adjustment

(A1 on impairment map)



Individual assessment
Historical data adjustment (1/3)

The historical data itself on the Clients' operational results for the purposes of estimation its future performance is not exhaustive

- Forward looking concept requires to incorporate into analysis all the available significant information;
- Not all that information might and can be reflected in the current or previous accounting periods financial statements;
- An entity shall adjust historical data on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows (B5.5.52);
- Not necessarily identify every possible scenario or worst and best cases;
- Must consider the risk that a credit loss occurs reflecting both the possibility of a credit loss or no credit loss occurring.

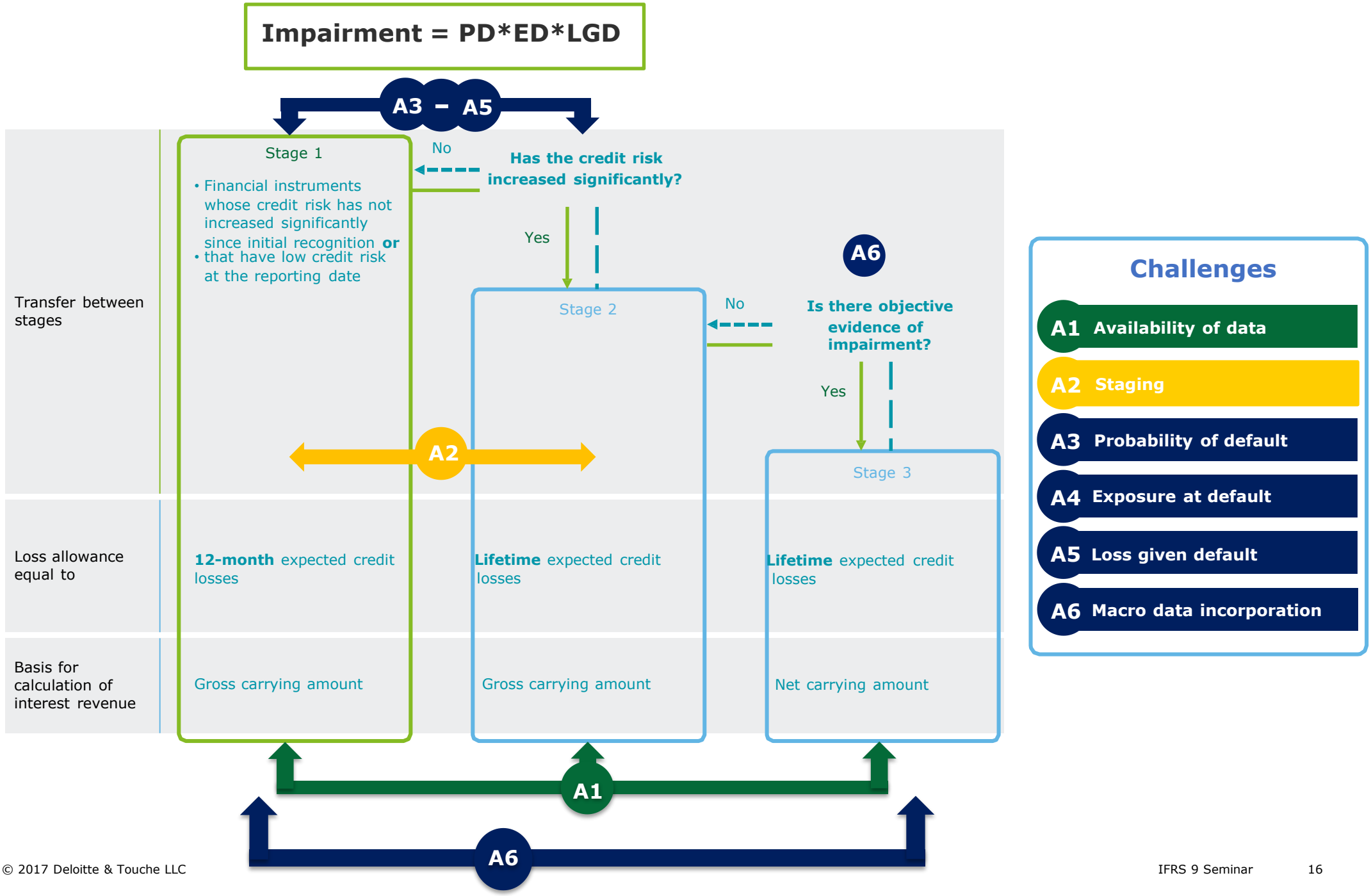
An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes

Individual assessment
Historical data adjustment (2/3)

Risk-adjusted budgeting

a. Determination of Clients core items under uncertainty (Sales, Sales Prices, COGS and etc.)
b. Identification of key corporate-level risks and their interrelation;
c. Identification of main risk-factors;

IFRS 9 Impairment concept

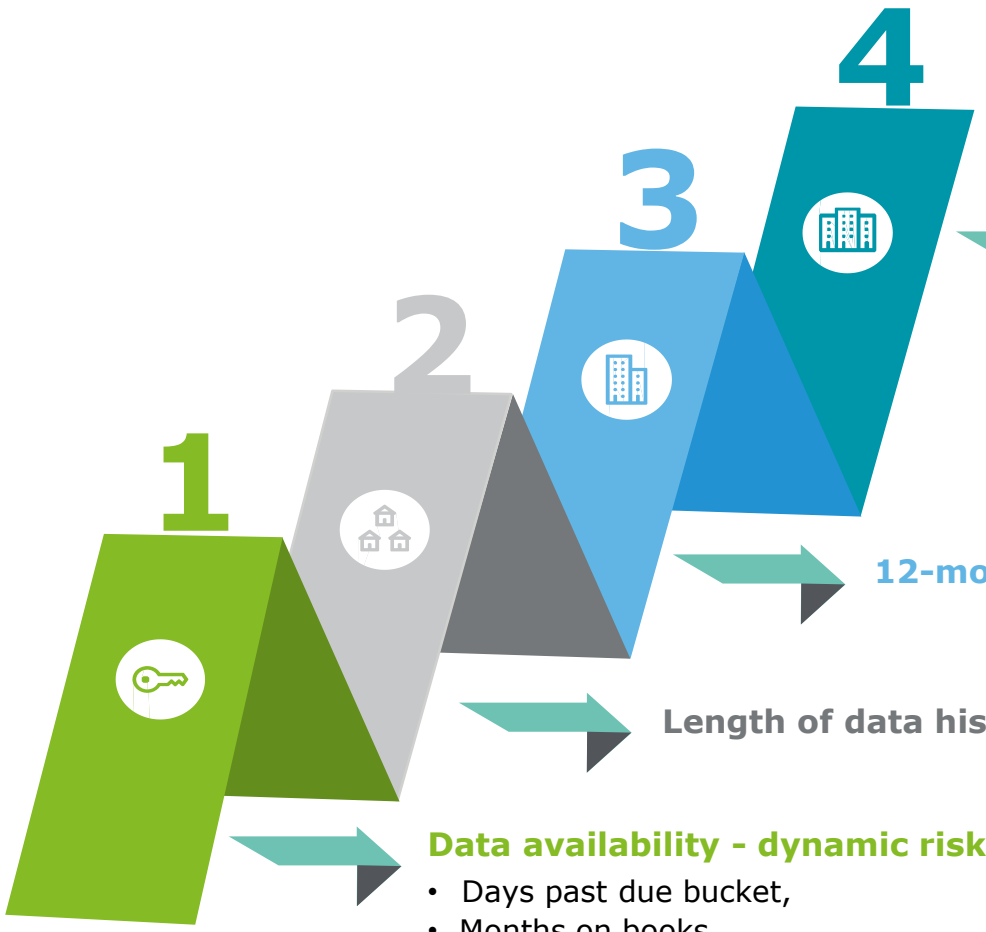


Challenge 1

Data availability Significant increase in credit risk (A1 on the impairment map)

Collective assessment

Data availability (1/3)



Data availability - static risk characteristics

- Product characteristics/ currency / portfolio,
- Client segment / industry,
- Vintage / original maturity,
- Scoring – application,
- Scoring CB at origination,
- LtV at origination

12-month PDs availability

Length of data history vs default flag

Data availability - dynamic risk characteristics

- Days past due bucket,
- Months on books,
- Scoring - behavioural,
- Scoring CB,
- Rating

The special attention should be drawn to the data related to other credit risk management tools, which could be potentially utilized for the purposes of IFRS 9 modelling

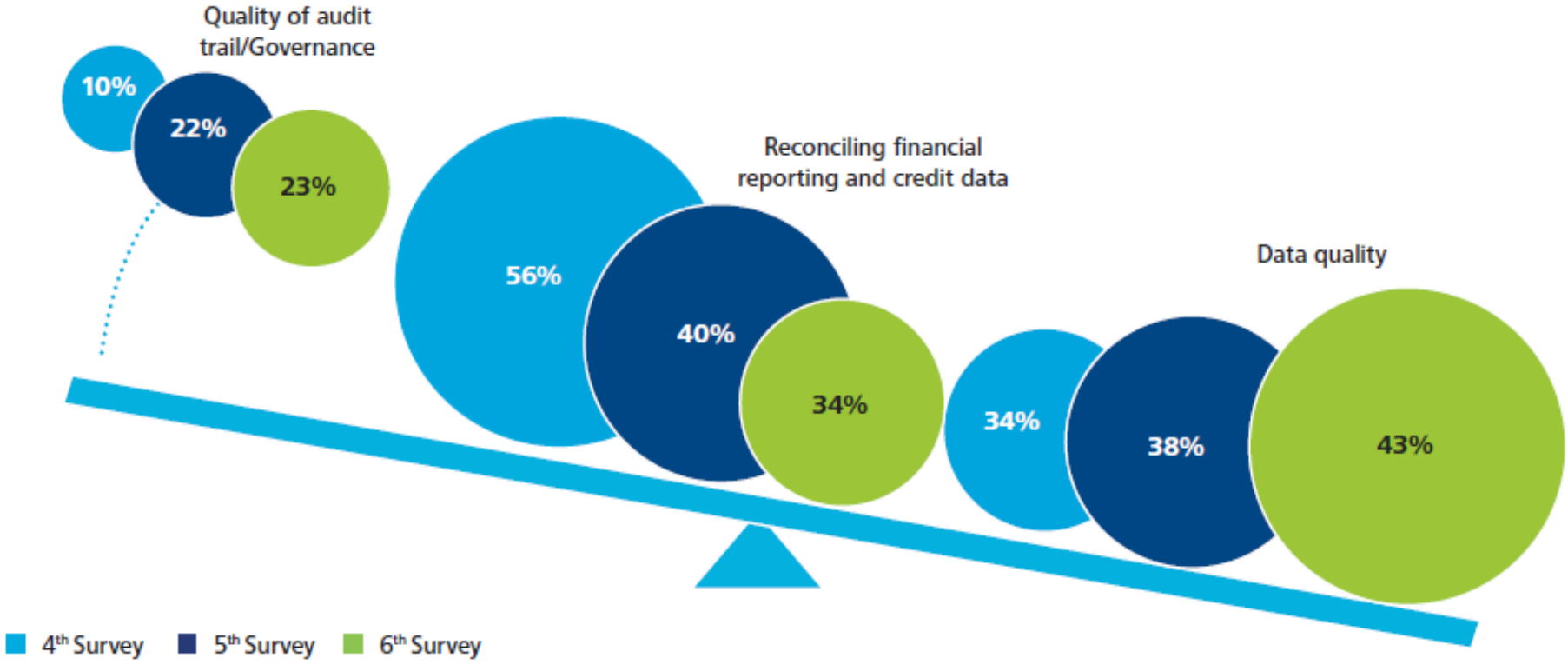
Collective assessment
Data availability (2/3)

Regular challenges relied to the input data collection:

- Adequacy, quality, completeness and representativeness of the data. Data accessibility
- What is included in adequate selection of data?
- Mismatch in the portfolio
- External data not as detailed as internal wishes, e.g. adjustments to financial statements will be missing, default definition differs from internal, not include qualitative factors
- Sufficient enough number of defaults needed per risk factor. Are many models can be build with this assumption?
- Approximation of missing values – problems later with RWA and ratings distribution unexpected results
- Use of internal non-rating data (for instance, scoring data and/or payment remarks)

Collective assessment
Data availability (3/3)

- What are the biggest concerns about using credit risk management systems and data for financial reporting purposes?

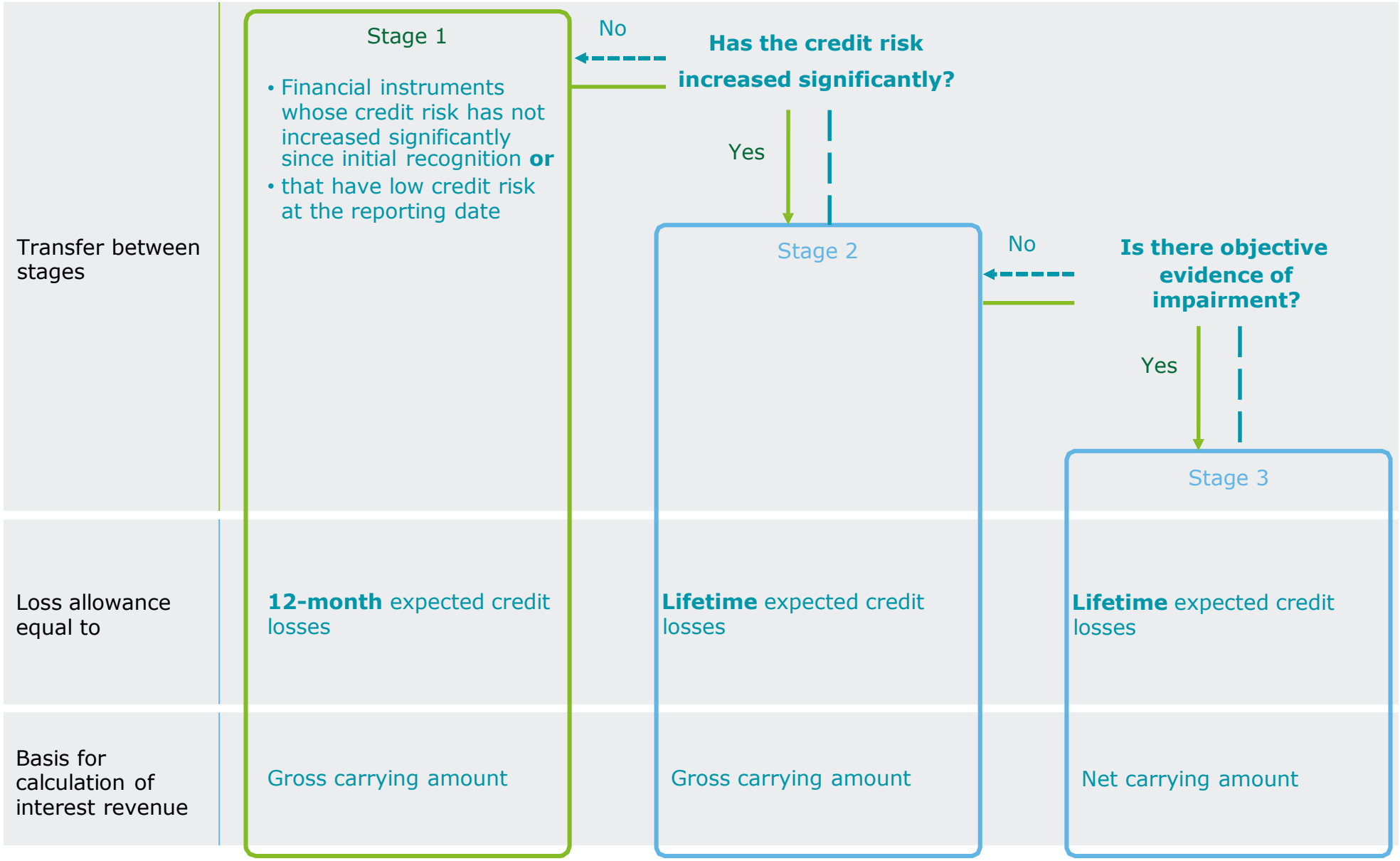


Challenge 2 – Staging and segmentation

(A2 On impairment map)

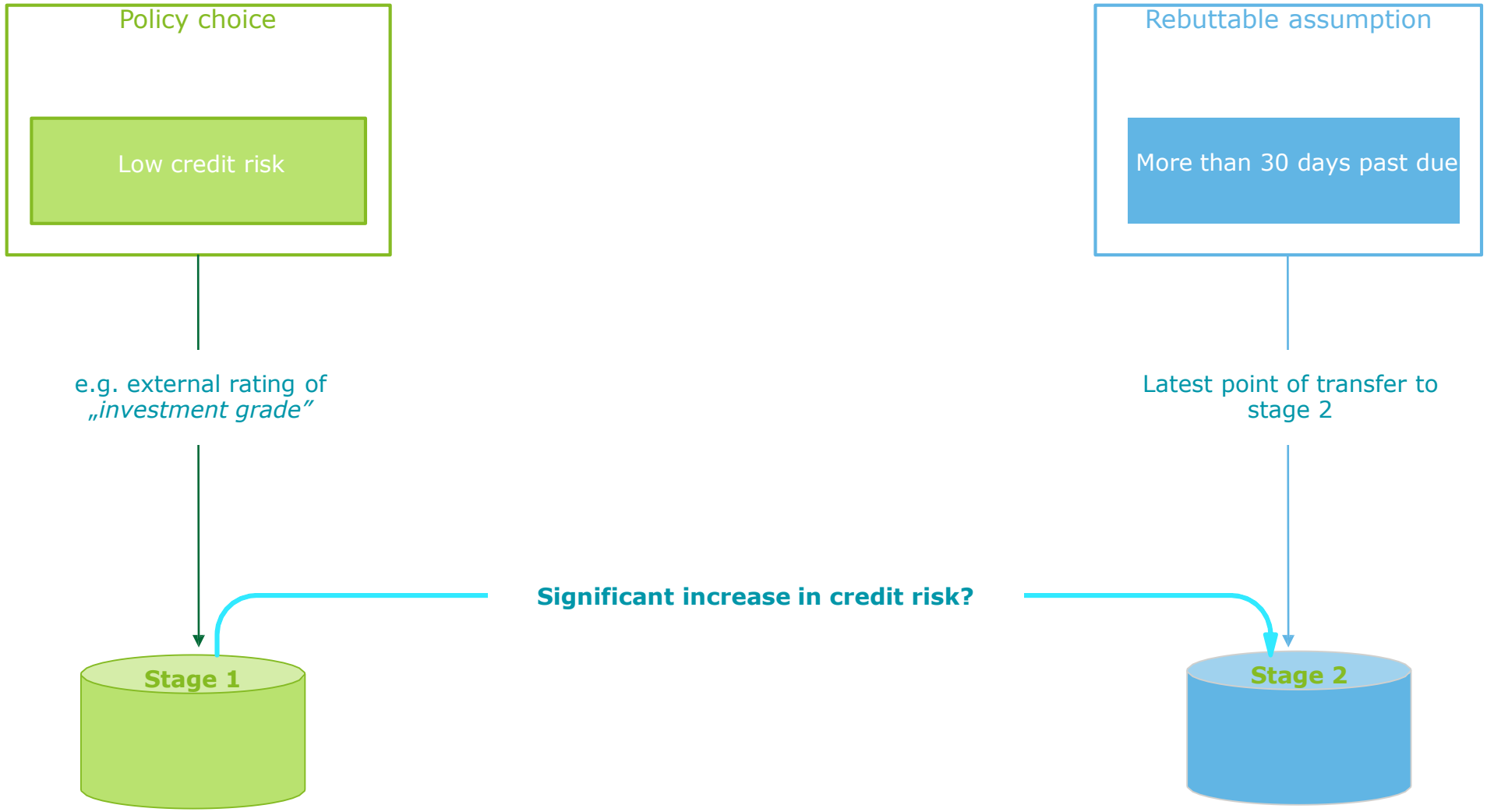
Staging and segmentation

Staging principles (1/3)



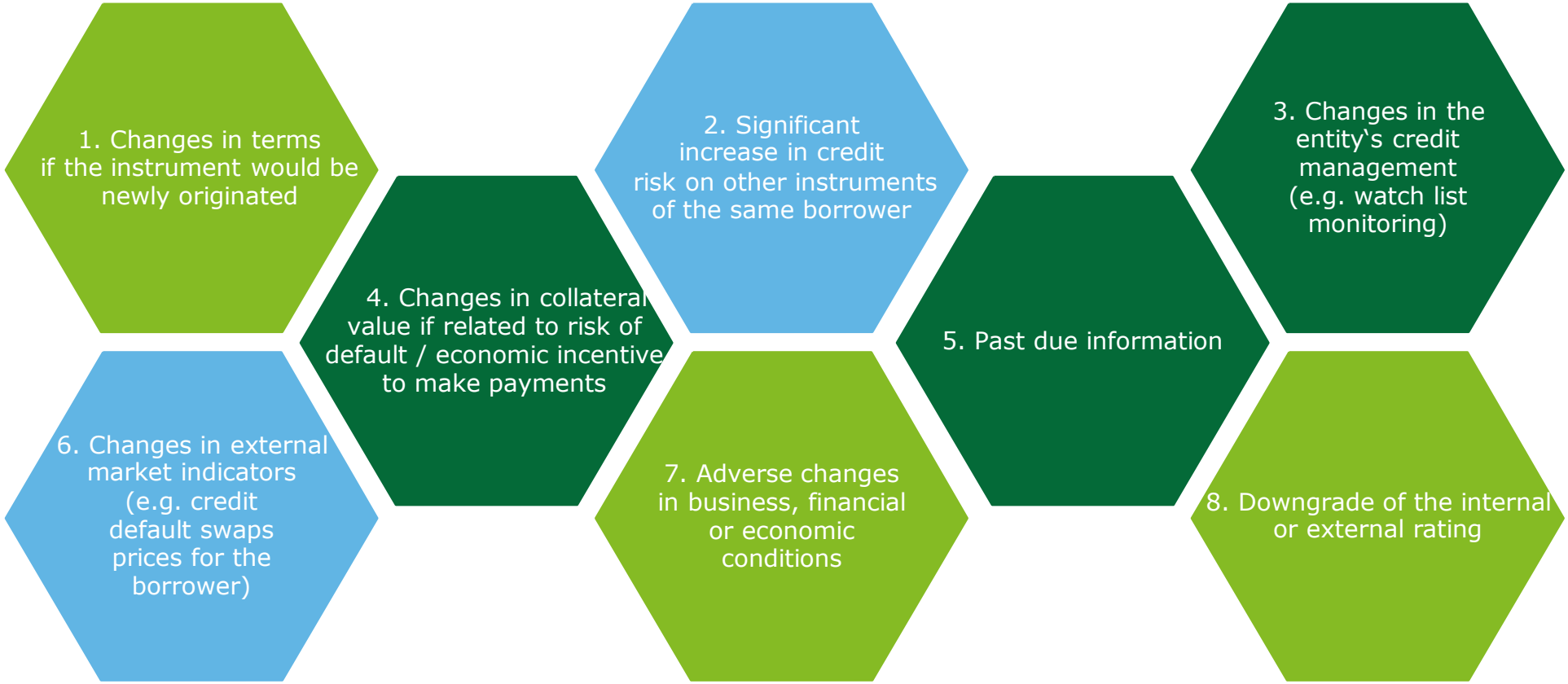
Staging and segmentation

Staging assumptions and approximations

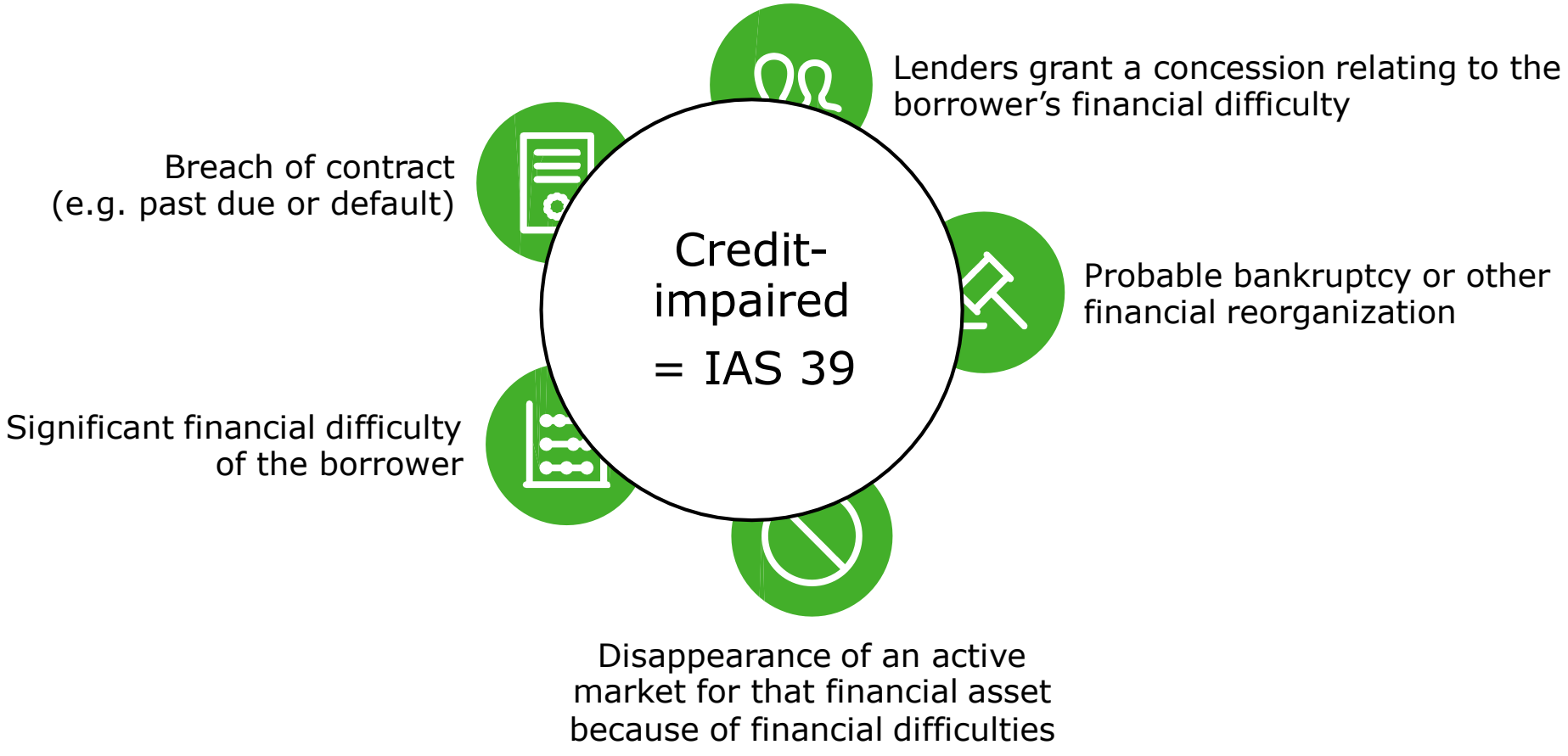


Significant increase in credit risk
Indicators examples

Possible indicators of increase in credit risk



Credit-impaired
Transfer to Stage 3



Staging and segmentation

What other banks do?

How do you expect to define and measure 'significant increase in credit risk'?*

	Mortgage	Other retail loans	SME	Corporate	Securities
Missed payments	66%	65%	56%	54%	46%
Enters a watch list/specialist problem credit team	35%	30%	49%	50%	31%
Step changes in internal grading/rating scales	36%	31%	39%	44%	34%
Modification/forbearance	41%	38%	40%	38%	26%
Relative change in lifetime (cumulative) PD compared to lifetime PD at origination	38%	33%	31%	29%	24%
Change in 12 month PD exceeds a predefined trigger	35%	31%	30%	29%	20%
Change in lifetime (cumulative) PD exceeds a predefined trigger	16%	15%	11%	11%	9%
Change in 12 month PD in each future year exceeds a predefined trigger	6%	6%	6%	6%	5%
Other	11%	9%	8%	8%	10%

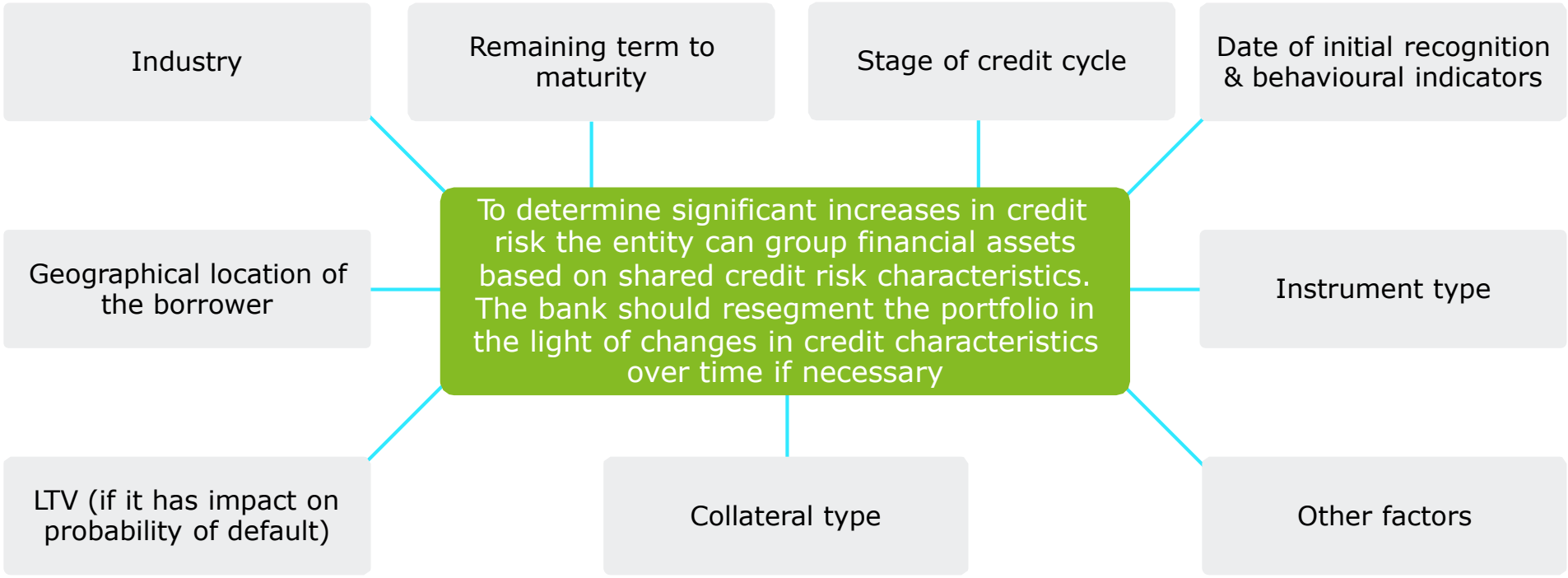
○ Most important factor
○ Second most important factor

See comment on next page

*Participants were asked to tick all options that apply for each portfolio. There was no limit to the number of responses that participants could select. Percentages displayed reflect the proportion of total participants responses to each response option.

Staging and segmentation
Segmentation criterions

In order to assess the staging of exposures and to measure a loss allowance on a collective basis, the bank groups its exposures into segments on the basis of **shared credit risk characteristics**.



The aggregation of financial instruments to assess whether there are changes in credit risk on a collective basis may change over time as new information becomes available on groups. The best practice staging assessment procedures requires the entity to ensure that the groups of exposures continue to share credit characteristics, and to resegment the portfolio when necessary, in the light of changes in credit characteristics over time.

Challenge 3 – Probability of Default

(A3-on impairment map)

Probability of Default

General concept

Probability of default ("PD") – an estimate of the likelihood of default over a given time horizon.

Probability of default used for IFRS 9 should reflect management's current view of the future and should be unbiased.

Two types of PDs are used for calculating ECLs:

12-month PDs	Lifetime PDs
12-month PDs - This is the estimated probability of default occurring within the next 12 months (or over the remaining life of the financial instrument if that is less than 12 months). This is used to calculate 12-month ECLs.	Lifetime PDs - This is the estimated probability of a default occurring over the remaining life of the financial instrument. This is used to calculate lifetime ECLs for 'stage 2' and 'stage 3' exposures.

IFRS 9 requirements: The assessment of whether lifetime expected credit losses should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring (B5.5.7). Further, it is a risk of default over the expected life of the financial instrument, not the amount of expected credit losses, that shall determine the Stage 2 assignment (refer to 5.5.9).

Probability of Default

Example: Lifetime PD vs conditional PD for a period

The 'conditional' means 'given the exposure was performing at the beginning of the k-th period'.

Assumptions

- Segment A embraces loans with maturity up to 3 years.
- Estimated 12-month PD for loans in segment A is **5%** (applicable or year 20X0).
- Taking into account expectation of downturn (and sensitivity of default rates to the macroeconomics), the 12-month conditional PD values for consecutive years for loans in segment A are **6%** and **7%** (applicable for year 20X1 and year 20X2 respectively).

What is 12-month PD and scope of application?

- The 12-month PD is 5%.
- This PD should be applied for loans in Stage 1
- For loans with maturity below 1 year PD can be transformed to shorter maturity (e.g. via linear extrapolation).

Probability of Default

Example: Lifetime PD vs conditional PD for a period

The 'conditional' means 'given the exposure was performing at the beginning of the k-th period'.

Assumptions

- Segment A embraces loans with maturity up to 3 years.
- Estimated 12-month PD for loans in segment A is **5%** (applicable for year 20X0).
- Taking into account expectation of downturn (and sensitivity of default rates to the macroeconomics), the 12-month conditional PD values for consecutive years for loans in segment A are **6%** and **7%** (applicable for year 20X1 and year 20X2 respectively).

What is Lifetime PD and scope of application?

- The Lifetime PD, for loans of maturity of 3 years, is 17% (i.e. 1 – 83%).
- This PD should be applied for loans in Stage 2
- For loans with maturity below 3 years PD can be transformed to shorter maturity.

Year	PD	SR	Cum SR
1	5%	95%	95%
2	6%	94%	89%
3	7%	93%	83%

*95% * 94%*

*89% * 93%*

PD – Probability of Default for a given year

SR – Survival Rate for a given year

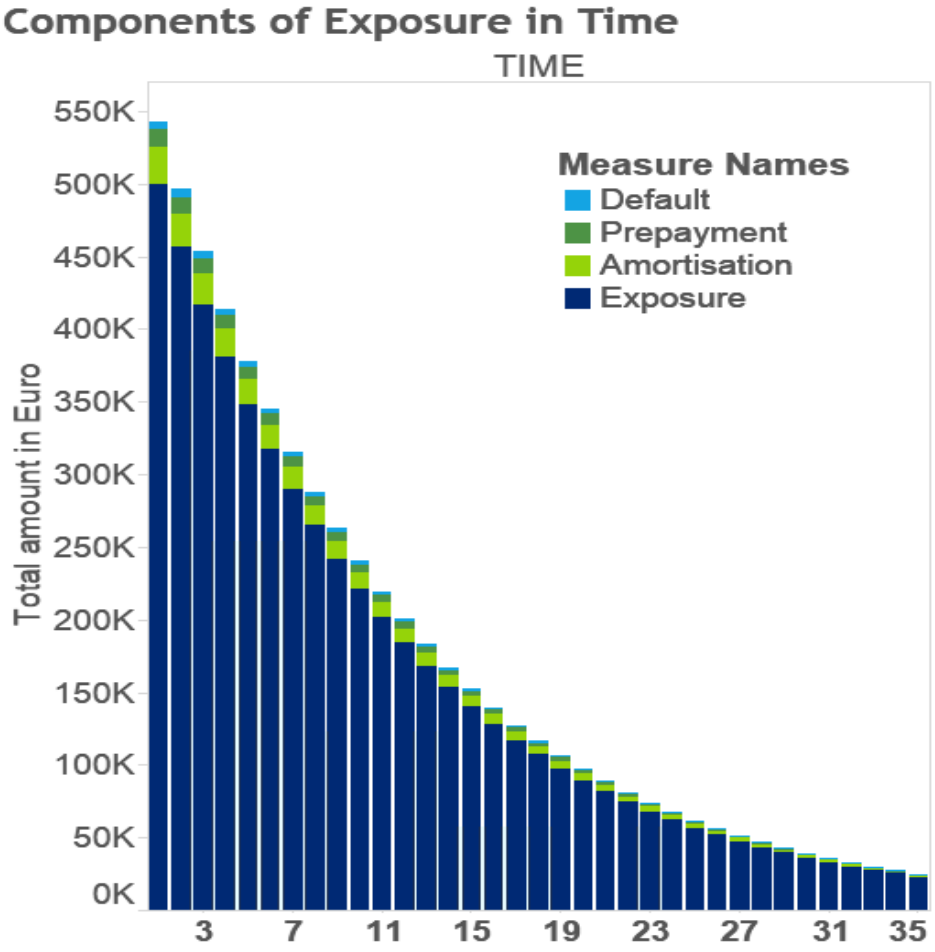
Cum SR – Cumulated Survival Rate for a given period

Challenge 4 – Exposure at Default

(A4-on impairment map)

Exposure at Default
Modelling challenges

Illustration of one of possible approaches



EAD = EAD on-balance + EAD off-balance.

Modelling challenges:

1. Determination of amortisation pattern
2. Contractual vs behavioural repayment profiles, including prepayments
3. Contractual vs behavioural maturities
4. **Expected life for revolving financial instruments**
5. Off-balance modelling
6. Incorporation of Survival Rate
7. Incorporation of Cure Rate

- The maximum period to consider when measuring expected credit losses is the maximum contractual period, including extension options
- There could be exception for some financial instruments which include both a loan and an undrawn commitment component

Challenge 5 – Loss given default

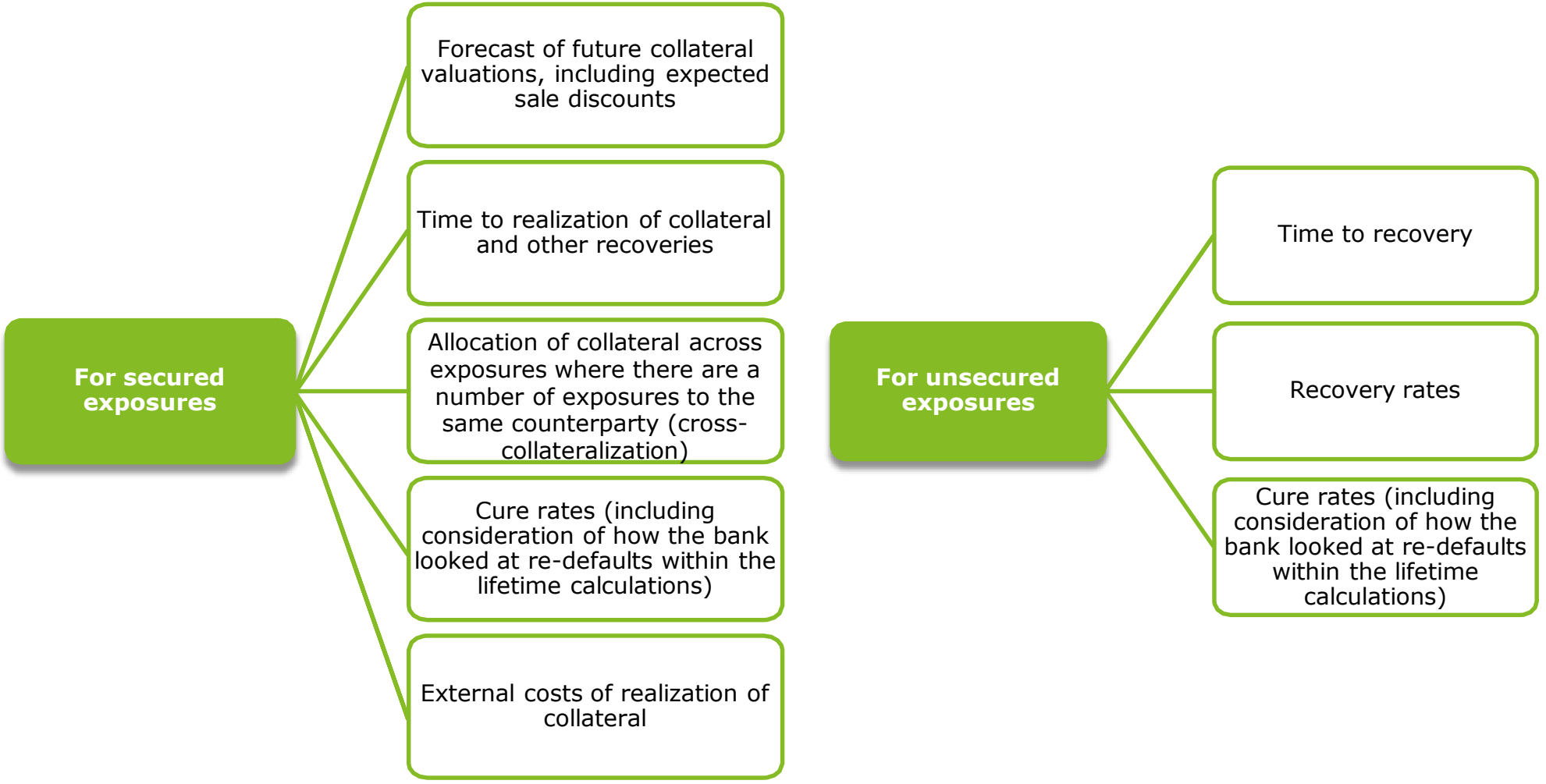
(A5 on impairment map)

Loss given default

General concept

Loss Given Default (LGD) is a percentage loss rate on EAD, given the obligor defaults.
It provides the loss that a bank is bound to incur when a default occurs.

Components to be considered when estimating LGD:



Challenge 6 – Macroeconomic data incorporation

(A6 on Impairment Map)

Macroeconomic data incorporation

Regulatory expectations – summary (IFRS 9, BCBS 350)

1. Neither IFRS 9 nor Basel Committee prescribes the exhaustive list of macroeconomic factors that should be employed in the ECL assessment or particular methods how they should be employed (principle-based approach).
2. Application of forward-looking information should enable and result in:
   a. Unbiased results for ECL amount,
   b. No delays in ECL recognition.
3. Expert judgment is expected to be employed, however on reasonable and justifiable basis.
4. The Bank should gather and store macroeconomic data (including forecasts) from different sources (including external).
5. Any assumptions made should be well documented internally and disclosed to the users of financial statements (IFRS 7).
6. Consistency of forward-looking information (used across the Bank) should be assured.
7. Preferably, it should be evaluated if one economic scenario is sufficient for the ECL assessment.
8. Incorporation of forward-looking scenarios will require judgement. Consequently, the importance of the IFRS 7 disclosure requirements (relating to how forward-looking information has been incorporated into the determination of expected credit losses) was emphasised.

Macroeconomic data incorporation

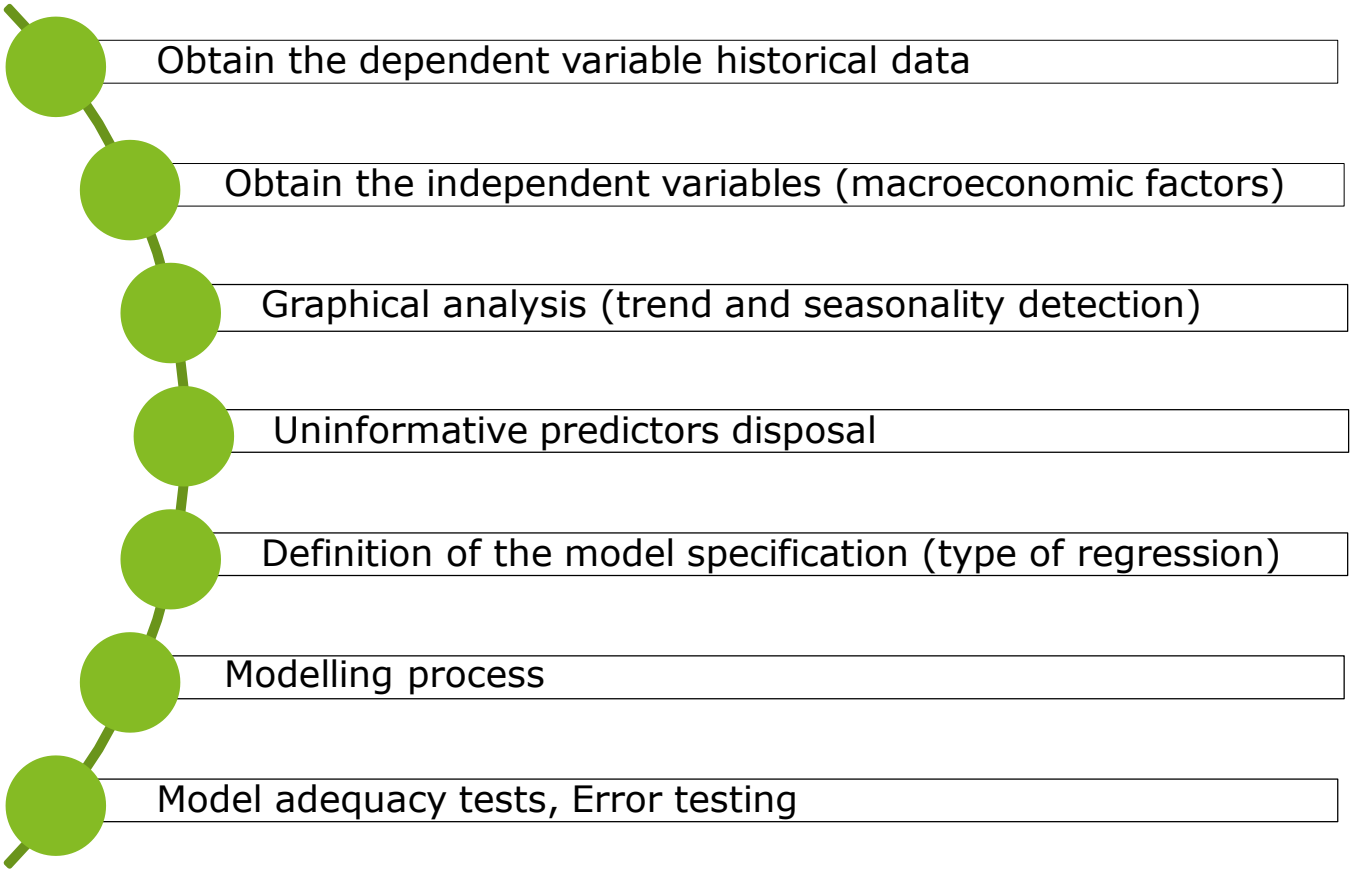
Sources and types of macroeconomic data (1/2)

Various macroeconomic factors can be used as long as they are relevant to the exposure being evaluated (e.g. retail or business), in accordance with the applicable accounting framework.

Exemplary macroeconomic factors

- GDP
- Unemployment rate
- Industrial production
- Import
- Export Interest
- rates Savings
- rates Earnings
- Inflation
- Property prices
- FX rates
- Liquidity conditions
- Technology conditions
-

The common process of the macroeconomic modelling steps:



Macroeconomic data incorporation
ITG interpretations (1/2)

Question: The submitters asked whether when measuring expected credit losses an entity can use a single forward-looking economic scenario or whether an entity needs to incorporate multiple forward-looking scenarios, and if so how.

ITG members comments summary:

- In line with 5.5.17(a) of IFRS 9, the measurement of expected credit losses is required to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.
- Consequently, it was noted that, for example, when there is a non-linear relationship between the different forward-looking scenarios and their associated credit losses, using a single forward-looking economic scenario would not meet this objective.
- Instead more than one forward-looking scenario would need to be incorporated into the measurement of expected credit losses.

Example

UR forecast	Prob. of forecast	Associated ECL	Delta of ECL
4%	25%	150	-20
5%	50%	170	0
6%	25%	220	+50

E(ECL) = 0.25*150 + 0.5*170 + 0.25*220 = **177.5**

E(UR) = 0.25*4% + 0.5*5% + 0.25*6% = 5% ->170

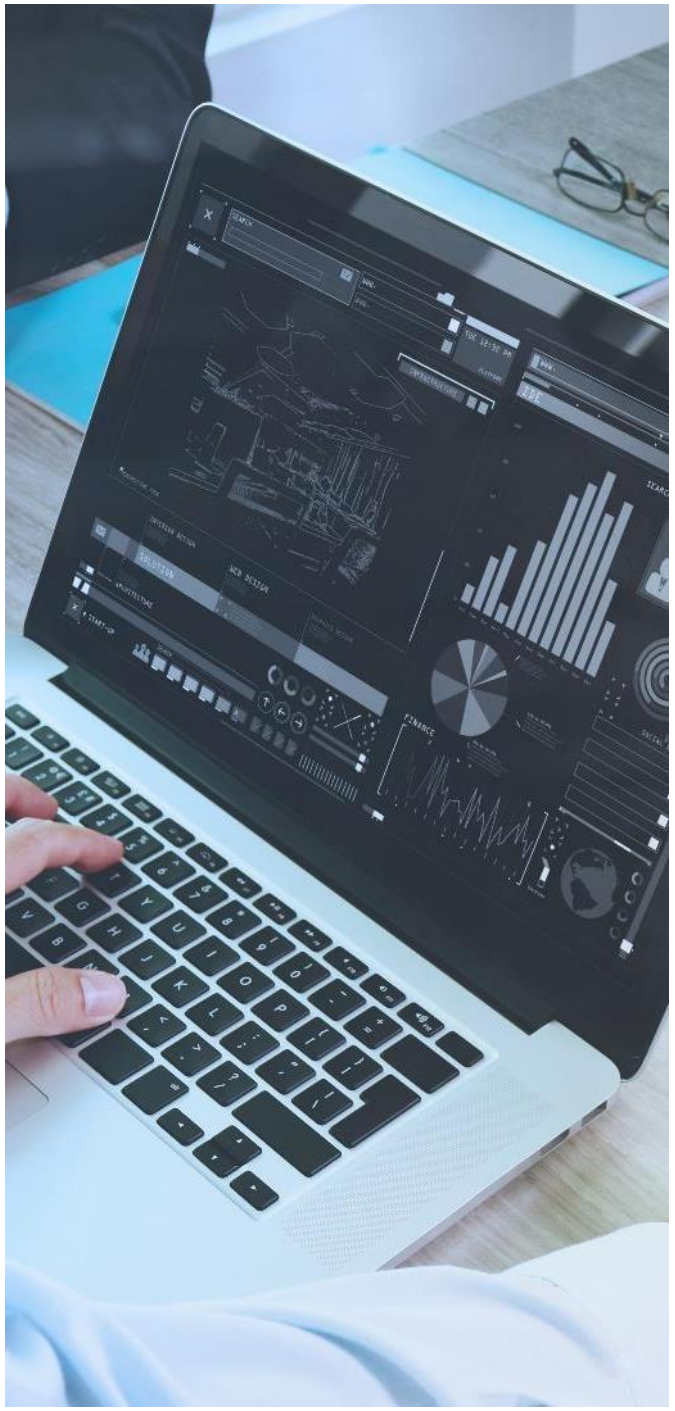
UR – Unemployment Rate

Based on Meeting Summary from 11 December 2015, of Transition Resource Group for Impairment of Financial Instruments ('ITG')

What you should know

High level impact on MFO-online lending

1. Most of the online lending assets because of the CF structure may fail the SPPI test if they are not supported by sufficient analysis
2. Most of the online lending will need to be classified at fair value through profit and loss if they are not supported by sufficient analysis
3. Fair valuation methodology for such lending will be required
4. **Potential solution**



Collective assessment-simplifications applied

- **Staging rule**

Simplification: Directly start from stage two

Potential effect: significant increase in impairment

- **Monitoring increase in credit risk**

Simplification:

Due to unavailability of the data at the beginning the organizations either use just overdue days for the staging rule or develop expert judgment until the sufficient statistics is created to perfect the model

Potential effect:

Due to unavailability of data and simple model, over pessimistic or optimistic provisioning rule, greater volatility in financial statements.

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