Accounting

News

Discussion

# MFRS News

## REMINDER: MFRS 9 and MFRS 15

**April 2018**

MFRS News is your monthly update on all things relating to Malaysian Financial Reporting Standards. We'll bring you up to speed on topical issues, provide comment and points of view and give you a summary of any significant developments.

We begin this edition by considering the key aspects of the two major new Standards came into effect on 1 January 2018 (MFRS 9 'Financial Instruments' and MFRS 15 'Revenue from Contracts with Customers') and take a look at issues that are currently attracting regulators' attention.

# Contents





# Reminder: MFRS 9 and MFRS 15

2018 sees some of the biggest changes in recent standard-setting came into effect. Both MFRS 9 'Financial Instruments' and MFRS 15 'Revenue from Contracts with Customers' are mandatory for accounting periods beginning on or 1 January 2018. While most companies will be well aware of the changes and will have already taken steps to start implementing them, we give you a brief overview of the most significant changes below.

## MFRS 9 'Financial Instruments'

### Classification and measurement of financial assets

The classification and measurement of financial assets was one of the areas of MFRS 139 'Financial Instruments: Recognition and Measurement' that received the most criticism during the financial crisis. In publishing the original 2009 version of IFRS 9, the IASB therefore made a conscious effort to reduce the complexity in accounting for financial assets by having just two categories (fair value and amortised cost). However, following comments that having just two categories created too sharp a dividing line and failed to reflect the way many businesses manage their financial assets, an additional category was added in July 2014 when IFRS 9 (2014) (equivalent to MFRS 9) was published. The result is that under MFRS 9 each financial asset is classified into one of three main classification categories:

- amortised cost
- fair value through other comprehensive income (FVTOCI)
- fair value through profit or loss (FVTPL).

As shown in the table, classification is determined by both:

a the entity's business model for managing the financial asset ('business model test'); and

b the contractual cash flow characteristics of the financial asset ('cash flow characteristics test').

In addition, MFRS 9 provides options allowing an entity to (on initial recognition only) irrevocably designate:

- financial assets that would otherwise be measured at amortised cost or fair value through other comprehensive income under MFRS 9's general principles at fair value through profit or loss, if this designation would reduce or eliminate a so-called 'accounting mismatch'
- equity instruments, which will otherwise need to be measured at fair value through profit or loss, in a special 'equity – fair value through other comprehensive income' category. This is available for any investment in equities within the scope of MFRS 9 apart from investments held for trading and contingent consideration receivable resulting from a business combination to which MFRS 3 'Business Combinations' applies.

| | **Business model** | | |
|---|---|---|---|
| | **Hold to collect** | **Hold to collect and sell** | **Other** |
| **Cash flows are solely payments of principal and interest (SPPI)** | Amortised cost | FVOCI* | FVPL |
| **Other types of cash flows** | FVPL | FVPL | FVPL |

* Excludes equity investments. Can elect to present FV changes in OCI.

# MFRS 9 'Financial Instruments' (cont.)

## Impairment

In determining IFRS 9's impairment requirements, the IASB's aim was to rectify a major perceived weakness in accounting that became evident during the financial crisis of 2007/8, namely that IAS 39 (equivalent to MFRS 139) resulted in 'too little, too late' – too few credit losses being recognised at too late a stage. MFRS 139's 'incurred loss' model delayed the recognition of impairment until objective evidence of a credit loss event had been identified. In addition, MFRS 139 was criticised for requiring different measures of impairment for similar assets depending on their classification. MFRS 9's impairment requirements use more forward-looking information to recognise expected credit losses for all debt-type financial assets that are not measured at fair value through profit or loss. One consequence is that a credit loss arises as soon as a company buys or originates a loan or receivable – a so-called 'day one loss'. Unlike MFRS 139, the amount of the recognised loss is the same irrespective of whether the asset is measured at amortised cost or at fair value through other comprehensive income.

Recognition of impairment therefore no longer depends on the company first identifying a credit loss event. Instead an entity always estimates an 'expected loss' considering a broader range of information, including:

- past events, such as experience of historical losses for similar financial instruments
- current conditions
- reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the financial instrument.

## Hedge accounting

MFRS 139's hedge accounting requirements had been heavily criticised for containing complex rules which either made it impossible for entities to use hedge accounting or, in some cases, simply put them off doing so.

MFRS 9's requirements on hedge accounting look to rectify some of these problems, aligning hedge accounting more closely with entities' risk management activities by:

- increasing the eligibility of both hedged items and hedging instruments
- introducing a more principles-based approach to assessing hedge effectiveness.

As a result, the new requirements should serve to reduce profit or loss volatility. The increased flexibility of the new requirements are however partly offset by entities being prohibited from voluntarily discontinuing hedge accounting and also by enhanced disclosure requirements.

**Expected credit losses**

Deterioration in credit quality

| Stage 1 – Performing | Stage 2 – Under-performing | Stage 3 – Non-performing |
|---|---|---|
| • financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk at the reporting date | • financial instruments that have deteriorated significantly in credit quality since initial recognition (unless they have low credit risk at the reporting date) but that do not have objective evidence of a credit loss event | • financial assets that have objective evidence of impairment at the reporting date |
| • 12-month expected credit losses are recognised<br>• interest revenue is calculated on the gross carrying amount of the asset. | • lifetime expected credit losses are recognised<br>• interest revenue is still calculated on the asset's gross carrying amount. | • lifetime expected credit losses are recognised<br>• interest revenue is calculated on the net carrying amount (ie reduced for expected credit losses). |
| Credit risk = low | Credit risk > low | |

# MFRS 15 'Revenue from Contracts with Customers'

MFRS 15 'Revenue from Contracts with Customers' replaces MFRS 111 'Construction Contracts', MFRS 118 'Revenue', IFRIC 15 'Agreements for the Construction of Real Estate' and all other revenue-related Interpretations. All transactions within its scope are analysed against a single, control-based model centred around the following 5-steps:

**A five step model for revenue recognition**

1. Identify the contract(s) with the customer
2. Identify the separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognise revenue when or as an entity satisfies performance obligations

MFRS 15 changes the criteria for determining whether revenue is recognised at a point in time or over time. In addition, while the following points may vary in terms of their expected impact from industry to industry, MFRS 15 has more guidance in many areas where current MFRS are lacking such as:

- multiple-element arrangements
- contract modifications
- non-cash and variable consideration
- rights of return and other customer options
- seller repurchase options and agreements
- warranties
- principal versus agent (gross versus net)
- licensing intellectual property
- breakage
- non-refundable upfront fees
- consignment and bill-and-hold arrangements.

MFRS 15 requires considerably more disclosure about revenue recognition including information about contract balances and changes, remaining performance obligations (backlog), and key judgements around the timing of and methods for recognising revenue.

The Grant Thornton Malaysia has issued a publication on MFRS 15 'Revenue from Contracts with Customers', including:

- Prepare for revenue recognition standard with MFRS 15 Contract Review Tool
- Special Edition of MFRS Hot Topics

Grant Thornton

An instinct for growth™

grantthornton.com.my