Concerns of IFRS 9 Implementation in Thailand

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ABSTRACT

This research aims to understand the experts' viewpoints on the concerns of IFRS 9 implementation in Thailand context. There are still many in the accounting sectors who are unfamiliar with the coming IFRS 9 changes. This study performed qualitatively analysis with exploratory research using in-depth interviews between October and November of year 2017 with seven Thai banking experts who are heavily involved in the implementation of IFRS 9. The research findings contribute to the available literature by raising awareness of business process, policy, and regulation in IFRS 9 implementation. Results show that stakeholders who will be affected by IFRS 9 were practitioners (banks, auditors, and consultants), customers (SMEs), investors, and analysts. We also found that even though Thailand is unique in both banking system and consumer behavior, the research findings can contribute to the existing literatures in a Western context. The greatest concerns among the informants include the new method in recognizing credit losses by using expected credit losses as well as the irreversible methods of classification and measurement of an asset. These raise concerns on the volatility of earnings and financial position of a firm.

Keywords: IFRS 9, TFRS 9, Impairment, Volatility

บทความวิจัย

ประเด็นข้อพิจารณาของการนำ IFRS 9 มาใช้ในประเทศไทย

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บทคัดย่อ

การวิจัยนี้มีวัตถุประสงค์เพื่อทำความเข้าในมุมมองของผู้ที่มีความเชี่ยวชาญในประเด็นข้อพิจารณาของการนำ IFRS 9 มาใช้ในบริบทของประเทศไทย ซึ่งยังมีผู้อยู่ในส่วนงานเกี่ยวกับบัญชีมากมายที่ยังไม่คุ้นเคยกับการเปลี่ยนแปลงอันเนื่องมาจาก IFRS 9 ที่กำลังจะมาถึงนี้ การศึกษานี้ใช้วิธีการวิจัยเชิงสำรวจแบบเชิงคุณภาพ โดยใช้การสัมภาษณ์เชิงลึกระหว่างเดือนตุลาคมถึงเดือนพฤศจิกายน พ.ศ. 2560 กับผู้ที่มีความเชี่ยวชาญและเกี่ยวข้องอย่างมากกับการนำ IFRS 9 มาใช้ของธนาคารในประเทศไทย ผลของงานวิจัยนี้ก่อให้เกิดการรับรู้ถึงกระบวนการทางธุรกิจ นโยบาย และข้อกำหนดกฎหมาย ในการนำ IFRS 9 มาใช้ ผลการศึกษาพบว่า ผู้มีส่วนได้เสียที่ได้รับผลกระทบจาก IFRS 9 ประกอบด้วย ผู้ปฏิบัติงาน (ธนาคาร ผู้สอบบัญชี และที่ปรึกษา) ลูกค้า (SMEs) นักลงทุน และนักวิเคราะห์ นอกจากนั้นยังพบว่า แม้ว่าประเทศไทยจะมีความแตกต่างทั้งในเรื่องระบบธนาคารและพฤติกรรมของลูกค้า ผลของการศึกษาก็ยังมีประโยชน์ต่อความรู้ในบริบทของทางตะวันตก โดยพบว่า เรื่องที่เป็นประเด็นข้อพิจารณาที่สำคัญที่สุดจากผู้ให้สัมภาษณ์ คือ วิธีการใหม่เกี่ยวกับเรื่องการรับรู้การขาดทุนของการให้สินเชื่อโดยใช้วิธี Expected Credit Losses และวิธีการห้ามปรับกลับ (The Irreversible Method) ของการจัดประเภทและการวัดมูลค่าของสินทรัพย์ ซึ่งก่อให้เกิดประเด็นในเรื่องของการผันผวนของกำไรและสถานทางการเงินของกิจการ

คำสำคัญ: IFRS 9 TFRS 9 การด้อยค่า ความผันผวน

1. Introduction

International Financial Reporting Standard No. 9 (IFRS 9) Financial Instruments is a replacement of IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 New requirements which contains a significant new impairment as well as revised classification and measurement requirements of financial assets have consequences for business operation in Thailand. Accounting standards in Thailand generally follows the international financial reporting standards (IFRS) and, as such, these IFRS 9 standards will have an enormous impact on Thai accounting standards, which will be adopted as Thai Financial Reporting Standard No. 9 (TFRS 9) and will become effective in 2019.

These new methods of reclassification and measurement should raise two major concerns of many organizations. Firstly, IFRS 9 will undoubtedly affect business processes and practices of financial institutions which will directly impact not only small and medium sized enterprises (SMEs) but also consumers on how such financial institutions approve their loans. Secondly, IFRS 9 will raise a concern on those financial institutions' volatility of profit and loss statements.

We found that there are major concerns regarding what will happen after the implementation of TFRS 9. One of the major concerns is the expected increase in the provision of accounts receivable due to reclassification of the credit rating of debtors and a new calculation of this provision. As a result, the adjustments of loan contract terms between lenders and borrowers are considered as a financial and economic concern (Chen, et al., 2015). We cannot deny that the well-being of financial institutions is in favor of a country's survival because these institutions are capital providers and one of the key components of an economic system. The higher the debt provisions these institutions have, lesser loan or capital offers debtors are allowed to get, which lowers the performance rating of these institutions. This can negatively affect the overall economic condition of the country. In addition, the representation of financial reporting is the reflection of the country's economic condition. As financial ratios from information of TFRS 9 implemented financial statements will tend to be pessimistically presented, overall economic condition may be affected to an even worse extent.

According to in-depth interviews with Thai banking experts, we found that there are not only concerns regarding the uncertainty and clarification regarding TFRS 9 implementation guidelines, but also questions have been raised regarding the readiness among Thai institutions who have financial instruments in their financial statements. For this research, we use TFRS 9 and IFRS 9 interchangeably because TFRS will adopt full IFRS 9 changes. The following sections detail research method, findings and discussion, conclusions and recommendations.

2. Research Method

This study utilized a case study approach. This methodology is appropriate to this study because we conducted an exploratory research by performing in-depth interviews of a complex issue (Cresswell, 2007) with Thai bank experts who are heavily involved in the current processes. We conducted multiple interviews between October and November of year 2017. This research purposively conducts interviews with seven Thai bank senior officers at the upper management levels. TFRS 9 will have a prominently effect on financial institutions so that informants who have extensive expertise in IFRS 9 and are heavily involved with the implementation and preparation of the upcoming TFRS 9 were chosen. Each interview occurs multiple rounds between 30–60 minutes. The qualitative case study approach and triangulations with other sources of information are also performed. Because of the importance of high confidentiality and at the request of informants, we do not use any machining records and we cannot disclose their names and institutions. We applied semi-structured questions to ask informants about the expected effects of IFRS 9 implementation which are composed of "What are the expected benefits or other effects of TFRS 9 on your business?", "What are the expected overall consequences of TFRS 9 implementation?", "How will your business and other firms in Thailand prepare for this standard?", and "What are your recommendations for TFRS 9 implementation, and do you need any support for preparing of its implementation?"

We took detailed memos and compared and carefully review informants' responses after interview sessions for validation. We also request to revisit or contact interviewees in the case of any unclear information or the need for additional information. Information received from the informants was then compared and contrasted, and a reflection of overall meaning was determined in order to come up with the final results of the study. Table 1 demonstrates an example of common words expressed by informants during interviews regarding concerns and challenges of IFRS 9 implementation.

Table 1 Example of comments and commons key words from informants

Comments	Key words
"IFRS 9 uses both risk management framework along with financial model to calculate the amount of provision by using uncertainty factors in forward looking such as macroeconomic factors."	Looking forward Risk model calculation Capability vs. credibility Macroeconomic factors
"Accountant has to know more than just accounting theory; for example, accountant has to learn risk management framework because it affects asset (net) and expenses numbers."	Local accounting options Expected provision Segmentation among debtors/customers

Table 1 Example of comments and commons key words from informants (Cont.)

Comments	Key words
"Our bank has to come up with new policies and procedures for IFRS 9 implementation as well as communicate them to our business units."	Rules and regulations Direction and communication
"Small and medium-size businesses will be significantly impacted in terms of how they apply for a loan. We believe that many SMEs who have limited collateral will have difficulty in obtaining a loan."	SME Portfolio Collateral Credit quality
"Due to the effect of consumer behavior on provisions, there will be a significant increase in credit risk. Bank's provisions will be much higher than before IFRS 9 implementation."	High credit risk Thai context Consumer behavior
"the consequence of a significant increase in provision will increase expense and decrease profit. This means there is volatility of P&L. Investors may choose not to invest with us."	Profit and loss Shareholders and investors

3. Summary of Findings and Discussions

3.1 Effects on rules and regulations

We found that financial institutions have to modify core banking system and business processes to be ready for IFRS 9 and to be ready for complexity in changing classification and measurement methods that will result. Following Hooper and Gacsal (2011) and the results obtained from expert interviews, we conducted, there are significant questions and issues raised such as "When is a financial instrument a financial asset, a financial liability or an equity instrument?", as well as how to assess eligibility of the fair value option, when to apply the rules-based reclassification criteria, how to apply the complex rules on the treatment of derivatives and embedded derivatives, and how to apply correctly the two aspects of interpretation of accounting documentation with speculative perspective on the affected assets. Table 2 demonstrates the challenges of IFRS 9 implementation.

IFRS 9 requires firms to be more conservative by using a complex approach which includes examining information and predicting ahead of time to calculate an expected credit loss (ECL) instead of using the incurred loss model from the International Accounting Standard No. 39 (IAS 39) or accounts receivable aging concept. Under IFRS 9, the economic trend of an asset is used as part of an information set to calculate provision. In addition, there are concerns about how asset classification changes during different stages, which

Table 2 The challenges of IFRS 9 implementation (Taylor, 2015)

Matters	Challenges	Mitigation
Business model (BM)	BM is defined by senior management Process and systems require documentation in the BM of reasons for sale which will have an impact on accounting	Use of existing BM documentation and portfolio structures as a starting point Communicate the new policy, requirement and strategic options to business units
Contractual cash flows	Solely payments of principal and interest (SPPI) on the principal amount will affect assessment at the instrument level Business units to be included	System implementation Training of business units
Fair value (FV) assessment	High-quality FV assessment needed for structured loans FV assessment needed for modified loans which may result in P&L and equity volatility	Implementation of FV models for loans Implementation of IT systems
Transitional impacts	Availability of data on transition Determining opening position impacts Assessment of FV may be needed for loans currently at amortized cost	Identify data gaps and capacity of existing IT systems Deploy simulation tools to identify and quantify impacts Develop, build and test FV models for loans
Disclosures	Reconciliation between existing method of measurement and new measurement categories under IFRS 9 Additional qualitative and quantitative information is required to be disclosed Need to communicate to analyst and investors	Mock-up of disclosures Regular contact with regulators and investors Potential for national disclosures and/or guidelines

Source: PwC

is based on asset performance. The three stages include: good credit quality (stage 1), significant increase of credit risk (stage 2), and impairment of credit (stage 3). The informants' opinions on this change of method from 5 stages to 3 stages is that it will cause less credit approvals because banks have to provide more provision for each loan through the expected credit life of the asset. The unintended consequence that concerns experts is that it will drive potential customers (debtors) away from banks and toward underground loan providers with outrageous interest rates on their loans. Currently, however, the Thai government is engaged in trying to eradicate this type of high interest business practice.

According to IFRS 9 rules, the irreversible methods of classification and measurement will apply at the time of initial recognition, which is based on the company's business model. The purpose is to match accounting treatments according to business model and its treatment of assets and liabilities. For example, various business models might be affected by a realized fair value of an investment portfolio, contractual cash flows, a local authority holding a portfolio of quoted and unquoted shares for capital gain, and a multi-national company holding bonds to fund operations. Management is now given a prearranged option to present fair value changes in either Other Comprehensive Income (OCI) or Profit and Loss Statement (P&L). The designation is available on recognition and is irrevocable. However, through OCI, there is no recycling of the changes through P&L, although the dividends from such investments will continue to be recognized in P&L. This raises concern on the volatility of profit.

3.2 Effects on stakeholders

We found that the implementation of TFRS 9 will affect many stakeholders, from business units to regulators, e.g., financial institutions (banks), customers, small and medium enterprises (SMEs), investors, analysts, auditors, and consultants. There are four main issues raised for this implementation—practitioner issues, customer issues, interpretation issues, and investor and analyst issues. Figure 1 demonstrates a summary of stakeholders of the IFRS 9 implementation.

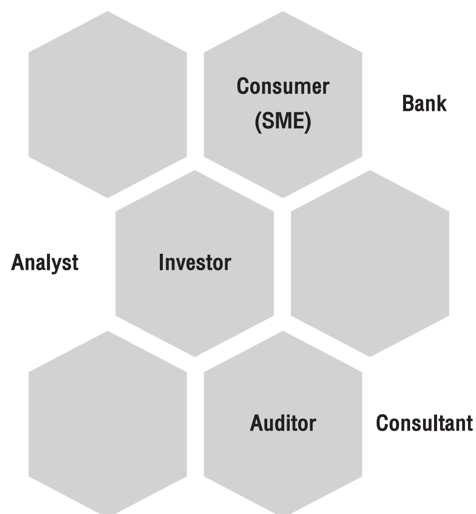

Figure 1: Summary of the IFRS 9 - affected stakeholders

IFRS 9 is a principle-based standard which is rather new and there is limitation of interpretations of its practical standard available. We found that there are different opinions and interpretations of

IFRS 9 regarding the assumptions and conditions in setting criteria of customer categories among banks, consultants, and auditors. Points to consider are possible effects on both the banking system (in terms of database readiness) and consumer behavior (in terms of the reclassification criteria of customers' credit default and credit rating). These possible effects will differ in Thailand, as opposed to Western countries. This implies the need for careful consideration of possible effects after full implement of IFRS 9 and subsequently TFRS 9, especially in relation to its appropriateness for Thailand. The application of the practical standard with clear direction of the TFRS 9 is called for among the informants. The main concern to the Thai banking system after TFRS 9 implementation is the possibility of causing an economic hardship on consumers.

For the practitioner, a bank will have to implement new credit evaluation and approval policy. TFRS 9 will have a significant effect on releasing credit to customers. Consequently, small and medium-sized enterprise (SME) customers who have insufficient collateral will experience a severe impact from TFRS 9. A bank has to invest in a new management information system which includes both technology software and experts in IFRS 9. This is necessary for compliance, accuracy, reliability and credibility in the evaluation and calculation method of asset and liability fair value. In addition, the lifetime expected credit loss (ECL) will rise because of significantly increased credit risk, which will in turn raise operation costs, and this cost will likely be passed on to customers. According to our informant comments, the compliance to TFRS 9 will impact at least 90 percent of a bank's business process, specifically regarding revenues and expenses.

As for preparation and implementation issues, informants inform that there are many challenges regarding the data preparation process in compliance to IFRS 9. Informants commented that Thai banks use the standardized approach (SA) unlike European banks which use the internal ratings-based (IRB) approach to measuring risk-weighted assets (Huizinga, 2016). The significant difference between these two models is that the IRB model has internal data which makes it easier for European banks to implement IFRS 9 than for Thai banks. For compliance with TFRS 9, Thai banks will not be able to provide some non-existing data and additional business policies and procedures will need to be established.

As for the customer issues, SMEs require more documentation from the bank to apply for a loan as well as to accommodate the credit evaluation process of TFRS 9. This loan approval process will significantly increase bank costs. This will result in more strictness and limitation in credit loan approval, especially for new startup businesses and SMEs that have insufficient collateral.

As for interpretation issues, the lack of transferred knowledge and understanding of IFRS 9 among banks, consultants, and auditors causes concerns for these parties. The concerns relate to the use of fair value, such as measurement-relevance, as well as to disclosure, artificial volatility and stability, presentation of unrealized gains and losses, and the difficulty in estimation (Bentley & Franklin, 2013). Principle-based standards are written to be legalistic in order to cover a variety of treatment and to avoid partisanship. However, it downside to these standards is that they are time consuming to evaluate and difficult to interpret among parties such as regulators, banks, consultants and auditors. Consequently, the practitioners call for local options (rule-based standards) which should work soundly, independently and objectively and are vital to judgement call under the Code of Ethics. Informants commented that TFRS 9 should provide them a practical option with a transitional workforce to study each provision of IFRS 9 to make sure that it is suitable to Thai business context. In addition, according to the treatment of derivatives, IFRS 9 is more concerned with fair value, classification, and measurement rather than conservative rule of accounting integrity (which is evident based using historical data). Consequently, IFRS 9-implemented financial statements will have a high degree of discretionary information blended in with financial information. Informants also believed that TFRS 9 will make the bank's portfolio smaller, which means bank has to work harder to find another potential customer, driving up the bank cost.

As the investor and analyst issues, the difficulty in analyzing and interpretation of financial reporting can discourage both analysts and investors from investing in Thai banks. Even though investors are assured to have international standard analysts on hand to assist during implementation of IFRS 9, the consistency of the reporting during the first couple of years after adopting IFRS 9 will likely deviate. This deviation will likely occur on both contractual and provision amounts, reflected on assets and liabilities, as well as on the presentation of P&L. In addition, informant have expressed opinion that after TFRS 9 implementation, bank financial statements will have two parts: "real" (from actual loan contract) and "speculation" (from looking forward of account receivables and setting of expected provision). Consequently, the misinterpretation of bank financial statements can be incurred from the increasing or decreasing of the provision of account receivable due to projection of potential economic variables. Depending on the conservativeness of the bank's policy, this can cause over- or understated P&L. An additional comment from the informants regarding provision accounts is that if the regulators do not set the clear rules and regulations, a situation of unfair competitiveness among Thai banks can result.

4. Conclusions and Recommendations

IFRS 9 aims to help firms, especially financial institutions, in aligning their financial accounting with a risk management approach. However, the provision of credit loss on assets and liabilities will significantly affect their financial reporting. Thai banks are expecting an increase of costs and additional problems following implementation due to several factors: problem identifying the measurement issues, having to develop and update policies, the need for documentation of debt covenants, planning regulatory capital, the requirement of additional data for disclosures, and difficulties aligning the new process with existing operating systems. The new rules of IFRS 9 will change how banks recognize credit losses by using expected credit losses (ECL) which looks forward to possible losses starting from the initial contract date to the end of the asset's lifetime. The economic state of the country at the start of a contract is also a new factor for the calculation of provision. As a result, banks will have to incorporate a larger provision. The complexity of non-financial variables, macroeconomic condition, and risk management framework should be further investigated to determine whether IFRS 9 is suitable for the Thai context. In order to prevent materially drastic changes in financial figures, which results in an unexpected decline in capital ratios, clear guidelines in communication and understanding of this new rule of TFRS 9 need to be discussed and established.

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