A new beginning: are banks ready for IFRS 9?

Companies, and banks in particular, need to start preparing now for the impact of a new financial reporting standard

ARE YOU A BANKER AND involved in key decision making or financial reporting? Then you must be aware that in July 2014 the International Accounting Standards Board (IASB) issued the final version of IFRS 9 Financial Instruments, which replaces IAS 39. This new standard has an effective date of 1 January 2018, with an early adoption permitted.

With less than three years to the effective date of this new standard, management teams need to assess its impact on their companies – and the impact will definitely be significant for banks. Banks need to closely examine the effect of IFRS 9 not only on their financial statements but also on their capital adequacy, IT systems, people, taxes, processes and product design among others. The new standard also requires retrospective application on classification and measurement if certain conditions are met, irrespective of the entity's business model in prior periods. Consequently, management teams must prepare ahead in order to comply.

IFRS 9 introduces a new model of classifying financial assets, which is driven by cashflow characteristics and the business model in which an asset is held. It also introduces a single impairment model that will apply to all financial instruments, which is a departure from the previous accounting requirements. Classification determines how financial assets and liabilities are accounted for in the financial statements. In addition, IFRS 9 introduces a new expected-loss impairment model that will require more timely recognition of expected credit losses. The new standard requires entities to account for expected credit losses when financial instruments are first recognised and to timely recognise full lifetime expected losses. This is likely to increase the levels of impairment for banks.

A successful transition towards IFRS 9 requires early preparation and analysis of its implications. The new impairment requirements give rise to a number of implementation challenges because new models will need to be developed to incorporate the forward-looking concept that is the basis of the new standard. More judgment will have to be exercised by management. New extensive disclosures will be required to improve comparability of information provided by different entities. These disclosures will be very demanding on data necessary to comply with all requirements.

Management should raise awareness of the changes and their potential impact on stakeholders and decision makers

The expected changes in the new standard will require training for management, those charged with governance and the heads of finance departments on how to process the changes. The training should focus on the impact of the expected changes on the key ratios, earnings, regulatory capital, business processes and tax among others. Management should also be able to identify and understand the decisions made by industry peers, restructuring of products, assessment of operational risks caused by the process changes and also managing the organisation-wide change in relation to increased competition for resources, data and processes alignment.

The changes will also have a direct effect on the operational and reporting systems for corporates. Banks should consider whether their IT systems are capable of catering for the new requirements or whether there is an investment required either to upgrade or build a completely new IT infrastructure.

Most banks have insufficient data warehouses to perform the analysis required under this new standard without significant involvement from multiple divisions across the banks. There is a need for the leadership of banks to encourage different divisions to get involved in the preparation for adoption of this new standard. Business areas have to be involved from the beginning.

Management should raise awareness of the changes and their potential impact on stakeholders and decision makers. This should incorporate an initial assessment of benefits and related costs of early adoption, as well as the design of the implementation road map to the initial application period. For example, shareholders need to be informed of the impact of new impairment requirements on their earnings.

In conclusion, all stakeholders need to embrace the changes and work towards adoption of the new standard to avoid last-minute surprises. This is not just an accounting change; it will affect people, business models, processes, systems and potentially reshape the balance sheets of companies.

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