

Much Adjustment Needed Ahead of IFRS 9 Instruments

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At the London summit in April, G-20 leaders agreed that accounting standards for financial instruments should be improved and simplified, especially in the areas of valuation and procyclicality, by the end of 2009. Subsequently, the International Accounting Standards Board (IASB) has undertaken a project to review IAS 39 Financial Instruments: Recognition and Measurement by dividing the project into three phases. Two phases of the project have already been published, resulting in the new title of the standard - IFRS 9 Financial Instruments.

As a result of Phase I, which focuses on the classification and measurement of financial instruments, only two categories of financial assets will be presented on balance sheets: amortised cost and fair value. This requirement will come into effect from January 1, 2013. The new classification and measurement in Phase I will affect internal operations and managerial decisions of commercial banks, since they need to review all financial assets and group them into new categories.

Existing loans and held-to-maturity debt investment portfolios will basically be transferred to the amortised-cost category, while trading and derivatives portfolios will normally constitute the fair value category. The interesting point is that there will no longer be an available-for-sale portfolio, which has usually been a grey area. With two categories of financial assets, accounting records will be simpler, better understandable by all stakeholders and more consistent with the regulator's point of view on trading books and banking books.

Phase II focuses on the amortised cost and impairment methodology. In this connection, the expected-loss model has been introduced to correct the weakness in the incurred-loss model that fails to provide adequate loan-loss provisioning during periods of economic downturn. The exposure draft of this Phase has been published this month, and the comments on the draft will be due by June next year.

Under Phase II, the significant adjustment of IAS 39 has been with regard to amortised cost and impairment. As the G-20 has pointed out that the concept of the incurred-loss model of loan impairment supports procyclicality in financial systems, the IASB has incorporated the expected cash-flow concept into the amortised-cost calculation.

Under this new method, expected credit losses of each instrument will be estimated and adjusted to the expected cash flow before being discounted with the effective interest rate. Therefore, the amount of loans and expenses in financial statements will already reflect future losses. Although the new method aims to alleviate procyclicality, there remains major concern for business entities on how to estimate credit losses. In particular, a well-developed data-base and IT system would be critical for financial institutions applying the new IAS 39.

Next year, Phase III of the project will be conducted and this is expected to bring improvements, which cover hedge accounting to simplify accounting treatment of banks' hedging activities.

As for Thailand, the latest version of IAS 39, or IFRS 9, is expected to be implemented in 2013. From now on, extensive data collection as well as system and operational adjustment will therefore become necessary for all financial institutions.

(The views expressed are the author's own.)

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