MOORE STEPHENS

Moore Stephens KSC presents

IFRS 9
Practical Implications 2017

Technical Event-Recap

Moving forward requires expertise

MOORE STEPHENS

01

02

General session

03

About Moore Stephens KSC

Introduction-About ACCA

Head of ACCA South-Eastern Europe

Andreia Stanciu

ACCA organized an event about **IFRS 9 financial impact for corporate entities** in association with Moore Stephens KSC to discuss the challenges and implications of IFRS 9.

ACCA has more than 198,000 fully qualified members and 486,000 students worldwide.

81%
of ACCA students based overseas

186+
different nationalities

95
ACCA offices and centers globally
Global footprint that closely matches many multinational organisations

181
countries have ACCA students and members

57%
of ACCA members based overseas

Introduction-Moore Stephens KSC

Moore Stephens KSC:

Andrei Stan, Partner

Elena Panainte, Senior Manager

Moore Stephens KSC represented by Andrei Stan, Partner and Elena Panainte, Senior manager participated at ACCA technical event IFRS 9: Financial impact on corporate entities in Timisoara as speakers and spoke about practical implication of IFRS 9.

They spoke about challenges of new IFRS 9 and Modelling approaches for IFRS 9 impairment.

Moore Stephens KSC believes in reaching out to maximum audience and share knowledge and serve industries with their services and expertise and our online publications are helping us to achieve this at good extent.

This **Technical Event-Recap** highlights challenges and modelling approaches of IFRS 9 which we addressed in the event.

International Financial Reporting Standard 9 (IFRS 9) is a new accounting standard set to replace International Accounting Standard 39 (IAS 39). It introduces a new approach to accounting for financial instruments and is expected to become effective in January 2018.

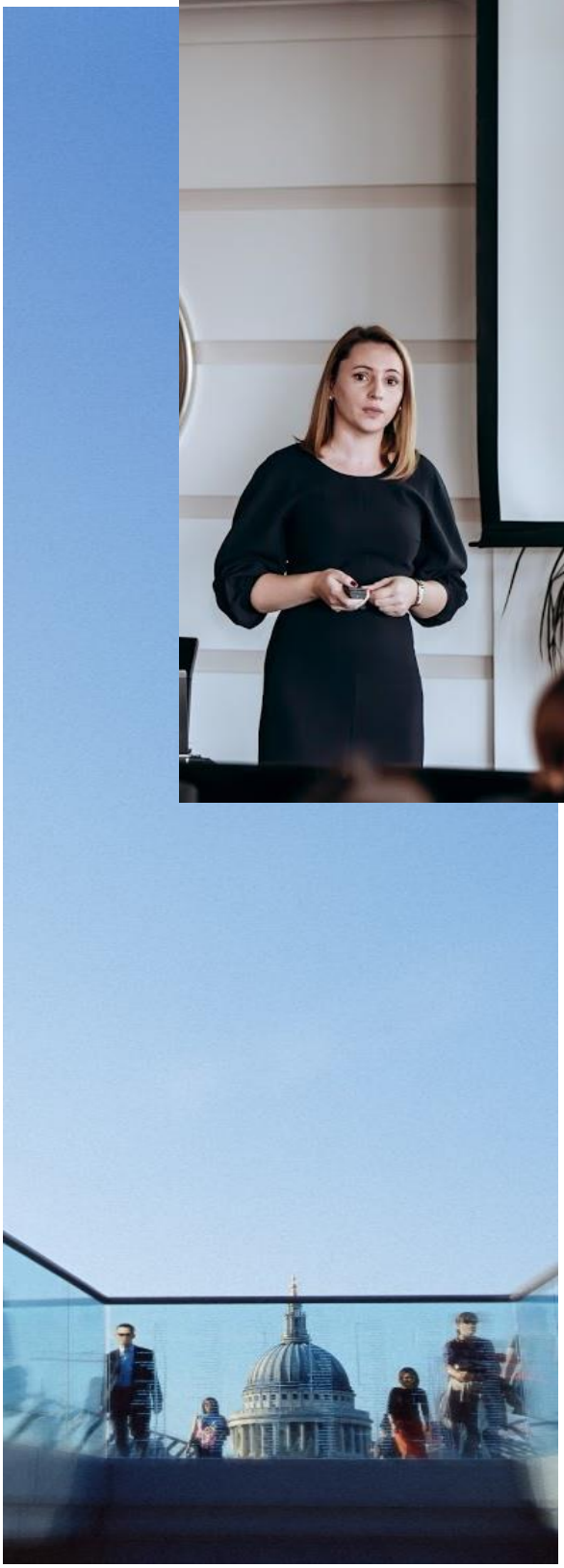
Why IFRS 9?

Critics of IAS 39 'Financial instruments: Recognition and Measurement

- IAS 39 resulted in 'too little, too late' – too few credit losses being recognized at too late stage;
- IAS 39's 'incurred loss' model delayed the recognition of impairment until objective evidence of a credit loss event had been identified.
- IAS 39 requires different measures of impairment for similar assets depending on their classification.

IFRS 9 rewrites the accounting rules and principles for the impairment of financial assets.

Challenges of IFRS 9

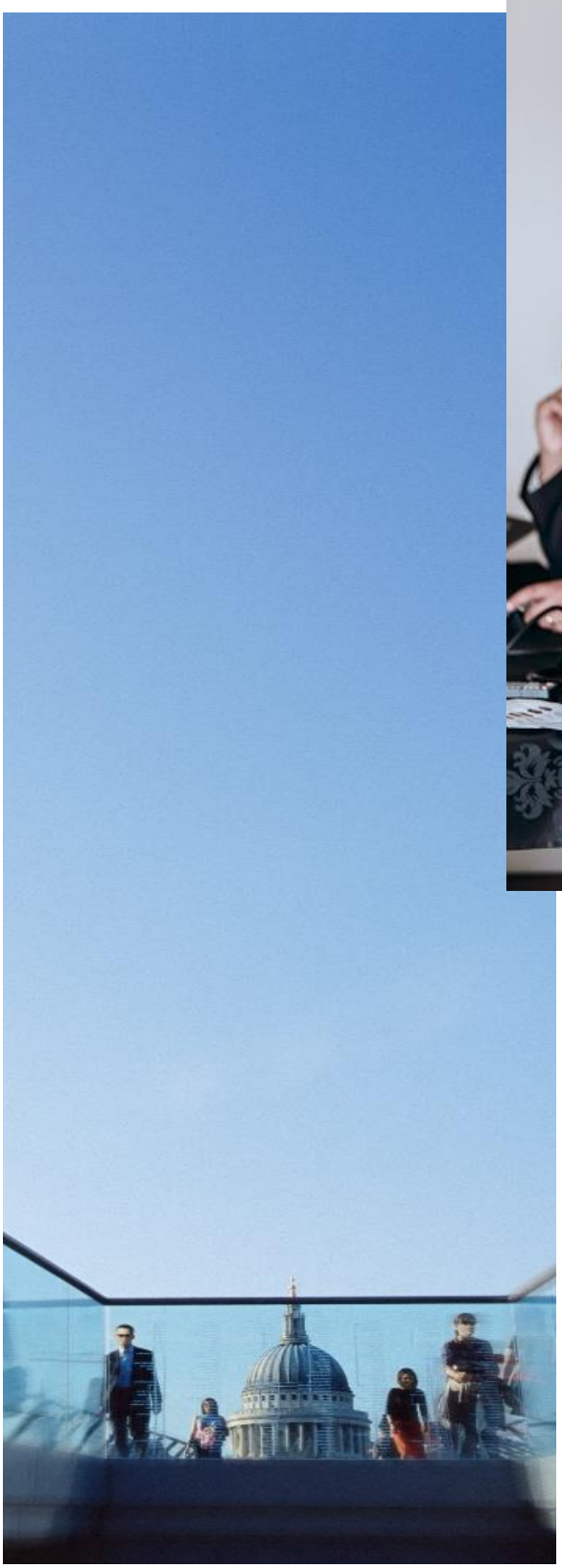


IFRS 9 Financial Instruments: impairment approach

IFRS 9 general approach is based on credit quality and allocates loans in three stages:

- STAGE 1 – **12 month ECL** - covers instruments that have no deteriorated significantly in credit quality since initial recognition or that have low credit risk;
- STAGE 2 – **Life time ECL** - covers financial instruments that have deteriorated significantly in credit quality since initial recognition but that do not have objective evidence of a credit loss event;
- STAGE 3 – **Life time ECL** - covers financial assets that have objective evidence of impairment at the reporting date.

Modelling Approach



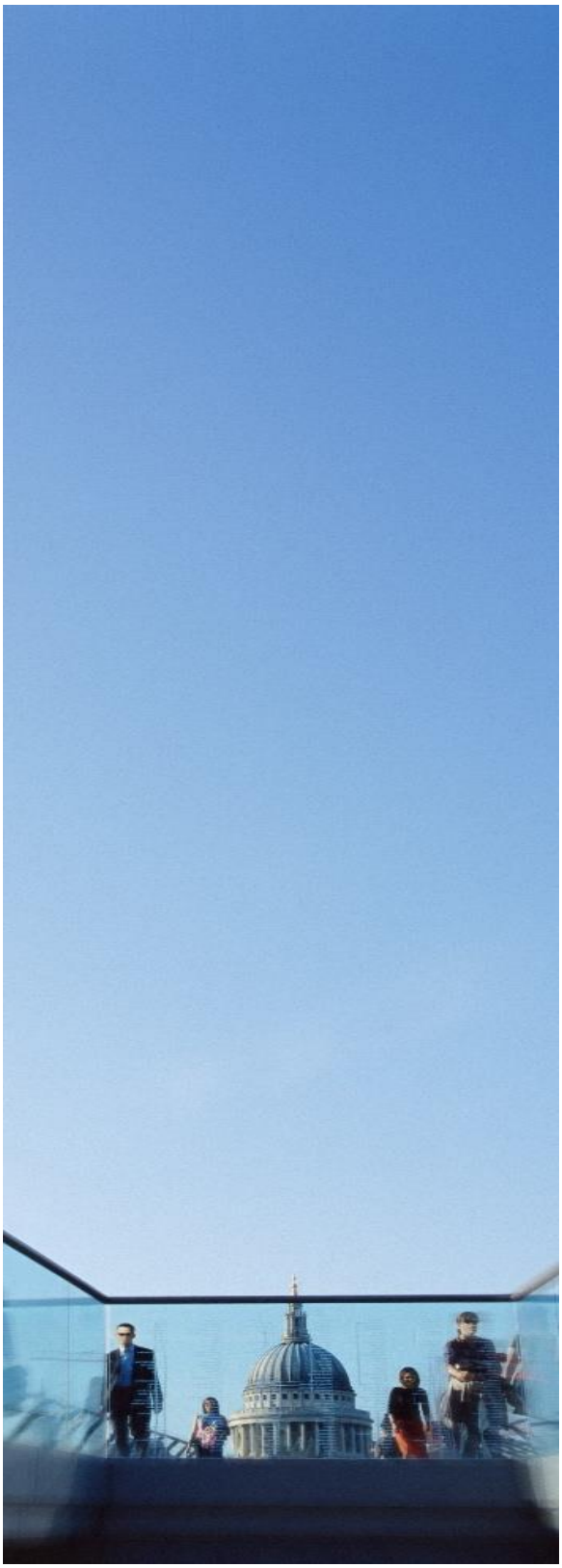
Stage allocation, outlining the following aspects:

- ❑ Benchmark analysis: overview on key assumptions
- ❑ Transfer criteria
  - Indicators for the evaluation of credit risk increase
  - PD comparison
  - Default exposure

Risk parameters calculation, outlining the following aspects:

- ❑ Methodological framework for Lifetime PD model
- ❑ Methodological framework for LGD
- ❑ Methodological framework for EAD

Stage allocation-Benchmark analysis



Trigger 1

Significant increase in credit risk

Benchmarking analysis: main results

- Each bank defines criteria and hypothesis for classifying exposures in Stage 2 as risk appetite, availability of information and portfolios features could be the drivers to define the criteria for the classification
- Banks might use
  - A single metric (i.e. PD variation) as a primary factor for Stage 2 classification
  - A combination of factors (i.e. days past due, credit ratings, restructuring events etc.)

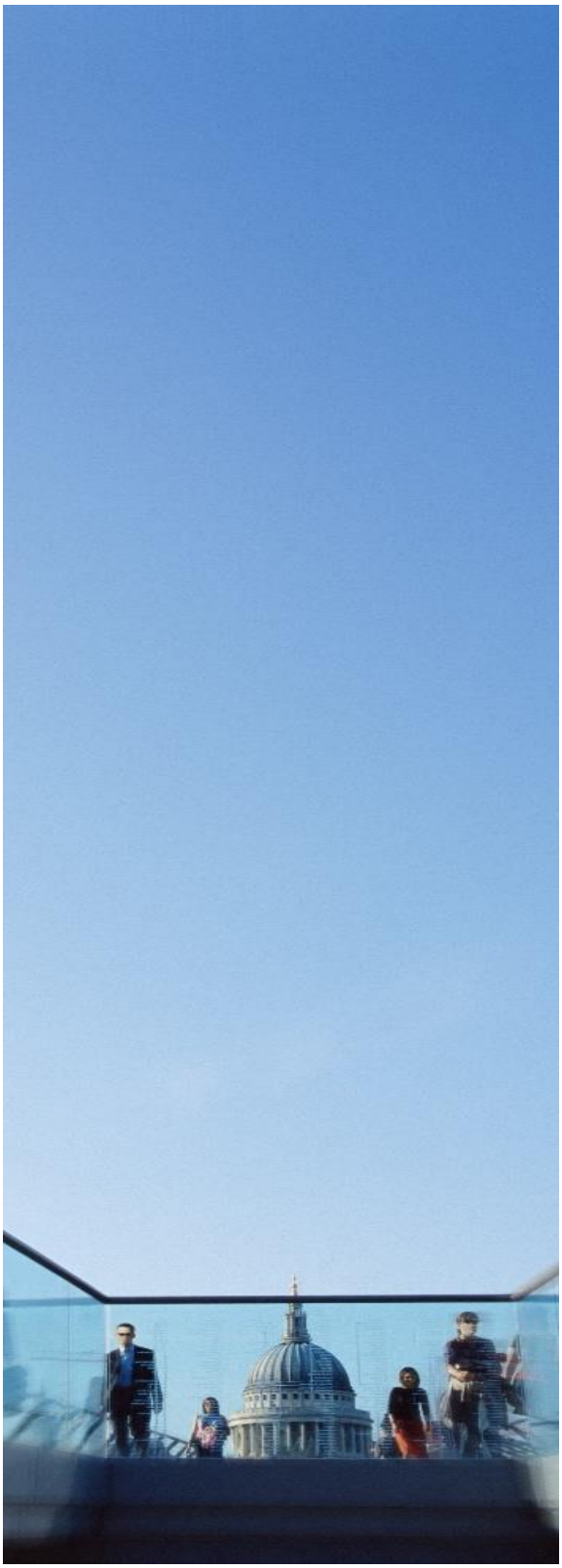
Trigger 2

30 dpd Rebuttable presumption

Benchmarking analysis: main results

- The Basel Committee does not expect that banks will use the "more than 30 days past due rebuttable presumption" as a primary indicator of significant increase in credit risk. However some banks are taking into account the idea of using 30 days past due criterion for particular portfolios
- Some local regulators put pressure to adopt the 30 dpd as key criteria

Stage allocation-Benchmark analysis



Trigger 3

Default definition

Benchmarking analysis: main results

- Banks are planning to use a combination of approaches but they should consider the variation of PD as primary indicator. In particular, most of the Banks have planned to use the lifetime PD variations as a trigger to measure risk increases
- Because the stage allocation is based on the change of the credit quality between the inception date and the reporting date
  - Assets with identical PDs can be in Stage 1 or Stage 2
  - Assets in Stage 1 may have higher PDs than assets in Stage 2

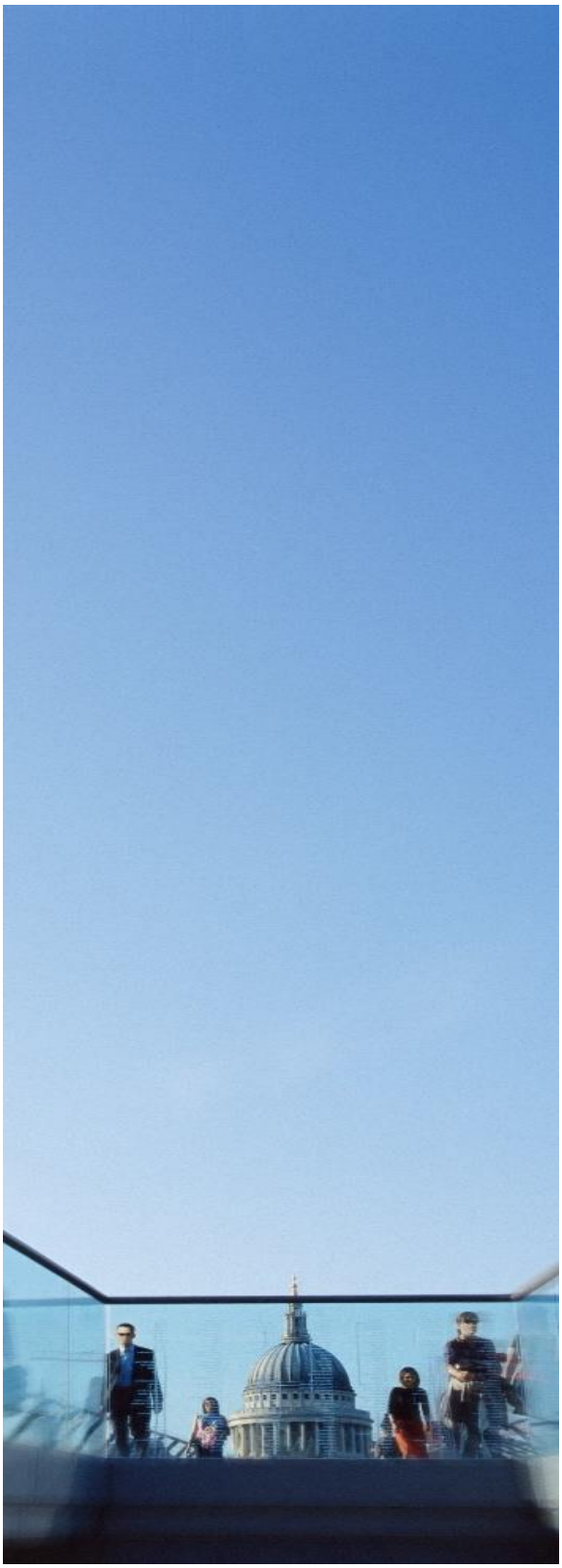
Trigger 4

Combination of the different triggers

Benchmarking analysis: main results

- For evaluating all potential indicators, IFRS 9 requires banks to consider past events, current conditions and future macroeconomic scenarios according to reasonable and supportable information available without undue costs or effort
- Macros events for each country contain a different pattern for the banks

Stage allocation: Classification of Exposure



- **At the origination** financial instruments are classified **in Stage 1.** The IFRS 9 principle states that, if data are not reliable enough for measuring creditworthiness **exposure shall prudently be classified in Stage 2**, unless it can be demonstrated that the credit belongs to the low credit risk class.
- **All defaulted loans are classified in Stage 3**
- Based on **indications included in IFRS 9 principle and best practice of the sector**, it is suggested to adopt the following criteria in order to assign exposures to the three stages:

Stage I

Low credit risk exposure

Performing exposures without past due days

Performing exposures with lest than 30 past due days

Calculation of the Expected Loss 1 year

Stage II

Performing exposures with more than 30 past due days

Modified performing exposures

Unlikely to pay

Estimation of lifetime PD and Lifetime Expected Loss

Stage III

Exposures more than 90 days pd

Unlikely to pay

Risk parameters calculation

The main distinction that can be carried out regarding the portfolios is about the coverage of internal models. More specifically, it is worth to distinguish among the scored or non scored portfolios

CASE 1: IRB PORTFOLIOS or PORTFOLIOS COVERED BY INTERNAL MODELS

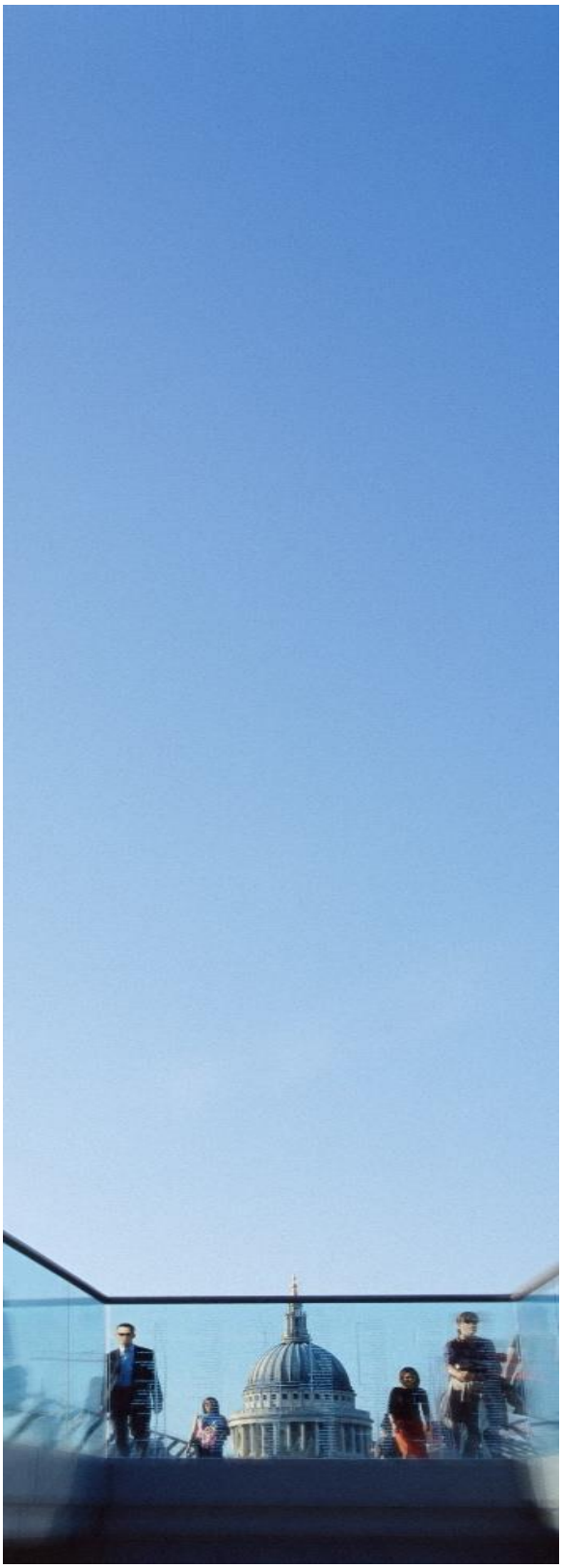
The first case involves banks/ risk segments for which the risk parameters are available, based on

- IRB models
- Internal models used for managerial purposes

CASE 2: PORTFOLIOS NOT COVERED BY INTERNAL MODELS

- The second case involves banks/ risk segments for which the risk parameters are not calculated based on internal models but utilizing other risk related information

Risk parameters calculation



Methodological framework for Lifetime PD model – Illustrative example

Phase I: Initial parameters identification

Breakdown of portfolio based on a set of drivers

Historical (internal, rating agencies or benchmark) default rates series for each segment

Phase II: Inclusion of Forward looking element

Macroeconomic conditioning -Estimation of an econometric multivariate model by a short list of variables explaining observed default series

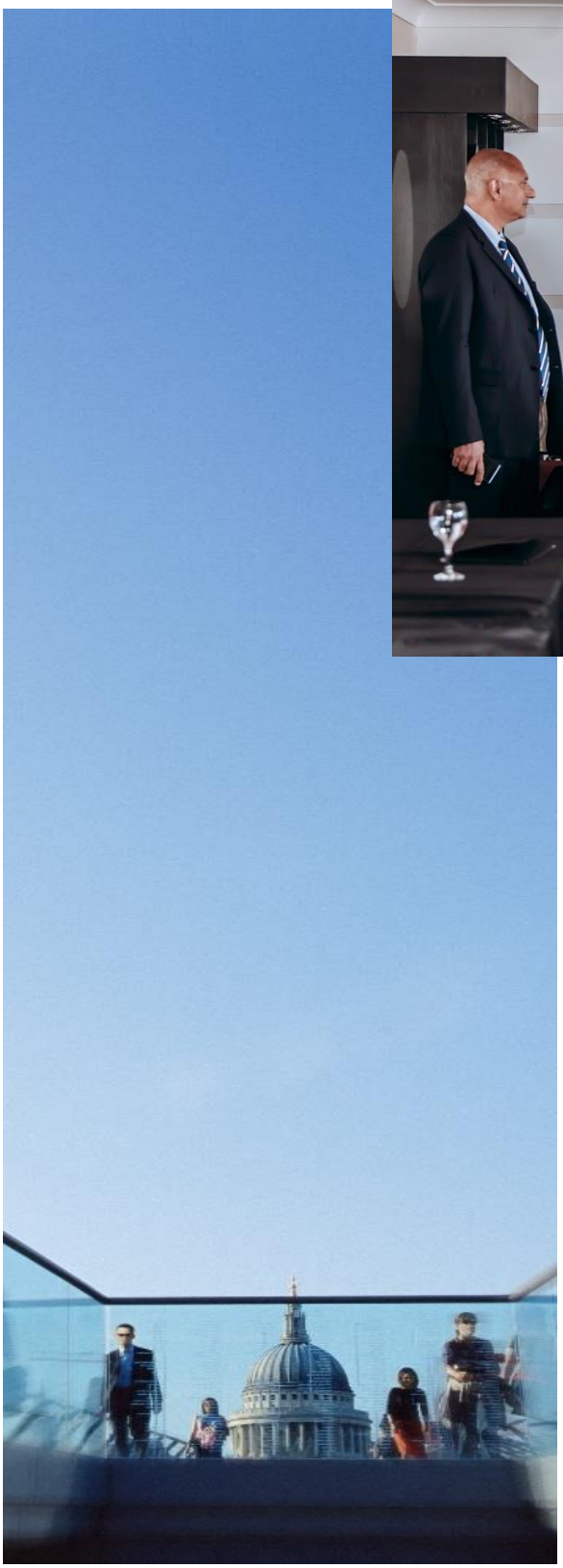
Application of macro scenario in the future -Forecast of future Default Rate by Econometric model

Phase III: Lifetime projection

Multi-year PD projection-Lifetime PD is calculated as dichotomous forward looking matrices multiplication

Multi-year PD per segment

Key Challenges



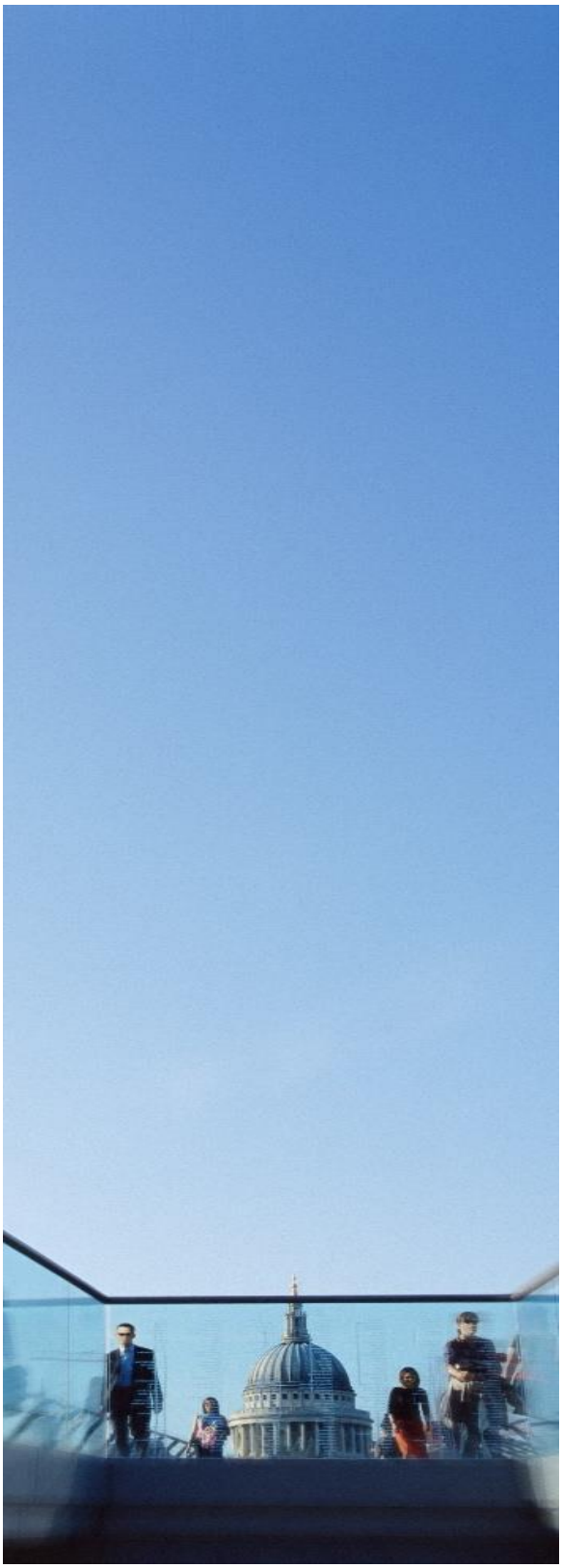
- Use of absolute / relative low credit risk
- Define different criteria per historical portfolios
- Define Unlikely to Pay (UTP)
- Define forbearance criteria (including period of forbearance)
- Macroeconomic factors

Stage allocation

- IFRS 9 IT system able to support the macro scenarios
- Definition of maturity dates and cash flows for revolving credit facilities
- Incorporation of macros scenarios and consistency with Basel II/Basel III
- Definition of origination and maturity dates for modified loans that might led to de – recognition
- Determination of system generated reports (system dimensions) for reporting and data output purposes.

ECL & Reporting

How Moore Stephens can help



IFRS 9 represents a significant change to the accounting for financial instruments.

The implementation date is fast approaching leaving little remaining time for clients to prepare.

GAP & Impact

Training

Reporting

How can we help?

1. Performing a **gap analysis**
2. Assessing the **financial impact**
3. Assisting with your IFRS 9 roadmap & programme governance
4. **Training** and workshops
5. Detailed implementation support including:
    - ❑ Impairment model build
    - ❑ Data/systems and controls impact assessment
    - ❑ Reporting and disclosures

Contact us

We have offices located in Romania and the R.Moldova who can provide tailored services to your business. For more information on how we can help you succeed contact us on the information below

Moore Stephens KSC

Bucharest Office
014472, 175 Calea Floreasca, Floreasca Tower building, 13th Floor, District 1
Bucharest – Romania

T: +4 0374 490 074
F:+4 0374 094 191
E: info@moorestephens-ksc.ro

www.moorestephens-ksc.ro

Timisoara Office
30056, 1 Ionel Bratianu Square,
Bratianu Real Estate
Timisoara – Romania

T: +4 0374 490 074
F:+4 0374 094 191
E: info@moorestephens-ksc.ro

www.moorestephens-ksc.ro

Chisinau Office
MD 2004, 202 Stefan cel Mare Bvd., Kentford building, 9th floor
Chisinau – Moldova
T +373 22 022 555
F: +373 22 022 556
E: info@moorestephenes-ksc.md

www.moorestephens-ksc.md

MOORE STEPHENS