The Transition from IAS 39 to IFRS 9 and Its Impact on Financial Performance: Case of a Moroccan Public Financial Institution

Abdallah Bellagdid¹, Abdelhak Sahibeddine¹, Imane Britel² and Christophe Godowski²

¹National School of Business and Management, University of Chouaib Doukkali, Morocco
²The Institute of Business Administration, University of Limoges, France

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Abstract: The following framework provides a thorough insight into the international accounting standards with a particular focus on the one pertaining to the financial instruments IFRS 9 applied and monitored, for instance, by a financial public institution. It also sheds a light on the procedure that needs to be followed by other entities upon the implementation of a new international accounting standard. The investigation conducted, the methodology used as well as interviews established with the staff of consolidation and calculations practiced has allowed for the elaboration a comparative study between real situation and simulated situation (IFRS 9). Synthetic as well as visual, the study has led us to formulate a detailed and all-encompassing vision on the impact of this transition on the financial performance of the financial group, without omitting the risk aspect relative to this concept represented by prudential supervision. The value of the present research lies to identify the various representations of this new international accounting standard, to propose recommendations for a perfect control and realization of its strategic as well as operational objectives.

1 INTRODUCTION

The international accounting standards, known as IAS (International Accounting Standards) or IFRS (International Financial Reporting Standards) were born of a meticulous desire to create a single European accounting standard. This new accounting model aims to redefine certain concepts, notably financial transparency, comparability of financial statements and improved quality of information.

In its capacity as a public body, the organization adopted international accounting standards in its financial approach in 2008 and applied them to the consolidated financial statements. The Accounting and Consolidation Department of the financial group monitors compliance with these standards.

However, as part of the project to modernize international accounting standards in order to adapt to the international economic and financial context, the management responsible continually updates the annual financial statements in line with the notices issued by the IASB. The year 2018 was marked by the advent of IFRS 9 on financial instruments.

The transition from IAS 39 to this new standard is a challenge not only for this financial group, but also for all financial institutions. This transition is described as a far-reaching trajectory because of its representations and repercussions on the accounting logic (the new provisioning principle), as well as on the consolidated financial statements for fiscal year 2018.

It is important to note that the application of these standards and the monitoring of related reforms is not limited to compliance with regulatory requirements. It also focuses on a molar approach that seeks to improve macroeconomic indicators while strengthening the country’s international competitive position.

The present work sets out a certain number of objectives, starting with a review of the transition to the new standard, the quantification of its impact on the financial performance of the financial group, and finally proposing avenues for improvement and making appropriate recommendations.

Our research therefore consists of linking two poles: that of the application of international accounting standards in the consolidated financial statements and that of financial performance.

We assume that any reform within this framework directly influences the performance and
Does the adoption of the international accounting standard IFRS 9 impact the financial performance of a public entity - case of a public financial institution? -

This questioning can be broken down into three sub-questions:

- First, the premeditation of the reforms of international accounting standards: What contribution does the mastery of norms make to the financial performance of the financial group?
- Secondly, to what extent can the financial group's mastery of international accounting standards support its accounting activity?
- Finally, to what extent can the international accounting standard IFRS 9 influence the prudential ratio of a public financial institution?

Based on the above considerations, the methodology that seems to us the most suitable is a hybrid approach. It involves applying a qualitative approach, through the elaboration of an individual interview guide. We will try to complete it with quantitative data through the application of the methods and tools of the quantitative approach.

Our plan for this research is twofold: The first part consists in forging the theoretical construct of our work. The second part constitutes the empirical pole. We then present the impact of the transition from IAS 39 to IFRS 9 on the Group's financial performance, the state of completion of our work and the areas for improvement in order to better control future reforms.

2 LITERATUREREVIEW

The analysis of the impact of the transition from IAS 39 to IFRS 9 on financial performance requires first of all an assessment of the environment in which this accounting reform will be adopted, while highlighting the main contributions of the new IFRS 9 to the accounting sphere, and then an exploration of previous work that has dealt with this issue.

2.1 From IAS 39 to IFRS 9

The entry into force of IAS 39 in 2001 was highly unproven since it used the fair value method, which was a real obstacle for financial institutions in terms of asset recognition. This state of affairs has led users of international accounting standards and experts in the field to reconsider their positions on IAS 39 because:

- Insolvency in terms of management of financial instruments;
- The lack of transparency preserved by this standard;
- The use of Fair Value as a valuation option;
- Non-anticipation of market events in terms of asset impairment.

This non-exhaustive list of criticisms was the trigger point for the draft IFRS 9 standard. In July 2014, the IASB (International Accounting Standards Board) published the final version of the IFRS9 standard entitled "Financial Instruments" to replace IAS39 "Financial Instruments: Recognition and Measurement".

The new standard, which came into force on January 1, 2018, is complex to apply and has brought several new accounting and financial innovations, including a new classification and measurement of financial instruments, the introduction of the provisioning principle of expected credit losses (ECL) and the reform of hedge accounting.

2.2 Impact of IFRS 9 on Financial Performance: State of Play

The application of IFRS 9 has aroused the interest of scientific researchers because it has brought about enormous changes, especially for financial institutions. However, it should be noted that the number of scientific research studies dealing with this accounting reform remains too small, in contrast to the many agencies and auditing firms that have conducted studies to measure the real impact of the application of the said standard.

In order to complete this transitional phase, Bank Al Maghreb had granted a 2-month grace period to institutions for the quarterly financial publication of consolidated accounts. This affirms the great vigilance that must be adopted by institutions for a non defaulting application of the standard.

In addition, we conducted an international Benchmarking exercise involving a group of consolidating entities that have anticipated the application of IFRS 9 in 2017. The objective was to estimate the impact of the application of IFRS 9 on shareholders’ equity and consequently on the statement of financial position. We have selected a sample of international financial institutions with a sizeable portfolio. It is important to note that no Moroccan group has anticipated the implementation
of the new IFRS 9 standard or quantified its impact on the financial statements.

Table 1: International benchmarking.

<table>
<thead>
<tr>
<th>Group</th>
<th>Impact on the balance sheet structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>PNB Paribas</td>
<td>A €2.5 billion net tax decrease in Shareholders' Equity; accompanied by a €3.3 billion change in the overall amount of impairment.</td>
</tr>
<tr>
<td>Société Générale</td>
<td>The decrease in the value of consolidated shareholders' equity of 1 milliard €.</td>
</tr>
<tr>
<td>ENGIE</td>
<td>The Group values the loss on consolidated consolidated equity at €235 million; compared to a loss of €224 million recorded in K. own share.</td>
</tr>
<tr>
<td>BPCE</td>
<td>Changes in the JV (net of tax) charged to equity for an amount of €(198) million. Gains and losses due to the reclassification of certain assets are transferred to reserves for an amount of €3 million.</td>
</tr>
</tbody>
</table>

In the same context, the U.S. rating agency Fitch Ratings published on Monday, August 6, 2018 the results of its study analyzing the first-time adoption of IFRS 9 on the capital of Moroccan banks. The published financial statements of banks, in the first quarter of 2018, confirmed the increase in bond provisions, accompanied by the reduction of equity capital to 13.8% for BCP, 10.5% for BMCE Bank and 9.1% for Attijariwafa Bank - all national banks of systemic importance - and 3.2% for Credit du Maroc.

3 METHODOLOGY OF THE STUDY

This section begins with a presentation of the epistemological and methodological position advocated for measuring the impact of the adoption of IFRS 9 on the financial performance of a government organization. It then goes on to explain the nature and survey tools used to reconcile the said standard.

3.1 Sample

The study was carried out within a public financial institution with a scope of 145 subsidiaries in all business lines and industries. The Group's diversified structure makes the analysis of the impact of the transition and changeover to IFRS 9 within this institution very interesting and will provide relevant answers to the questions raised.

3.2 Nature of the Investigation

In order to provide an answer to our research question, that of the impact of the application of IFRS 9 on the financial performance of this institution, it is crucial to establish a hypothesis that constitutes the starting point of our research. We therefore assume that the change in accounting regulations, in particular the transition from IAS39 to IFRS9, has a direct impact on the performance and financial health of the organization.

This hypothesis must be analyzed and tested to measure its degree of conformity and validity. In this respect, our research is part of the positivist current (Verifiability, Confirmability and Rebuttability), in
order to identify the causes and consequences of the events produced. Through this epistemological paradigm, we seek to study the refutability or acceptance of our hypothesis, which is the basis of our research.

In terms of methodological considerations, we have opted for a hybrid approach. On the one hand, the quantitative component in order to trace and explain the staging of links and causes and effects with respect to our research theme, to evaluate the implementation of this new standard and to measure its impact. On the other hand, there is a qualitative component through the development of an interview guide, since both approaches are based on a logic of concordance as well as opposition.

In addition, our research is part of a hypothetico-deductive approach that leads us to avenues of reflection and analysis applicable to the different aspects studied. This approach also allows us to construct the theoretical prerequisites concerning international accounting standards that will serve as a basis for the verification of hypotheses.

3.3 Conduct of the Investigation

We have chosen a conceptual model, a logic of reflection, to respond to the problem we have set. It is a question of starting with the interview guide in order to obtain a preconfirmation of the hypothesis, an instrument of access to reality.

Next, a reclassification model for all financial instruments will be implemented and applied to the Group's financial statements. We can therefore observe and quantify the various changes in the financial statements, consolidated balance sheet and statement of comprehensive income.

At this stage, the establishment of a comparative study between real and simulated situations becomes possible, which will allow us to assess the impact on financial performance (the recommended KPIs) and the prudential base (3 fundamental pillars of equity capital).

4 RESULTS OF THE EMPIRICAL STUDY OF THE FINANCIAL GROUP

This section begins by describing the approaches followed and the lines of analysis undertaken, and then presents the results of the various studies envisaged.

4.1 Maintenance of the Accounting and Consolidation Department

Following the interview guide developed and implemented with the staff of the institution's consolidation service, we collected a set of responses that we analyzed carefully in order to formulate a typical response (Appendix). The main lines of investigation selected for this survey are as follows:

Axis1: Understanding and assessing the transition from IAS 39 to IFRS 9;
Axis2: Identification of the requirements in terms of application of the new standard and assessment of the impact of the change on the financial governance of the financial group;
Axis3: Formulation of observations on the shortcomings raised in this standard, while suggesting avenues for improvement as well as prospects for the development of this work.

After analyzing the responses to the interview guide, we were first able to assess the criticality of the transition to IFRS 9 and the various changes and restatements applied. In addition to that, the existence of an effective impact on the Group's financial performance has been confirmed, even if the Group remains slightly influenced by the structural soundness and composition of its securities portfolio.

4.2 Financial Instrument Reclassification Model

The first phase of the IFRS 9 project on the classification of financial instruments is the main component of the project, since it is by determining the category to which a financial instrument can be assigned that its measurement and recognition method can be determined.

This phase represents the basis and starting point of the transition process put in place. It is the work of art of a study about the specificities and rules prescribed by IFRS 9. At this stage, the institution must be vigilant in order to assure protection from potential risks that may arise.

The recognition of provisions categories of financial instruments under IFRS 9 like Bonds included in the portfolio of available-for-sale assets (AFS) and listed held-to-maturity assets (HTM) which was not permitted to recognize as provision
under IAS 39. In addition, a new test was added in order to recognize some instrument category, it is the SPPI test.

### 4.3 Impact on Financial Performance

Before presenting the impact on the financial performance of the financial group, we believe it is useful to present a summary comparative study of the actual and simulated situation of the group's main financial statements in 2017 (consolidated balance sheet and statement of comprehensive income).

- **Comparative study between the impact of IFRS 9 on the actual and simulated asset situation**

Because of the application of IFRS 9, we have prepared a simulated consolidated balance sheet in accordance with the rules prescribed in this standard, and in application of the reconciliation table that we have previously stated. The simulated assets and liabilities of the establishment are as follows:

Table 2: Simulated and actual 2017 situation.

<table>
<thead>
<tr>
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<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2 347 16</td>
<td>234 162</td>
<td></td>
</tr>
<tr>
<td></td>
<td>615</td>
<td>975</td>
<td>in %</td>
</tr>
<tr>
<td></td>
<td>0,2359%</td>
<td>553 640%</td>
<td></td>
</tr>
</tbody>
</table>

The impact of the new standard has been greatly weakened by the provisions and processes put in place by the Group's consolidation management, without omitting the Group's status as a public institution with a solid and varied portfolio.

This change in the financial position is explained by the new allocation of financial instruments due to the application of the new expected loss principle included in the provisions of IFRS 9. It should be noted that the provisioning rate applied is 9.5%. For simplification purposes, this rate is applicable for the upward revision of the total amount of provisions actually recognized and for the recognition of provisions on financial instruments not provided for in the actual fiscal year. We note the new values in this table:

Table 3: Recognition of the provision according to the ECL principle.

<table>
<thead>
<tr>
<th>Category of Financial Inst.</th>
<th>Actual provision 2017</th>
<th>Actual value of the End Time en MDH</th>
<th>Simulated provision 2017</th>
<th>Simulated value of the End Time en MDH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets at the JVR*</td>
<td>No provision on this category</td>
<td>8,822,275</td>
<td>A provision should be recognized on adjusted variable income securities in the AFS category.</td>
<td>45,329,676</td>
</tr>
<tr>
<td>Available-for-sale financial assets**</td>
<td>No provision has been made.</td>
<td>49,833,921</td>
<td>A provision must be recognized on bonds included in the fixed-income securities portfolio.</td>
<td>13,326,520</td>
</tr>
<tr>
<td>Loans and receivables from credit institutions and similar institutions</td>
<td>6,194,000 DH</td>
<td>15,094,815</td>
<td>The new Mt according to IFRS 9 is: (6 194 000 * 1,095) = 6,782,430 DH</td>
<td>15,094,226</td>
</tr>
<tr>
<td>Loans and receivables from customers</td>
<td>1,557,252 MDH</td>
<td>42,410,959</td>
<td>The new provision will therefore be: (1 557 252 * 1,095) = 1,705,191 MDH</td>
<td>42,263,019</td>
</tr>
<tr>
<td>HTM at amortized cost***</td>
<td>No provision has been made.</td>
<td>35,114,321</td>
<td>A provision must be recorded on the HTM side. The provision is: 4 264 321 * 9,5% = 405,111 DH</td>
<td>34,709,211</td>
</tr>
<tr>
<td>Total</td>
<td>151,276,291 MDH</td>
<td>150,722,653 MDH</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Increase in the value of Financial Assets at FVR following the reclassification of variable income securities from the Available-for-sale category.
** Decrease in the value of variable income securities
*** Previously referred to as Held-to-maturity assets. This category includes Treasury bills and listed HTMs
We have recognized an impairment loss on financial instruments due to the application of the new ECL provisioning principle. The new amount of provision (151,276,291 - 150,722,651) = 553,640 MDH, corresponds to the amount of the variation of the patrimonial situation. This provision will be charged to the group's consolidated reserves and will therefore directly affect the integrated shareholders' equity.

- Comparative study of the impact of IFRS 9 on the income statement

This involves applying the average new cost of risk of certain financial institutions, which in our case is 9.5%

Table 4: Simulated statement of comprehensive income.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net banking income</td>
<td>6,805,078</td>
<td>6,805,078</td>
</tr>
<tr>
<td>Gross Operating Income</td>
<td>790,044</td>
<td>790,044</td>
</tr>
<tr>
<td>- Cost of Risk</td>
<td>-95,562</td>
<td>-104,640</td>
</tr>
<tr>
<td>Pre-tax income (loss)</td>
<td>691,925</td>
<td>682,847</td>
</tr>
<tr>
<td>- Income tax expense</td>
<td>-754,683</td>
<td>-747,995</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>-62,758</td>
<td>-65,149</td>
</tr>
<tr>
<td>Non-controlling interests</td>
<td>-149,284</td>
<td>-149,284</td>
</tr>
<tr>
<td>Net income (Group share)</td>
<td>86,526</td>
<td>84,135</td>
</tr>
</tbody>
</table>

(84,135 - 86,526) = -2,391

It appears from our simulation that the net result, group share, varied negatively by 2,841%. It should be noted that due to the regulations, the group did not make any movement on the income statement although the balance sheet structure and the consolidated income statement of the group are negatively impacted, except that this impact remains sustained and manageable due to the structure of the group and the solidity of its securities portfolio

- Study of the impact of IFRS 9 on financial performance

The evaluation of the institution's financial performance is automatically linked to the calculation of a number of KPIs that are considered relevant and that unfailingly meet our needs in terms of analysis.

Table 5: Economic Profitability Ratio.

<table>
<thead>
<tr>
<th>Ratios</th>
<th>ROE</th>
<th>ROE group</th>
<th>ROI</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>R</td>
<td>S</td>
<td>R</td>
</tr>
<tr>
<td>Result</td>
<td>0.28</td>
<td>0.29</td>
<td>0.55</td>
</tr>
<tr>
<td>Impact</td>
<td>-0.0074%</td>
<td>+0.0204%</td>
<td>+0.0570%</td>
</tr>
</tbody>
</table>

We note that the group is performing negatively in terms of integrated ROE. The latter is explained by the integrated net income which is (-62,758 MDH). This negative result has been eased by the implementation of the provisions of the new IFRS 9 standard; a ROE of -0.2930% recorded by a decrease of -0.0074% compared to the actual situation.

Contrary to the integrated ROE, the Group's ROE shows minimal positive results, due to the RNPG, which is the result of a compensation between the integrated net income and that relating to minority interests (+86,526 MDH). The impact of IFRS 9 being positive in this case +0.0204%, since the RNPG remains at the same level, while shareholders' equity excluding minority interests and unrealized gains or losses has decreased, following the volatility of consolidated reserves (-17.33%).

In terms of ROCE, the ratio remains invariable. However, the level of WCR will be impacted in the coming years, as 37% of the total amount of provisions will be allocated to the deferred tax item, which will reduce it significantly. It should be noted that the Group creates value, since the ROCE is higher than the WACC in the actual and simulated situation.

Finally, the ROI shows a rate of (6.6142%) for the actual situation, as it was positively influenced +0.0570% in the simulated scenario following the application of IFRS 9 (6.6712%). This still amounts to a reduction in shareholders' equity in the face of the stability of the net banking income achieved by the group.

Table 6: Simulated statement of comprehensive income.

<table>
<thead>
<tr>
<th>Calculated Method</th>
<th>Result Real</th>
<th>Simulated</th>
<th>Impact IFRS 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leverage effect Rf.Re</td>
<td>(Economic profitability - Tx. Interest(1 - Tx. IS)) / (Net indebtedness) / K.</td>
<td>12.98%</td>
<td>13.31%</td>
</tr>
</tbody>
</table>

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We note that all the calculated efficiencies provide a positive leverage effect. The use of debt within the group has led to an increase in the group's return on equity. Indeed, the implementation of IFRS 9 has a positive impact of +0.3355% on the leverage effect. The existence of this effect depends on the superiority of the economic profitability over the interest rate applied to the financial group.

This indicator links asset management, the achievement of a net margin and, lastly, debt control. We note through the calculation that the adoption of IFRS 9 leads to an increase in all the components of the model +0.0102%. The company is in good financial health and nothing will prevent it from achieving its objectives.

Study of the impact of IFRS 9 on the prudential base

Basel and international accounting standards are often exhibited in a study framework where several interactions are identified that can be synergistic or even antagonistic. Moreover, it appeared to us from our analysis of the Group's structure and our studies on the applicability of IFRS 9 that this could impact one of the pillars of any financial institution, namely the prudential base stipulated at the Basel III level.

Pillar 1: Increasing Regulatory Funds and Improving their Quality: We found that the group complies with the minimum capital requirements. However, a decrease in the equity ratios was observed. This means that IFRS 9 has an effective impact, but one that remains sustained and manageable.

Pillar 2: Strengthening Risk Management Mechanisms (LCR & NSFR): We can state from the figures observed and our analysis of the current context that, once again, the institution seems to be asserting its subtlety and the solidity of its structure, which in no way seems to be overwhelmed by the advent of this new standard.

Pillar 3: Culminating Leverage Effect: Leverage is defined as the ratio of total assets to shareholders' equity. Banks used this ratio as a relevant indicator.
We note from our calculations that the institution largely complies with the minimum set for equity leverage, which is 3%. The impact of IFRS 9 on this third pillar is not a cause for concern for the Group's accounting and finance department.

5 CONTRIBUTION AND PERSPECTIVES OF THE STUDY

The study we conducted on the impact of the transition from IAS 39 to IFRS 9 is the result of an interview with the Group's consolidators, combined with a brief analysis of the various extensions of this transition, materialized by the calculation of various KPIs, while referring to the history of the work carried out in the same research framework.

It should be noted that the survey was established in an estimation logic, by comparing the existing with the closest reality. Moreover, the focus of this research is not limited solely to the study and control of the impact of the implementation of IFRS 9 within the financial group, but is also interested in the preparation of a preventive process allowing a better integration of the new accounting standards.

In the first quarter of 2018, the financial group under review published its consolidated financial statements including the impact of the first-time adoption of IFRS 9. The latter showed the gross impact of the evaluation of expected credit losses amounted to 321 millions MAD. On the other hand, the simulated study we conducted showed a provision amount, according to the new principle, of 553 MDH. This difference has been absorbed on the one hand, by the fact that the simulated study had as the only variable the new IFRS 9. And on the other hand, due to the doubling of its GNP which reached 1.6 MMDH in 2018 against 734.9 MMDH in 2017 for the first quarter, in addition to its RNPG which amounted to 236 MMDH, up 109% over a year.

There seem to be many avenues for extending our research work, because of its novelty, its originality, but above all because of its representations and implications. A large-scale work that requires a continuous and perpetually updated effort so that not only this financial group, but also all institutions can accompany the mutations and changes imposed by the special accounting bodies.

6 GENERAL CONCLUSION

Several factors motivated us to choose this research topic. First, the intellectual curiosity and the desire to assimilate successfully part of the sphere of international accounting standards, namely IFRS 9. Then, our presentiment and conviction, that the appropriation by this financial group of the transition from IAS 39 to IFRS 9 would bring real added value.

The methodology of our research follows the process of developing and implementing an international accounting standard, from assimilation to the evaluation of differences and impact in order to decide on the transition and deliver the appropriate comments and interpretations.

Our field survey fits well with the hybrid approach, bringing together both qualitative and quantitative tools. It relies on the opinions expressed, as well as calculations to study the structural variability of the main financial statements and then assess the impact on the financial performance.

This work has enabled us to obtain a global and detailed view of what other establishments and consolidating entities could encounter following the adoption of this new standard, and its impact on the structure of their financial statements and consequently the addition on financial performance.

In conclusion, this research has provided us with an understanding of how the group is preparing for the new accounting requirements and what the impact might be on an establishment of this size. We should note that international accounting standards in general have now become a necessity for groups and institutions to ensure good financial governance in full compliance with regulatory requirements. We hope that, through this work, we have contributed to the debate on the impact of the implementation of IFRS 9, and that the actions carried out in the field have succeeded in providing answers to this problem.

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