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March 20, 2018

EDS.306.2

Circular to All Chief Executives of Commercial Banks, Credit Institutions and Microfinance Deposit-Taking Institutions

IFRS 9: Financial Instruments

Please refer to the Bank of Uganda Circular *Ref. EDS.306* **dated** July 12, 2017 requiring Supervised Financial Institutions (SFIs) to submit reports indicating the level of preparedness for the implementation of International Financial Reporting Standard (IFRS) 9: **Financial Instruments** as well as the impact of this standard on each SFI's Capital Adequacy.

Bank of Uganda's review of the reports submitted revealed that the SFIs were at varying stages of preparedness with regard to implementation of this accounting standard. Accordingly, Bank of Uganda will continue to evaluate the SFIs' implementation programs as well as the impact of this standard on Capital Adequacy. To this end, SFIs are hereby directed as follows:

1. Reporting requirements

- In addition to the regular prudential quarterly returns, all SFIs shall submit to Bank of Uganda financial statements prepared in accordance with IFRS 9 for the quarters ending March, June and September 2018. The format of the quarterly IFRS Financial Statements will be similar to the Annual Financial Statements only that SFIs do not have to include the Notes to the Accounts.
- However, the Financial Statements for the March 2018 quarter must include disclosures relating to IFRS 9 implementation, reviewed by the External Auditors. These disclosures shall include, but are not limited to the following;

i) *Governance Framework*

- Details of the governance framework instituted in the institution to oversee the implementation of IFRS 9, highlighting the role of the Board and Senior Management.
- A gap analysis report regarding the skills set, processes, technology, information and controls necessary to ensure effective implementation of the standard. Additionally, the institutions must submit their IFRS 9 implementation plan, with an update on the progress made in achieving the plan.

- Updates of all risk management, accounting and credit policies, processes, structures, information systems, manuals and responsibilities relating to IFRS 9 implementation.
- The likely impact of the standard's requirements on the institutions' strategy, particularly with regard to credit growth, investment in Government securities, investment in other financial instruments and other key areas.

ii) *Classification of financial assets*

- The institutions' basis for determining the business model in which assets/a group of assets are classified.
- The methodology to be employed in assessing whether contractual cash flows are solely payments of principal and interest.
- The basis for designating or revoking a designation to measure a financial instrument as measured at Fair Value through Profit or Loss (FVTPL).
- A schedule showing changes in classification of financial instruments arising from adoption of IFRS 9, as well as the impact of these changes on the financial statements as at March 31, 2018.

iii) *Impairment*

- All factors that will be considered in assessing whether credit risk has increased significantly since recognition of the instrument and the SFI's plan to continuously update these criteria in line with changes in the operating environment.
- The entity's basis for defining default;
- How the SFI will compute Expected Credit Losses (ECL) and specifically how it will arrive at the following key inputs of the ECL model;
    a) Credit Risk Grades
    b) Probability of Default (PD)
    c) Loss Given Default (LGD)
    d) Exposure at Default (EAD)
    e) Effective Interest Rate
- The basis for grouping financial instruments where modeling of the aforementioned inputs is carried out on a collective basis.
- The SFI's approach to incorporating internal data, external data, macro-economic indicators and forward-looking information into the assessment of credit risk.
- SFIs should indicate how the impact of forward looking factors such as changes in economic and industry fundamentals are factored into their ECL models.
- Application of the standard in case of modification of financial assets.
- A comparison of IFRS 9 impairment costs vis-à-vis FIA, 2004 provisions.

2. Disclosures relating to IFRS 9 to be included in the Financial Statements as at December 31, 2017

In addition to the disclosure requirements relating to IFRS 9 required under IFRS 7, all SFIs shall include in the financial statements for the year ended December 31, 2017, disclosures relating to the following:

- The expected impact of IFRS 9 transition arrangements i.e. the impact of reclassification of financial instruments as well as implementation costs on the financial performance of the institution expressed as an absolute amount or as a percentage.
- The expected impact of IFRS 9 impairment costs on the financial performance of the institution expressed as an absolute amount or as a percentage.
- Whether the institution will adopt the restatement or no restatement option, and the rationale for the preferred option.
- Impact of IFRS 9 on SFIs' Core Capital as at January 01, 2018 (Day-1 impact).
- Assessment of whether the SFI's Core Capital arrived at after taking into account both the transition and impairment effects of IFRS 9 (even when compliant with the regulatory minimums) is sufficient to foster the SFI's growth prospects as articulated in the Strategic Plan.
- A comparison of IFRS 9 vis-à-vis IAS 39 loan loss provisions as well as a comparison of IFRS 9 vis-à-vis and FIA 2004 loan loss provisions.
- SFIs should indicate the challenges faced in the implementation of IFRS 9.

SFIs shall continue to apply the prudential requirements enshrined in the Financial Institutions (Credit Classification and Provisioning) Regulations, 2005 and the Micro Finance Deposit-Taking Institutions (Asset Quality) Regulations, 2004 in the assessment of Specific and General Provisions for their credit exposures. In this respect, the Prudential Returns submitted to Bank of Uganda shall be prepared in line with the FIA, 2004 and the MDIA, 2003.

Given that the audited Annual Accounts must be prepared in accordance with International Financial Reporting Standards, SFIs shall continue to apply the current treatment of the differences in loan loss provisions arrived at using FIA, 2004 or MDIA, 2003 and IFRS 9. Where the provisions (Specific Provisions + General Provisions) based on the FIA, 2004 or MDIA, 2003 exceed the IFRS 9 impairment charges, the difference will continue to be appropriated from retained earnings to the Credit Risk Reserve. The Credit Risk Reserve is still not eligible for inclusion in the capital computation.

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