

# Financial Reporting Advisory Board Paper

## IFRS 9 Financial Instruments: Work plan for implementation

<b>Issue:</b>	A paper was presented to the Board in November 2014 providing an initial high-level analysis of the new IFRS 9 Standard. Following discussion of the new Standard and its potential implications for the public sector it was agreed that the Relevant Authorities would collaborate to plan for the Standard's introduction and to determine what work needed to be undertaken for implementation. This paper provides an update on the progress of work undertaken by the Relevant Authorities, agreed next steps and a high level work plan towards implementation of the Standard in the public sector. HM Treasury and the other Relevant Authorities ask that the Board provide comment on and agree the forward work plan.
<b>Impact on guidance:</b>	No impact at this stage.
<b>IAS/IFRS adaptation?</b>	None proposed at this stage. This will be considered in a later paper to the Board.
<b>Impact on WGA?</b>	Not at this stage.
<b>IPSAS compliant?</b>	Not consistent with IPSAS.
<b>Interpretation for the public sector context?</b>	This will be revisited in a later paper to the Board.
<b>Impact on budgetary regime?</b>	Without adaptation, the Standard may have an impact on departmental budgets.
<b>Alignment with National Accounts</b>	The Treasury is examining IFRS 9 against the ESA10 National Accounts framework as this will be applicable at the time when the Standard becomes effective.
<b>Impact on Estimates?</b>	Without adaptation, the Standard may have an impact on the Estimates' process.
<b>Recommendation:</b>	HM Treasury and the other Relevant Authorities ask that the Board provide comment on and agree the forward work plan.
<b>Timing:</b>	No changes are expected to be made to the FReM until the 2018/19 financial year.

## DETAIL

1. This paper provides an overview of work undertaken by the Relevant Authorities, agreed next steps and a high level work plan towards implementation of the Standard in the public sector.

### **Summary of IFRS 9 and initial view of public sector implications**

2. The IASB developed IFRS 9 in three phases between 2009 and finalising in July 2014. Application is retrospective from January 2018 subject to transitional reliefs. The Standard's objective is to provide users with more useful information about an entity's expected credit losses and to update the amount of expected credit losses recognised at each reporting date of financial instruments.
3. IFRS 9 applies a single classification and measurement approach to all types of financial assets; at amortised cost or at fair value through either OCI or residually through profit or loss.
4. Below is a table summarising the classification and measurement model for financial assets under IFRS 9:

<b>Are the cash flows considered to be solely principal and interest?</b>	<b>What is the business model?</b>	<b>What is the measurement category?</b>	<b>Are alternative options available?</b>	
YES	<i>Held to collect contractual cash flows only</i>	<i>Amortised cost</i>	<i>Fair value through profit or loss option **</i>	
YES	<b><i>Held to collect contractual cash flows AND to sell</i></b>	<b><i>Fair value through other comprehensive income *</i></b>	<b><i>Fair value through profit or loss **</i></b>	<b><i>New category introduced under IFRS 9</i></b>
YES	<i>All other strategies</i>	<i>Fair value through profit or loss</i>		
NO		Fair value through profit or loss	Fair value through other comprehensive income option for equity investments ***	

\* Interest, impairment and foreign currency recognised in profit or loss, with all other gains or losses recognised in other comprehensive income. Upon derecognition amounts in other comprehensive income are reclassified to profit or loss.

\*\* If at initial recognition the financial asset is irrevocably designated at fair value through profit or loss as doing so eliminates or reduces a measurement or recognition inconsistency.

\*\*\* Dividends recognised in profit or loss with all other gains or loss recognised in other comprehensive income. Upon derecognition amounts in other comprehensive income are not reclassified to profit or loss.

5. The Standard carries forward unchanged almost all of the accounting requirements in IAS 39 for financial liabilities and contains a single forward-looking 'expected-loss' impairment model. It is applied to all financial instruments subject to impairment accounting which, will result in earlier and more timely recognition of expected credit losses. The new model also requires that an impairment allowance, for expected credit losses, be raised even where no evidence of deterioration is present.
6. IFRS 9 introduces a reformed model for hedge accounting which principally aligns the accounting treatment with risk management activities.
7. The introduction of IFRS 9 is likely to have the greatest impact on banks and other financial institutions. In central government, these changes are likely to have a significant impact, if introduced without adaptation, on departments that have substantial financial assets. IFRS 9 has practical implications particularly for assets where no active market exists. IFRS 9 may increase the volatility of provisions and spending pressures on departments. It may also lead to difficulties in obtaining valuations if existing adaptations under IAS 39 were not continued.

### ***Initial planning and next steps***

8. HM Treasury, CIPFA, and the Department of Finance and Personnel Northern Ireland (DFPNI) convened to consider the implementation of the Standard and to agree next steps. HM Treasury are leading on the coordination of this exercise but all Relevant Authorities have agreed to contribute as required to ensure a coherent approach to public sector implementation. The approach to planning for implementation is intentionally similar to that for IFRS 15 (which is also being adopted to a similar timeframe).
9. The immediate next steps in the planning exercise are as follows:
  - a. Securing external technical assistance;
  - b. Creation of a technical working group; and
  - c. Scoping the public sector landscape.

### **Securing external technical assistance**

10. The Relevant Authorities aim to secure external technical assistance to take advantage of existing experience of planning for implementation of the Standard in the private sector. This will provide useful insight into assessing whether similar implementation issues will apply in the public sector. Furthermore, there is value in leveraging the expertise and experience arising through discussions already being had with private sector clients. This will aid the Relevant Authorities in identifying and confirming what information needs to be obtained and clarified with public sector entities during the initial informal consultation over the summer of 2015. The Board are asked to suggest sources of external technical assistance for this project.
11. This initial assistance will focus on providing technical expertise and an impact analysis in the commercial landscape with relevance to the public sector.

### **Creation of a technical working group – application of IFRS 9 to the public sector**

12. The Relevant Authorities will establish a technical working group which will include the external assistance obtained. All Relevant Authorities are content to form part of the technical working group and agree this should be launched prior to any public sector consultation in order to fully understand the implications of the Standard before approaching the relevant sectors.
13. The terms of reference for the technical working group are still to be determined, but will include a review of the existing FrEM adaptations/interpretation for financial instruments and consideration of whether they remain appropriate. HM Treasury are to lead on this analysis for central government with CIPFA considering the adaptations for the Code.

### **Scoping the public sector landscape**

14. The Relevant Authorities will survey their respective departmental and sector landscapes as part of an initial impact assessment to better understand the breadth and depth of the impact of introducing the new Standard (and to understand implementation barriers). It will mainly focus on identifying the 'big players' – i.e. those most impacted by the Standard - and the extent of their financial instruments.
15. Each Relevant Authority will approach their own sectors using the most suitable mechanism to them in targeting the required public sector audience. HM Treasury plans to utilise a 'Finance Director letter' from the Deputy Director of Government Financial Reporting. This is considered to be the best instrument to achieve participation in the exercise.
16. The Relevant Authorities agreed that it will be important to consult early in the process so that entities can advise their Relevant Authorities of any potentially significant financial management implications.
17. Following this exercise key stakeholders and preparers of the accounts will be invited to participate in a workshop to consider findings from the initial public sector consultation. Additionally, the use of external consultants at this point will be engaged to analyse feedback from both the consultation and workshop to scope relevant potential interpretations or adaptations for the public sector.

### **High level work plan**

18. A high level work plan with practical steps towards implementation has been agreed between the Relevant Authorities to allow for 2017-18 adoption, with implementation in 2018-19. This workplan takes into consideration the possible implications on a spending review in 2015 and hence is brought forward by one year:
  - March 2015 – Paper on high level work plan to the FRAB
  - Spring 2015 – Creation of technical working group (with external assistance)
  - Summer 2015 – Initial consultation with public sector stakeholders as part of scoping exercise
  - November 2015 – Technical paper to FRAB detailing implications across the public sector and initial consideration of interpretations or adaptations (as required)

- March 2016 – Second paper to FRAB addressing any relevant issues and points of clarification, and proposed Exposure Draft
- Summer 2016 – Exposure draft issued inviting comment from stakeholders
- November 2016– Paper to FRAB seeking agreement to adopt the standard on the basis of the Exposure Draft (in light of consultation) along with FReM updated, with implementation in the 2018/19 FReM.
- January 2018 – IFRS implementation date
- April 2018 - UK public sector implementation of IFRS 9 (2018/19 FReM)

### ***Future updates to the FRAB***

19. HM Treasury anticipate that a verbal progress update will be provided to the FRAB at the next meeting in June 2015, which will be followed by the initial technical paper for the November 2015 FRAB meeting.

### ***Proposed text for the Government Financial Reporting Manual***

20. Relevant amendments including any interpretations or adaptations will be drafted for consideration for the 2018-19 FReM.

### ***Recommendation***

21. HM Treasury and the other Relevant Authorities ask that the Board provide comment on and agree the forward work plan.

**HM Treasury**

**26 March 2015**