MALAYSIAN INSTITUTE OF ACCOUNTANTS

FREQUENTLY-ASKED QUESTIONS (FAQs) FOR MFRS 9 *FINANCIAL INSTRUMENTS*

MFRS 9 *Financial Instruments* was issued by the Malaysian Accounting Standards Board on 17 November 2014. MFRS 9 will be effective for financial period beginning on or after 1 January 2018 with early application permitted.

As part of FRSIC initiative to assist preparers to implement MFRS 9, FRSIC via its sub-group, FRSIC Financial Services Task Force (FRSIC-FSTF) has established 3 work streams to identify MFRS 9 implementation issues. These work streams consist of preparers, auditors and regulators.

Compiled in this FAQs are some of the implementation issues that the staff of the Institute received which have been discussed by the work streams. The discussion points and conclusions to the questions have been prepared by the staff of the Institute and are not necessarily the views of the Institute.

Auditors and preparers are expected to use professional judgement in determining if the questions and conclusions are both appropriate and relevant to their circumstances.

Introduction

MFRS 9 establishes the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This Standard replaces MFRS 139 *Financial Instruments: Recognition and Measurement.*

The following are major changes introduced in MFRS 9:

1. **Classification and measurement of financial assets and liabilities**

   MFRS 9 requires an entity to classify its financial assets based on the business models within which they are held as well as their contractual cash flow characteristic. In relation to classification and measurement of financial liabilities, in cases where fair value option is applied, MFRS 9 requires the fair value change due to entity's own credit to be recorded in other comprehensive income rather than in profit or loss, unless this creates an accounting mismatch.

2. **Impairment methodology**

   MFRS 9 replaces the 'incurred losses model' in MFRS 139 with the 'expected credit losses model'. Under the expected credit losses model, an entity is required to recognise loss allowance for a financial instrument at an amount equal to the *12-month expected credit losses* or *lifetime expected credit losses*. Impairment methodology introduces under MFRS 9 also emphasises on forward-looking information to reflect instruments' expected credit losses.

3. **Hedge accounting**

   MFRS 9 aligns hedge accounting more closely with risk management, establishes a more principle-based approach to hedge accounting and addresses inconsistencies and weaknesses in the hedge accounting model in MFRS 139.

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SCOPE

Q1. It is common for parent companies and their subsidiaries to enter into intra-group loans. These loans may vary in terms and conditions. Most of the time, the loans are advanced on favourable terms (often interest free). Some of the loans have no written terms (i.e. no interest and fixed repayment terms).

For intra-group loans with no written terms, where repayment is not expected in the foreseeable future, are these financial assets in the scope of MFRS 9 or should they be accounted for as part of the net investment in subsidiary by the parent in its separate financial statements (i.e. within the scope of MFRS 127 *Separate Financial Statements*)?

Intra-group loans with written terms would generally fall under the scope of MFRS 9 where loans are recognised at fair value on initial recognition based on the market rate of interest for similar loans. All requirements of MFRS 9 will therefore be applicable, including impairment.

However, intra-group loans with no written terms are judgmental and require assessment of the economic substance of such loans. These loans may not be within the scope of MFRS 9 if in substance, such loans reflect long-term capital injection rather than normal operational funding such as payment of expenses made on behalf. As such, an entity needs to assess the nature of such intra-group loans, including past practice and payment pattern of such loans. If such loans are determined to be a capital injection, different measurement and impairment requirements apply to it, which are not governed under MFRS 9. Where the loan is a capital injection from parent companies to subsidiaries, it falls under the scope of MFRS 127.

CLASSIFICATION, RECOGNITION AND DERECOGNITION

Q2. Paragraph 4.1.2 provides that a financial asset shall be measured at amortised cost if it is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and the contractual terms of the financial assets are solely payments of principal and interest on the principal amount outstanding. Paragraph B4.1.3B further explains that sales that occur may be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if such sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent).

How can it be determined whether such sales are 'infrequent' or 'insignificant in value'?

Paragraph 4.1.1 emphasises that an entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of:

1. The entity's business model for managing the financial assets; and
2. The contractual cash flow characteristics of the financial assets.

An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. Hence, it does not depend on management's intentions for an individual instrument – i.e. portfolio rather than instrument-by-instrument basis.

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MFRS 9 clarifies that the entity's business model determines whether cash flow will result from collecting contractual cash flows, selling financial assets or both. Information about past sales and expectations about future sales provide evidence related to how the entity's stated objective for managing financial assets is achieved and, specifically, how cash flows are realised [refer paragraph B4.1.2C]. This includes:

(a) How the performance of the business model and the financial assets held are evaluated and reported;
(b) The risks that affect the performance of the business model and the way which those risks are managed; and
(c) How managers of the business are compensated (i.e. whether based on the fair value of the asset managed or the contractual cash flows collected). [refer paragraph B4.1.2B]

Sales in themselves do not determine the business model and therefore cannot be considered in isolation. There is no bright line in order to assess whether sales are 'infrequent' or 'insignificant in value'. An entity will need to use judgment, based on facts and circumstances when making such assessment. It is important to understand the reasons for those sales and whether such sales are consistent with the entity's hold to collect business model.

Using the principle outlined above, determination of whether sales are 'infrequent' or 'insignificant in value' shall be made, for instance:

(a) To compare the sales value against the value of the portfolio that is subject to business model assessment;
(b) To compare expected sales over the expected lives or average lives of the instruments in the portfolio;
(c) To assess the reason(s) of the sales, for e.g. to manage credit risk of the portfolio or an individual asset or as part of recovery process etc.

Q3. Depending on contractual terms, perpetual instruments may or may not meet the definition of equity as defined in MFRS 132 *Financial Instruments: Presentation*. How would this impact classification when the holders account for the asset under MFRS 9?

An entity shall assess whether its investment in perpetual instrument meets the definition of an equity instrument or debt instrument in MFRS 132. If such an instrument is determined to be an equity instrument, MFRS 9 requires the instrument to be carried at fair value with changes in fair value to be recognised in profit or loss, unless an entity makes an irrevocable election at initial recognition to present changes in fair value in other comprehensive income without recycling to profit or loss [refer paragraph 4.1.4].

On the other hand, if the investment in a perpetual instrument is a debt instrument in accordance with its specific terms and conditions, an entity shall assess whether such instrument shall be measured at amortised cost or at fair value through other comprehensive income or at fair value through profit or loss, based on the entity's business model for managing the instrument and contractual cash flow characteristics of the instrument [refer to paragraphs 4.1.2 and 4.1.2A].

Q4. Trade receivables held by corporates are often subject to factoring arrangements. Depending on the terms and conditions, a factoring may or may not result in derecognition of the trade receivables. Is the "sale" referred to in the business model assessment under MFRS 9 equivalent to "derecognition" under MFRS 9? Are sales considered to have taken

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place when the trade receivables are transferred under factoring agreements and accordingly, qualify for derecognition in its entirety?

Paragraph 3.2.2 requires an entity to determine whether derecognition should be applied to a part of a financial asset (or a part of a group of similar financial asset) or a financial asset (or a group of similar financial asset) in its entirety.

Paragraph 3.2.3 further states that an entity shall derecognise a financial asset when, and only when:

(a) The contractual rights to the cash flows from the financial asset expire; or
(b) It transfers the financial asset and the transfer qualifies for derecognition.

As such, if the factoring arrangement meets the criteria above, the trade receivables shall be derecognised and sales can be considered to have taken place. Conversely, if the factoring arrangement does not meet the criteria above, such as when an entity provides guarantee on the recoverability of trade receivables, the trade receivables shall not be derecognised as the entity still retains substantially all the risks and rewards of ownership. Accordingly, there is no sale.

Q5. Companies may have set up a master factoring agreement with a bank which resulted in the trade receivables transferred meeting the derecognition criteria in MFRS 9. However, at the inception of a trade receivable, it is often unknown whether it will be subject to factoring. Such a decision is normally made later in the process. In such circumstances, what would be the applicable business model for the trade receivables?

Paragraph 4.1.1 emphasises that an entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of:

1. The entity's business model for managing the financial assets; and
2. The contractual cash flow characteristics of the financial assets.

An entity needs to consider whether the trade receivables still meet the business model whose objective is to hold financial assets in order to collect contractual cash flows. Among others, an entity shall assess the intention and reason of the factoring arrangement. Paragraph B4.1.3 clarifies that although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus, an entity's business model can be to hold financial assets to collect contractual cash flows even when the sales of financial assets occur or are expected to occur in the future.

For instance, if the factoring arrangement is entered when there is an increase in the assets' credit risk or to manage credit concentration risk, the business model may still be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. Likewise, if an entity has committed to factoring arrangement with regard to its trade receivables, regardless of whether there is an increase in an asset's credit risk or credit concentration risk, it may be an indicator that the entity's business model is not to hold such asset in order to collect contractual cash flows.

Based on the objectives and reasons of factoring arrangement, an entity may need to further segregate or segmentise its trade receivables into different portfolio in order to reflect the level

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at which an entity manages those trade receivables. For instance, those "pre-qualified" trade receivables will be classified as one portfolio carried at fair value while other trade receivables will be classified in another portfolio carried at amotised cost.

MEASUREMENT

SUBSEQUENT MEASUREMENT

Q6. Paragraph 46(c) of MFRS 139 *Financial Instruments: Recognition and Measurement* allows an entity to measure its investment in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured at cost. However, under MFRS 9, an entity is required to measure its investment in equity instruments at fair value through other comprehensive income or fair value through profit or loss. How does an entity derive the fair value of such an investment?

MFRS 9 requires an entity to measure equity instruments at fair value. Fair value measurement approach is governed under MFRS 13 Fair Value Measurement where it introduces three widely used valuation techniques which are market approach, cost approach and income approach. Fair value of equity instruments that do not have a quoted market price in an active market will largely depend on other observable and unobservable inputs.

It should also be noted that paragraph B5.2.3 states that in limited circumstances, cost may be an appropriate estimate of fair value such as if insufficient more recent information is available to measure fair value or if there is a wide range of possible fair value measurements and cost represents the best estimates of fair value within that range. Paragraph B5.2.4 further states the list of indicators that cost might not be representative of fair value, although it is not exhaustive:

(a) a significant change in the performance of the investee compared with budgets, plans or milestones.
(b) changes in expectation that the investee's technical product milestones will be achieved.
(c) a significant change in the market for the investee's equity or its products or potential products.
(d) a significant change in the global economy or the economic environment in which the investee operates.
(e) a significant change in the performance of comparable entities, or in the valuations implied by the overall market.
(f) internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.
(g) evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties.

In practice, it is common for entities to measure or estimate fair value of unquoted equity investment based on a multiple of net tangible assets (NTA) or a multiple of net assets (NA) or adjusted NTA or adjusted NA. These methods involve deriving the fair value of an investee's equity instruments by reference to the fair value of its assets and liabilities (recognised and unrecognised) with appropriate adjustment. Such methods might be appropriate depending on the types of unquoted shares, and the nature of the business of the investee. Importantly, an entity shall ensure the fair value estimate is consistent with fair value measurement principle outlined in MFRS 13 *Fair Value Measurement*.

Entity may refer to the educational material issued by the IASB entitled "*Illustrative Examples to accompany IFRS 13 Fair Value Measurement for Unquoted Equity Instruments within the*

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Scope of IFRS 9 Financial Instruments" for a high level valuation guidance of unquoted equity instruments within the context of MFRS 13.

IMPAIRMENT

Q7. Does an entity's credit risk model need to be reviewed and validated?

Paragraph 5.5.4 states that the objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition — whether assessed on an individual or collective basis — considering all reasonable and supportable information, including that which is forward-looking. If the credit risk on a financial instrument has not increased significantly since initial recognition, the loss allowance for that financial instrument shall be measured at 12-month expected credit loss. MFRS 9, however, does not dictate the credit risk model that an entity should use for such assessment. As such, an entity may apply various approaches when assessing whether the credit risk on a financial instrument has increased significantly since initial recognition or when measuring expected credit losses, including ability to apply different approaches for different instruments [refer paragraph B5.5.12].

Considering the nature of expected credit losses model that requires reasonable and supportable forward-looking information, paragraph B5.5.52 further emphasises for a regular review of the methodology and assumptions used for estimating expected credit losses to reduce any differences between estimates and actual credit loss experience. An entity shall also take into consideration whether validation is needed arising from regulator's expectation on credit risk model. Principle 5 of Basel Committee's Guidance on credit risk and accounting for expected credit losses requires banks to have policies and procedures in place to appropriately validate models used to assess and measure expected credit losses.

Q8. Retail portfolio consists of individual customer loan accounts such as personal loans, hire purchase loans and credit card loans. Individual customer's credit rating is given only on initial recognition when banks perform customer's credit assessment. Subsequent to initial recognition, individual retail accounts are generally not monitored and tracked on systematic basis (i.e. no quarter or annual review). As such, can financial institutions rely on month-in-arrears (MIA) or days past due (DPD) for transfer criteria of retail portfolio?

Paragraph 5.5.9 requires an entity to assess at each reporting date, whether the credit risk on a financial instrument has increased significantly since initial recognition. Such assessment shall take into account reasonable and supportable information (that is available without undue cost or effort), including forward-looking information. Paragraph 5.5.11 further clarifies that if reasonable and supportable forward-looking information is available without undue cost or effort, an entity cannot rely solely on *past due* information when determining whether credit risk has increased significantly since initial recognition.

On the other hand, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, an entity may use past due information to determine whether there have been significant increases in credit risk since initial recognition. This is further clarified in paragraph B5.5.3 which states that an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due such as retail loans for which

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there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a customer breaches the contractual terms.

It is also noted that Basel framework emphasises the use of scoring or rating model, especially for financial institutions that are on Internal Ratings-Based (IRB) approach. This preference took comfort that such model is used by financial institutions to monitor, manage and measure credit risk in their businesses (the fulfilment of 'use-test').

Consistent with the principle in MFRS 9 and Basel framework, the following scenarios illustrate the application of MIA or DPD for transfer criteria:

1. <u>Scenario 1: An entity has a rating or scoring model and uses such model to monitor and manage its credit risk</u>
   If an entity has a rating or scoring model which incorporates forward-looking information and uses such model to monitor and manage its credit risk, such model should be used for transfer criteria. This is because reasonable and supportable forward-looking information is readily available without undue cost or effort, as embedded in the entity's rating or scoring model which has been used in monitoring and managing credit risk.

2. <u>Scenario 2: An entity has a rating or scoring model but have yet to use it to monitor and manage its credit risk</u>
   If an entity has a rating or scoring model but have not used it to monitor and manage its credit risk, MIA or DPD may be used for transfer criteria. Nevertheless, an entity should also consider to incorporate certain forward-looking information where relevant, including to further segregate retail portfolio into different risk profiles. This is because MIA or DPD in itself may not be sufficient to determine if there has been significant deterioration in credit risk and hence, should be supplemented with relevant and existing criteria used by the entity in monitoring and managing credit risk.

3. <u>Scenario 3: An entity has a rating or scoring model but in the process of recalibrating new model</u>
   If an entity has a rating or scoring model in which it uses to monitor and manage credit risk but at the same time, in the midst of recalibrating a new model, the current model should be used for transfer criteria. This is because, the new rating or scoring model is still in the process of being recalibrated and would still be subjected to validation before being put in use for monitoring and managing credit risk.

Q9. How do we determine what is reasonable and supportable forward-looking information when measuring ECL?

Paragraph B5.5.49 emphasises that reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort. Paragraph B5.5.51 further provides that an entity shall only consider all reasonable and supportable information that is relevant to the estimate of expected credit losses. As expected credit losses reflect the entity's own expectation of credit losses, the estimates shall be based on information that entity normally uses for credit management [refer paragraph B5.5.17(o)]. The entity is expected to be able to explain on how it arrives at its estimation, based on reasonable and supportable information. The expected credit losses (ECLs), by their nature, need to be updated frequently based on information available at the reporting date and can be reasonably assessed [refer paragraph B5.5.49]

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In achieving the principle of measuring ECLs by considering all reasonable and supportable information, including that which is forward-looking, an entity may consider the following approach to determine such information:

(a) Forward-looking information that are currently used by management in their business; including in credit risk management;
(b) Forward-looking information that are currently being used by peers for similar financial instruments (or a group of financial instruments);
(c) Other forward-looking information that are available in the market and industry and which are commonly used or referred to.

Q10. How should an entity deal with information that are available subsequent to the reporting date but before the issuance of the financial statements? Should it be included in the measurement of expected credit losses?

MFRS 9 does not specifically require information that are available subsequent to the reporting date to be included in the measurement of expected credit losses. However, an entity shall also consider requirements in MFRS 110 *Events after the Reporting Period* regarding the treatment of events that occur or information that are available, including forward-looking information, between the end of the reporting period and the date when the financial statements are authorised for issue.

Q11. For share margin financing, one of the common staging criteria is based on equity-to-loan of financing ratio (collateral coverage). In view that the share price is based on the quoted market price as of reporting date, is an entity required to perform projection on the share price in order to comply with forward-looking information requirement under MFRS 9?

Equity-to-loan or financing ratio (or collateral coverage) is commonly used by banks in determining staging of assets and measuring expected credit losses. The movement in collateral coverage is highly dependent on market prices of the underlying quoted shares, i.e. the collateral in the share margin financing. Share prices of listed companies reflect among others volatility in the market, current and future expected economic conditions and performances of the investee companies from market participants' perspective. Taking into consideration that the share prices of listed companies have included forward-looking information, as reflected by the market forces in determining the market prices and the price fluctuations, an entity need not perform projection on the share prices.

However, in certain circumstances, an entity may consider that a haircut is relevant and necessary, such as when the entity has doubt over the sales proceeds upon force sale of the shares.

Q12. Should forward-looking information be incorporated in probability of default (PD), loss given default (LGD) and exposure at default (EAD)?

Paragraph 5.5.4 states that the objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition — whether assessed on an individual or

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collective basis — considering all reasonable and supportable information, including that which is forward-looking.

Paragraph 5.5.17 further requires an entity to measure expected credit losses of a financial instrument in a way that reflects:

(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
(b) the time value of money; and
(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

In achieving the principle of the paragraphs above, an entity is expected to consider forward-looking information, where relevant, in the three components in measuring the expected credit losses, including potential effect of double-counting when it is applied to each of the three components of the PD, LGD and EAD in measuring ECLs.

Q13. A bank's economists would only be able to project macro-economic variables for certain number of years. Subsequent to that, should the ECL modelling revert to long run average/mean reversion method?

Paragraph B5.5.49 states that "*For the purpose of this Standard, reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort, including information about past events, current conditions and forecasts of future economic conditions. Information that is available for financial reporting purposes is considered to be available without undue cost or effort.*"

It is further clarified in paragraph B5.5.50 that "*An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of judgement that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases and the degree of judgement required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.*"

Based on the guidance provided in the paragraphs above, MFRS 9 allows an entity to maximise various sources of data, both internal and external to measure expected credit losses [refer paragraph B5.5.51]. To achieve this principle, an entity shall assess whether any of the following approaches can be used to project macro-economic variables after a certain number of years:

1. Use peer group experience or long-term projection for the comparable financial instrument (or group of financial instruments)[refer paragraph B5.5.51];
2. Use past and current forecast to project a long-term average [refer paragraph B5.5.52]; or
3. Use unadjusted historical pattern assuming that the pattern will continue, depending on the nature of the historical information and when it was calculated [refer paragraph B5.5.52].

Approach 3 should be used only under limited circumstance when the entity does not or could not form a view about the future state of economy and its effects on ECLs. In most cases, an

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entity would be able to and would have view(s) about the future state of economy based on related and observable information.

Q14. Macro-economic variables such as House Price Index (HPI) or Property Price Index (PPI) are the relevant forward-looking information of LGD for secured loans and financing given by banks. As these macro-economic variables have been experiencing upward trends, should an entity incorporate such variables in LGD estimation, which may lead to significant write back of expected credit losses?

MFRS 9 is a principle-based standard and focuses on measurement of expected credit losses that reflects on:

i. unbiased and probability-weighted amount;
ii. time value of money; and
iii. reasonable and supportable information that is available without undue cost or effort at the reporting date about past event, current conditions and forecasts of future economic conditions. [refer paragraph 5.5.17]

MFRS 9 also emphasises the need for an entity to incorporate variables that are specific to borrower or obligor, general economic conditions and an assessment of both current as well as future economic conditions as at the reporting date, regardless of the eventual outcome to expected credit losses amount [refer paragraph B5.5.51]. The judgement that an entity made of whether to incorporate certain variables or not, should be properly discussed, deliberated, approved, documented, revisited and reaffirmed from time to time.

The effects of these macro-economic factors should be considered in determining the LGD. While the LGD could be affected when e.g. an upward trend of collateral value is expected, the ECLs measured are required to be at point-in-time as at the reporting date.

Q15. What is the period that an entity should use to measure the expected credit losses? Can an entity select the period based on business practice?

Paragraph 5.5.19 clearly states that the maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if that longer period is consistent with business practice. Paragraph 5.5.20 however, acknowledges that some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments, and only those financial instruments, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

Q16. For investment bank business (stockbroking base), the main business activities is stockbroking services and as such, client and broker balances form the significant balance sheet items for investment bank. Clients and brokers are given certain number of days (grace period) to make settlement.

Should an entity calculate ECL for client and broker balances that are within the grace period (e.g. <T+3)?

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MFRS 9 introduces an expected credit losses model where an entity shall recognise a loss allowance on a financial asset that is measured at amortised cost or fair value through other comprehensive income, a lease receivable, a contract asset or a loan or financing commitment and a financial guarantee contract. As such, clients' and brokers' balances are subjected to expected credit losses.

An investment bank provides various finance-related and other services to individuals, corporations and governments such as raising financial capital by underwriting the issuance of securities, assisting in mergers and acquisitions activities and stockbroking activities (e.g. trading equity securities or derivatives). As such, client and broker balances are considered as trade receivables of the investment bank's businesses for the services rendered.

Paragraph 5.5.15 requires an entity to measure the loss allowance at an amount equal to lifetime expected credit losses for trade receivables that result from transactions that are within the scope of MFRS 15 that do not contain a significant financing component (e.g. with short settlement period within 12 months), or if the entity makes an accounting policy choice to measure the loss allowance at an amount equals to lifetime ECL for trade receivables with significant financing component.

As there can be practical challenges for preparers to gather and analyse sufficient historical data and past trends for client and broker balances within the grace period, as a practical expedient, taking into consideration the short term nature of these balances, an entity may decide to only measure and provide for lifetime ECL after the grace period (e.g. 3 days) on uncollected balances.

HEDGE ACCOUNTING

Q17. Paragraph 7.2.21 provides entities with an accounting policy choice between applying the hedge accounting requirements of MFRS 9 (Chapter 6) or continuing to apply the existing hedge accounting requirements in MFRS 139 for all hedge accounting, pending the completion of the project on the accounting for macro hedging. Can an entity adopt Chapter 6 at its preference financial period or upon completion of the project on the accounting for macro hedging?

Existing MFRS preparers
There is no clear guidance in MFRS 9 that dictate when the Chapter 6 *Hedge Accounting* of MFRS 9 should be applied by entities. However, entities shall consider whether applying hedge accounting requirements in MFRS 9 will present more relevant and reliable information [refer paragraph 10 of MFRS 108].

Transitioning Entities
Paragraph 9 of MFRS 1 *First-time Adoption of Malaysian Financial Reporting Standards* states that the transitional provisions in other MFRSs do not apply to first-time adopter, except as specified in Appendix B - E of MFRS 1. Since Appendix B - E of MFRS 1 does not provide any exemption equivalent to paragraph 7.2.21 of MFRS 9, transitioning entities (i.e. first-time adopters) are therefore required to apply the hedge accounting requirements of MFRS 9 upon adoption of the MFRS reporting framework for financial period beginning on or after 1 January 2018, if it chooses to apply hedge accounting.

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