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MFRS 9 Financial Instruments

Where do I start?

At Deloitte, we understand the new standard on financial instruments issued by the Malaysian Accounting Standards Board will have implications and pose challenges to organisations in different ways. With our MFRS experience, implementation approach, and global tools, we can help you evaluate the impact of MFRS 9 on your business, and partner you in your implementation of this new standard.

MFRS 9 Financial Instruments is effective for annual periods beginning on or after 1 January 2018, with early application permitted.

MFRS 9 replaces the current MFRS 139 and revises the accounting guidance for classification and measurement of financial assets, impairment and hedge accounting.

New or changed guidance

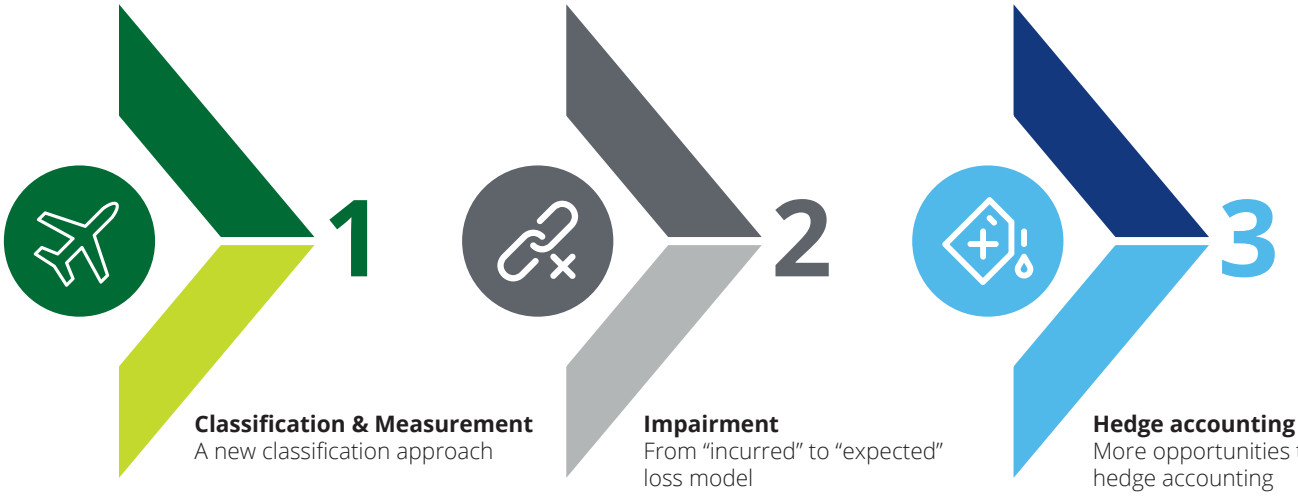
MFRS 9 introduces a new approach for the classification and measurement of financial assets by subjecting the financial assets to the "cash flows characteristics" and "business model" tests.

Additionally, the impairment model for financial assets has been changed. The impairment model for financial assets has been changed to one that is forward-looking and is based on expected credit losses.

Finally, MFRS 9 introduces new rules for general hedge accounting which will allow entities to reduce profit or loss volatility.

3 major areas in MFRS 9

The changes introduced by MFRS 9 will necessitate a rethink by companies of the way financial instruments are accounted for under the 3 major areas of classification and measurement, impairment and hedge accounting.



Classification & Measurement
A new classification approach

Impairment
From "incurred" to "expected" loss model

Hedge accounting
More opportunities to apply hedge accounting

Technical challenges

Challenges companies may face during their implementation include:

Classification & Measurement

- Determining characteristics of cash flows arising from individual contracts and whether they represent solely payments of principal and interest
- Substantiating the business objective of the financial assets as part of the entity's business model test
- Fair valuation of unquoted equity instruments held, or derivatives linked to unquoted equity instruments, where cost basis of measurement was previously permissible

Impairment

- Incorporating within credit monitoring process, criteria for identifying significant change in credit quality since initial recognition (Stage 1 to Stage 2)
- Developing methodology and credit risk models for measuring expected loss under new impairment model
- Leveraging practical expedients available in MFRS 9 in applying the expected loss model

Hedge Accounting

- Identifying additional opportunities to apply hedge accounting to reduce earnings volatility
- Evaluating changes needed to existing hedge documentation

Others

- Evaluating need to upgrade capabilities to support additional disclosures, especially those arising from new impairment and hedge accounting requirements
- Evaluating transitioning provisions from MFRS 139 to MFRS 9 – expedients available and impact on financials and disclosures

Companies will be required to capture additional information to support its implementation of the various aspects of MFRS 9. As a result, a transformation involving IT systems, processes and internal controls may in turn be required.

Have you developed your roadmap to MFRS 9 implementation?

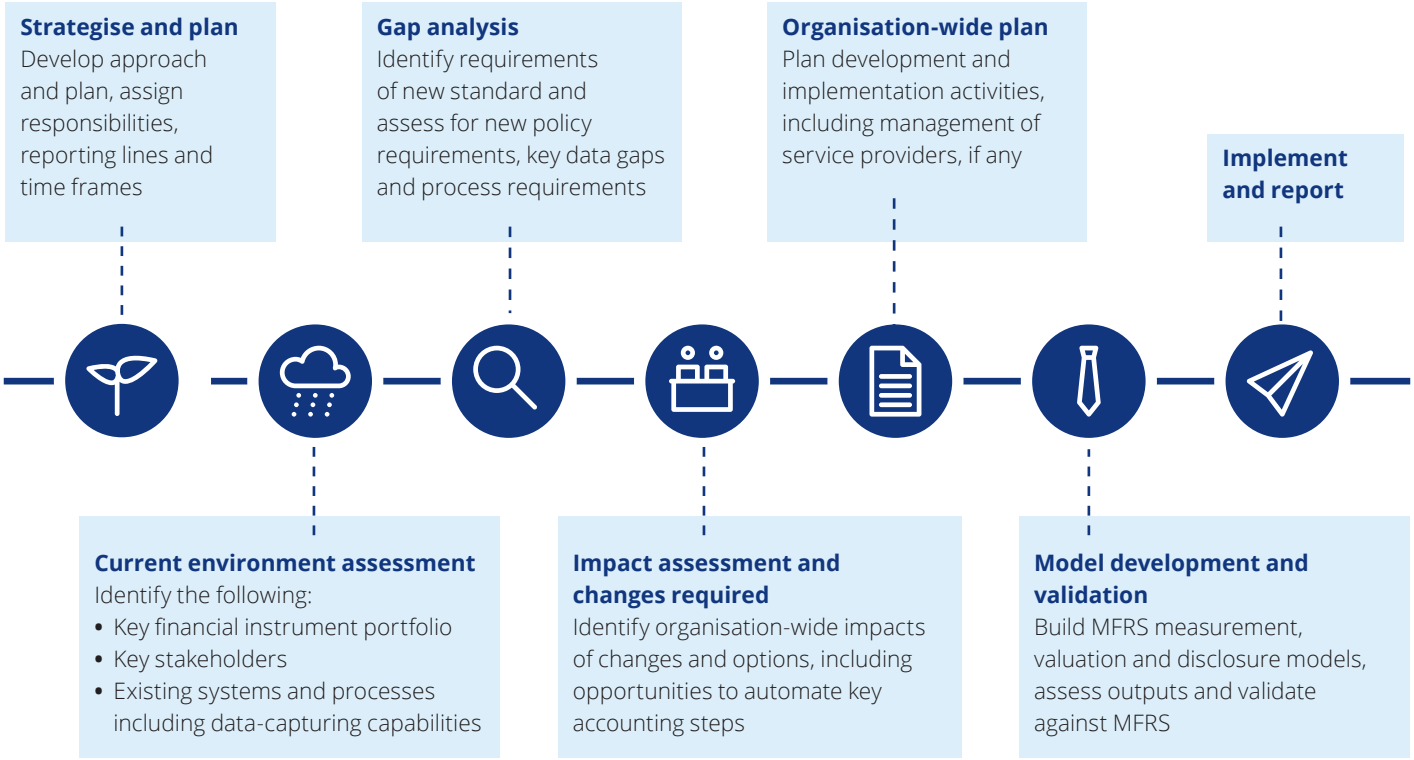
Successful adoption efforts will require full commitment from management and considerable amount of time is needed for review of implementation process. It is strongly recommended that organisations start assessing the impact immediately.

This will enable management to fulfil their duties and ensure quality financial reporting, be better prepared to deal with the implications on their financial reporting processes and explain the effects to stakeholders.

To kick-off this MFRS 9 implementation roadmap, the company should consider these factors:

- Whether those involved in financial statements preparation have sufficient knowledge of the new requirements, or if training is required;
- Whether additional manpower resources would be required (e.g., setting up project team, engaging external advisors) for evaluating, executing and monitoring the changes;
- Whether additional investments would be required to enhance existing IT systems and resources to support changes in processes and controls; and
- Whether there is sufficient credit / treasury expertise in developing credit risk models to calculate expected losses.

Approach that companies could consider in addressing the requirements of the new financial instruments accounting standard



Key issues

- Complexity of portfolio and capabilities of existing process and system set-up to facilitate classification of financial assets
- Fair valuation of unquoted equity investments or derivatives linked to unquoted equity investments
- Robustness of credit monitoring process to identify significant increases in credit risks since initial recognition
- Development of forward-looking credit models to estimate expected losses
- Accommodation of existing risk management strategies/practices to new hedge accounting model
- Additional disclosures requirements

Other impact

Companies should also be mindful that changes required by MFRS 9, for example the earlier recognition of impairment losses under the new impairment model, may have operational impact on key performance indicators and other key metrics used in compensation arrangements or financing facilities.

How Deloitte can help

With thousands of MFRS-experienced professionals in our global network, Deloitte has the necessary expertise and experience and provides a comprehensive range of MFRS-related services. As a multidisciplinary organisation, we are well-positioned to assist companies in addressing the implications of a new Standard across different industries.

As a complimentary service, we can perform a preliminary high-level assessment of your business to suggest a tailored solution from our range of service offerings that represents the shortest route to transition to MFRS 9, taking into account cost efficiency, amongst other factors.

Specifically, our service offerings, which can be provided either independently or in a combination, include:

A.	**Pre-Study**	**Understanding of MFRS 9 requirements** We conduct trainings to help preparers understand the requirements of MFRS 9. **Gap Analysis** Perform gap analysis of the new accounting standard to assess the readiness and prioritised tasks for implementation of the new MFRS using our proprietary tools, such as: • Portfolio Impact Assessment • Business Area Impact Assessment • MFRS 9 Questionnaire **Design Road Map** Based on the gap analysis, we can assist in the development of a detailed roadmap towards the new MFRS.
B.	**Classification & Measurement**	**Contractual Cash Flows** Using our proprietary checklist, assist to review contractual agreements/term sheets to scan for clauses which may contravene the test of solely payments of principal and interest ("SPPI"). **Business Model** Perform walkthrough of various portfolios of investments and treasury mandates, evaluate against MFRS 9 Business Model test requirements. Assist to prepare documentation/policies of underlying business model and segmentation according to MFRS 9 requirements. **Measurement** For organisations investing in non-quoted equity securities (or deriatives linked to non-quoted equity), we will provide valuation service offering to assist in valuing these securities which can no longer use the cost exemption under MFRS 139.
C.	**Impairment**	**Significant Increase in Credit Risk** Advisory support on establishing what constitutes a significant increase in credit risk and other related policies and procedures. **Developing Credit Models and Performing Quantitative Impact Analysis** Provide advisory support with respect to developing or validating forward looking credit models used to establish expected losses and perform scenario analysis through simulation and other tools. **Practical Expedient** Evaluating the financial and operational effects of adopting the available accounting policy choices and practical expedient available.

D.	**Hedge Accounting**	**Risk Management** Review risk management policies/practices and recommend MFRS 9 hedge accounting implementation suggestions. **Fair Value Measurement** Valuation support in respect of: • Determining changes in valuation for hedge effectiveness measurement purposes • Ascertaining appropriate amounts of 'costs of hedges' to be recognised in OCI as opposed to • PL where time values/ interest elements of options/forward contracts are not designated as hedging instrument • Measuring specific risk components within sub-components of non-financial items **Hedge Documentation** Provide advisory support in preparing hedge documentation. For those already applying MFRS 139 hedge accounting, we will provide support for the shift to MFRS 9 hedge documentation. **Ongoing Accounting Support** Provide advisory support in applying hedge accounting throughout the life of the hedge, including measuring hedge ineffectiveness, applying re-balancing requirements, etc.
E.	**Accounting Policy & Procedures**	**Financial Account Review** • Review chart of accounts mapping and how these can be remapped to meet MFRS 9 requirements. **Financial Statements Review** • Review and assist in updating accounting manual. • Assist in preparing pro-forma financial statements with relevant MFRS 9 disclosures.

Contact us

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