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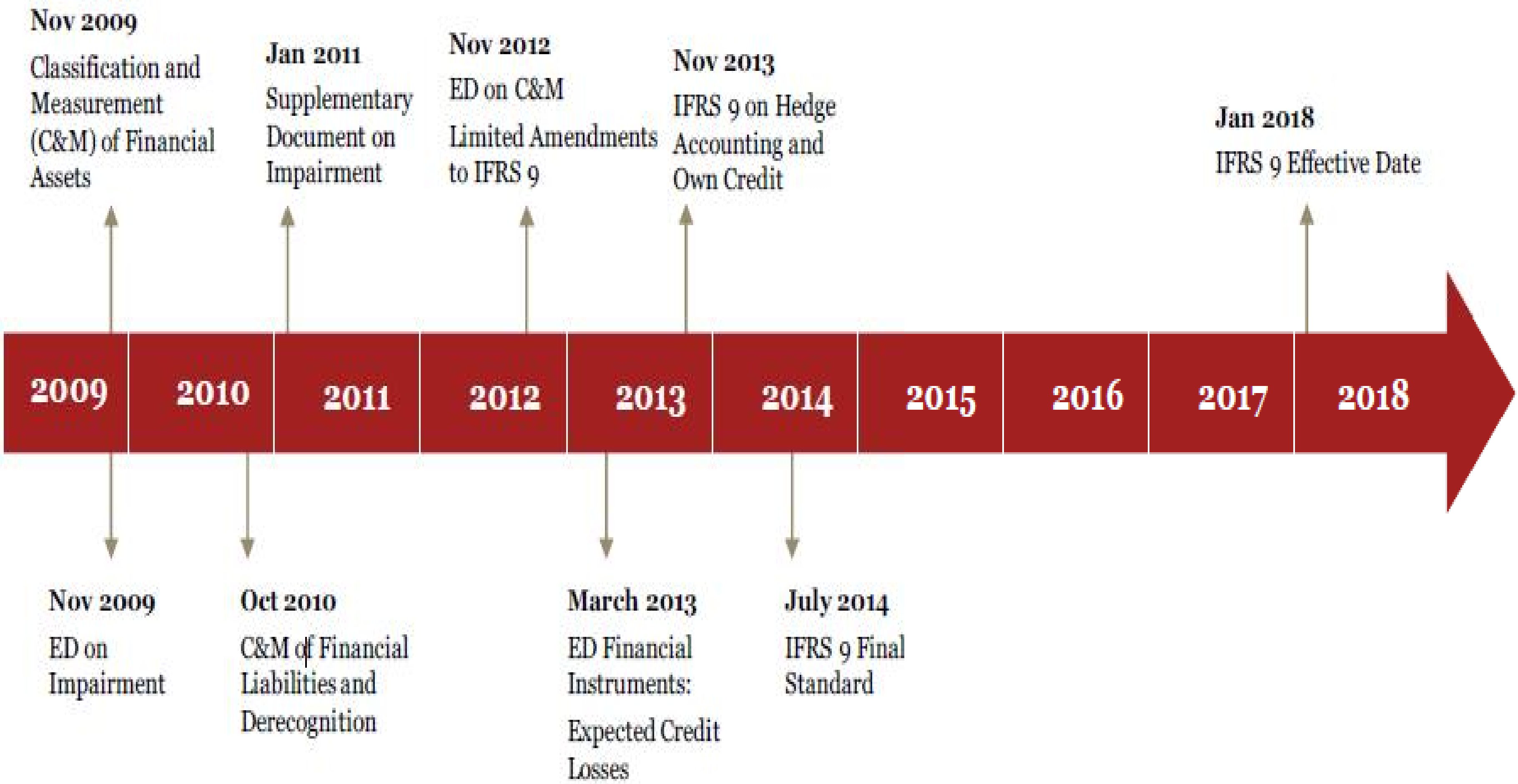
Presenter: David Mathuva
Strathmore Business School, Nairobi, Kenya

Credibility . Professionalism . AccountAbility

IFRS 9

Financial Instruments

Brief History of IFRS 9



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Objective of IFRS 9

- Establish principles for the financial reporting o:
  - *financial assets* and
  - *financial liabilities* that will present
- relevant and useful information to users of financial statements for their assessment of the:
  - amounts, timing and uncertainty of an entity's future cash flows.

Scope of IFRS 9

- **The Standard is applied by all entities to all types of financial instruments except:**
  - interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* or IAS 28 *Investments in Associates and Joint Ventures*.
  - rights and obligations under leases to which IAS 17 *Leases* applies.

Scope of IFRS 9

- Leases (exceptions)
  - derecognition and impairment of lease receivables recognised by a lessor
  - derecognition of finance lease payables recognised by a lessee
  - derivatives that are embedded in leases
- employers’ rights and obligations under employee benefit plans, to which IAS 19 *Employee Benefits* applies

Scope of IFRS 9

- financial instruments that meet the definition of an equity instrument in IAS 32 (including options and warrants)
- rights and obligations arising under (i) an insurance contract as defined in IFRS 4 *Insurance Contracts*
- any forward contract between an acquirer and a selling shareholder resulting into business combination – IFRS 3 *Business Combinations*
- loan commitments other than those loan commitments in IFRS 9
- financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies

Scope of IFRS 9

- rights to payments to reimburse the entity for expenditure that it is required to make to settle a liability that it recognises as a provision in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- rights and obligations within the scope of IFRS 15 *Revenue from Contracts with Customers* that are financial instruments

Loan Commitments Within the Scope of IFRS 9

- loan commitments that the entity designates as financial liabilities at fair value through profit or loss;
- loan commitments that can be settled net in cash or by delivering or issuing another financial instrument…
  - these are derivatives
- commitments to provide a loan at a below-market interest rate

Scope of IFRS 9

- Applied to:
  - those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or
  - by exchanging financial instruments, as if the contracts were financial instruments
- with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Scope of IFRS 9

- Ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments:
  - when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
  - when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments

Scope of IFRS 9

- when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin.
- when the non-financial item that is the subject of the contract is readily convertible to cash

- A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments (IFRS 9: 2.7)

Recognition and Derecognition

- Initial recognition:
  - recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument
  - classify and measure it accordingly
- Regular way purchase or sale of financial assets
  - recognised and derecognised, as applicable, using trade date accounting or settlement date accounting

Derecognition of Financial Assets

- An entity shall derecognise a financial asset when, and only when:
  - the contractual rights to the cash flows from the financial asset expire, or
  - it transfers the financial asset as set out
- Transfer of a financial asset
  - When contractual rights to receive the cash flows of the financial asset are transferred
  - retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions

Derecognition of Financial Assets

- When an entity transfers a financial asset, it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset.
  - If substantially all the risks and rewards of ownership are transferred, derecognise
  - If substantially all the risks and rewards of ownership are retained, do not derecognise

Derecognition of Financial Assets

- entity neither transfers nor retains substantially all the risks and rewards of ownership – determine whether it has retained control:
  - not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer;
  - retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset

Derecognition of Financial Assets

- On derecognition of a financial asset in its entirety, the difference between:
  - the carrying amount (measured at the date of derecognition) and
  - consideration received (including any new asset obtained less any new liability assumed) --- statement of profit or loss

Transferred Assets

- If a transferred asset continues to be recognised, the asset and the associated liability shall not be offset.
- Similarly, the entity shall not offset any income arising from the transferred asset with any expense incurred on the associated liability

The Case of Non-Cash Collateral

- Non-cash collateral (such as debt or equity instruments) to the transferee:
  - Key questions:
    - Does the transferee have the right to sell or repledge the collateral?
    - Has the transferor defaulted?
- If transferee has right by contract or custom to sell or repledge the collateral, then the transferor shall reclassify that asset in its statement of financial position (e.g. as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.

The Case of Non-Cash Collateral

- If the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.
- If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.

Derecognition of Financial Liabilities

- An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—i.e. when the obligation specified in the contract is discharged or cancelled or expires.
- The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.

Classification of Financial Assets

- An entity shall classify financial assets as subsequently measured:
  - at amortised cost,
  - fair value through OCI (FVOCI) or
  - fair value through profit or loss (FVPL)

    on the basis of both:
    - the entity's business model for managing the financial assets and
    - the contractual cash flow characteristics of the financial asset.

Classification of Financial Assets

- A financial asset shall be measured at amortised cost if both of the following conditions are met:
  - the financial asset 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 asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Classification of Financial Assets

- A financial asset shall be measured at fair value through OCI if both of the following conditions are met:
  - the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
  - the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Classification of Financial Assets

- Note:
  - principal is the fair value of the financial asset at initial recognition
  - interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin.

Classification of Financial Liabilities

- An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:
  - *financial liabilities at fair value through profit or loss*. Such liabilities, including *derivatives* that are liabilities, shall be subsequently measured at fair value.
  - financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.

Classification of Financial Liabilities

- *financial guarantee contracts*. After initial recognition, an issuer of such a contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:
  - the amount of the *loss allowance*
  - the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.
- commitments to provide a loan at a below-market interest rate.
- contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies

Embedded Derivatives

- A component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

Embedded Derivatives

- An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified
  - interest rate,
  - financial instrument price,
  - commodity price,
  - foreign exchange rate,
  - index of prices or rates,
  - credit rating or credit index, or other variable,
- provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Reclassification

- When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets.
- An entity shall not reclassify any financial liability.
  - an item that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such;
  - an item becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge; and
  - changes in measurement

Measurement

- Initial measurement:
  - Except for trade receivables, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Subsequent Measurement Of Financial Assets

- After initial recognition, an entity shall measure a financial asset using:
  - amortised cost;
  - fair value through OCI; or
  - fair value through profit or loss.

Amortised Cost Measurement

- Financial assets:
  - Effective interest method
    - **Interest revenue shall be calculated by applying the *effective interest method* to the *gross carrying amount of a financial asset* except for:**
      - *purchased or originated credit-impaired financial assets*. = use *purchased or originated credit-impaired financial assets*.
      - financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become *credit-impaired financial assets*. = use effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.

Write-off

- An entity shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event

Impairment: Credit Losses

- Recognition of Expected Credit Losses:
  - An entity shall recognise a loss allowance for *expected credit losses* on a financial asset, a lease receivable, a *contract asset* or a loan commitment and a financial guarantee contract to which the impairment requirements.
  - At each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the *lifetime expected credit losses* if the credit risk on that financial instrument has increased significantly since initial recognition.

Impairment: Credit Losses

- 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.

Impairment: Credit Losses

- If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to *12-month expected credit losses*.
- For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.

Impairment: Credit Losses

- An entity shall recognise in profit or loss, as an *impairment gain or loss*, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised

Determining Significant Increases in Credit Risk

- At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition.
- Consider:
  - change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses.
  - without undue cost or effort,

Measurement of Expected Credit Losses

- **An entity shall measure expected credit losses of a financial instrument in a way that reflects:**
  - an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
  - the time value of money; and
  - 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.

- You need not identify every possible scenario:
  - consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.
  - 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.

Reclassification of Financial Assets

- If FAs are reclassified, apply reclassification prospectively from the *reclassification date*.
  - The entity shall not restate any previously recognised gains, losses (including impairment gains or losses) or interest.
- If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through profit or loss measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in profit or loss

Reclassification of Financial Assets

- If an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the amortised cost measurement category, its fair value at the reclassification date becomes its new gross carrying amount.

Reclassification of Financial Assets

- If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through OCI measurement category, its fair value is measured at the reclassification date.
  - Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in OCI.
  - The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification.

Reclassification of Financial Assets

- If an entity reclassifies a financial asset out of the fair value through OCI measurement category and into the amortised cost measurement category, the financial asset is reclassified at its fair value at the reclassification date.
  - However, the cumulative gain or loss previously recognised in OCI is removed from equity and adjusted against the fair value of the financial asset at the reclassification date.

Reclassification of Financial Assets

- If an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the fair value through OCI measurement category, the financial asset continues to be measured at fair value.
- If an entity reclassifies a financial asset out of the fair value through OCI measurement category and into the fair value through profit or loss measurement category, the financial asset continues to be measured at fair value.

Gains and Losses

- A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in profit or loss unless:
  - it is part of a hedging relationship
  - it is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in OCI
  - it is a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's *credit risk* in OCI
  - it is a financial asset measured at fair value through OCI and the entity is required to recognise some changes in fair value in OCI

Gains and Losses

- *Dividends* are recognised in profit or loss only when:
  - the entity's right to receive payment of the dividend is established;
  - it is probable that the economic benefits associated with the dividend will flow to the entity; and
  - the amount of the dividend can be measured reliably.

Gains and Losses

- A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship shall be recognised in profit or loss when the financial asset is derecognised, and reclassified acordingly
- A gain or loss on a financial liability that is measured at amortised cost and is not part of a hedging relationship shall be recognised in profit or loss when the financial liability is derecognised and through the amortisation process.

Investments in Equity Instruments

- At initial recognition, an entity may make an irrevocable election to present in OCI subsequent changes in the fair value of an investment in an equity instrument within the scope of IFRS 9 that is neither *held for trading* nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies.
  - recognise in profit or loss dividends from that investment

Liabilities Designated As FVPL

- Present the following:
  - The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk
  - The remaining amount of change in the fair value of the liability shall be presented in profit or loss

Assets Measured at FVOCI

- A gain or loss on a financial asset measured at fair value through OCI shall be recognised in OCI, except for impairment gains or losses and foreign exchange gains and losses until the financial asset is derecognised or reclassified.
- Upon derecognition:
  - Cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss as a reclassification adjustment

Hedge Accounting

- Objective and scope of hedge accounting:
  - represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (or OCI, in the case of investments in equity instruments for which an entity has elected to present changes in fair value in OCI

Hedging Instruments

- Qualifying instruments:
  - A derivative measured at fair value through profit or loss except for some written options
  - A non-derivative financial asset or a non-derivative financial liability measured at fair value through profit or loss
    - unless it is a financial liability designated as at fair value through profit or loss for which the amount of its change in fair value that is attributable to changes in the credit risk of that liability is presented in other comprehensive income

Hedging Instruments

- For hedge accounting purposes, only contracts with a party external to the reporting entity (i.e. external to the group or individual entity that is being reported on) can be designated as hedging instruments.

Designation of Hedging Instruments

- A qualifying instrument must be designated in its entirety as a hedging instrument.
  - Note: A derivative instrument that combines a written option and a purchased option (for example, an interest rate collar) does not qualify as a hedging instrument if it is, in effect, a net written option at the date of designation

Fair Value Hedges

- As long as it qualifies recognise:
  - the gain or loss on the hedging instrument shall be recognised in profit or loss (or other comprehensive income, if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income
  - the hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in profit or loss.

Cash Flow Hedges

- As long as it qualifies, recognise:
  - the separate component of equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):
    - cumulative gain or loss on the hedging instrument from inception of the hedge; and
    - cumulative change in fair value (present value) of the hedged item (ie the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge.

Cash Flow Hedges

- the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (ie the portion that is offset by the change in the cash flow hedge reserve calculated in accordance with (a)) shall be recognised in other comprehensive income.
- any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in the cash flow hedge reserve calculated in accordance with (a)) is hedge ineffectiveness that shall be recognised in profit or loss.

Accounting for the Time Value of Options

- When an entity separates the intrinsic value and time value of an option contract and designates as the hedging instrument only the change in intrinsic value of the option, it shall account for the time value of the option as follows :
  - an entity shall distinguish the time value of options by the type of hedged item that the option hedges (see paragraph B6.5.29):
    - (i) a transaction related hedged item; or
    - (ii) a time-period related hedged item.

Accounting for the Time Value of Options

- the change in fair value of the time value of an option that hedges a transaction related hedged item shall be recognised in other comprehensive income to the extent that it relates to the hedged item and shall be accumulated in a separate component of equity.

Accounting For The Forward Element Of Forward Contracts And Foreign Currency Basis Instruments

- When an entity separates the forward element and the spot element of a forward contract and designates as the hedging instrument only the change in the value of the spot element of the forward contract, or when an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument, the entity may apply same treatment for options to the forward element of the forward contract or to the foreign currency basis spread in the same manner as it is applied to the time value of an option.

Illustrative Examples

Example 1

- On 1 January 20X1 an entity issues a 10-year bond with a par value of CU150,000 and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.
- The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:
  - LIBOR has decreased to 4.75 per cent.
  - the fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.
- The entity assumes a flat yield curve,

Approach

First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.	At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent. Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.

Approach

Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return	The contractual cash flows of the instrument at the end of the period are: • interest: CU12,000[3] per year for each of years 2–10. • principal: CU150,000 in year 10. The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is the end of period LIBOR rate of 4.75 per cent, plus the 3 per cent instrument-specific component. This gives a present value of CU152,367.[4]

Approach

The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph B5.7.18(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in other comprehensive income	The market price of the liability at the end of the period is CU153,811.[5] Thus, the entity presents CU1,444 in other comprehensive income, which is CU153,811 – CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.

Illustration 2

- 12-month expected credit loss measurement using an explicit 'probability of default' approach
  - Entity A originates a single 10 year amortising loan for CU1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PD) of 0.5 per cent over the next 12 months.
  - Entity A also determines that changes in the 12-month PD are a reasonable approximation of the changes in the lifetime PD for determining whether there has been a significant increase in credit risk since initial recognition.

Illustration 2

- At the reporting date (which is before payment on the loan is due), there has been no change in the 12-month PD and Entity A determines that there was no significant increase in credit risk since initial recognition. Entity A determines that 25 per cent of the gross carrying amount will be lost if the loan defaults (ie the LGD is 25 per cent).
- Entity A measures the loss allowance at an amount equal to 12-month expected credit losses using the 12-month PD of 0.5 per cent. Implicit in that calculation is the 99.5 per cent probability that there is no default.
- At the reporting date the loss allowance for the 12 month expected credit losses is CU1,250 (0.5% × 25% × CU1,000,000).

Illustration 3

- 12-month expected credit loss measurement based on a loss rate approach:
  - Bank A originates 2,000 bullet loans with a total gross carrying amount of CU500,000. Bank A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per client of CU200, for a total gross carrying amount of CU200,000. Group Y comprises 1,000 loans with a gross carrying amount per client of CU300, for a total gross carrying amount of CU300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees.

Illustration 3

- Bank A measures expected credit losses on the basis of a loss rate approach for Groups X and Y. In order to develop its loss rates, Bank A considers samples of its own historical default and loss experience for those types of loans.
- In addition, Bank A considers forward-looking information, and updates its historical information for current economic conditions as well as reasonable and supportable forecasts of future economic conditions.
- Historically, for a population of 1,000 loans in each group, Group X's loss rates are 0.3 per cent, based on four defaults, and historical loss rates for Group Y are 0.15 per cent, based on two defaults.

Illustration 3

	Number of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per annum average defaults	Estimated total gross carrying amount at default	Present value of observed loss[11]	Loss rate
Group	A	B	C = A × B	D	E = B × D	F	G = F ÷ C
X	1,000	CU200	CU200,000	4	CU800	CU600	0.3%
Y	1,000	CU300	CU300,000	2	CU600	CU450	0.15%

Illustration 3

- At the reporting date, Bank A expects an increase in defaults over the next 12 months compared to the historical rate.
- As a result, Bank A estimates five defaults in the next 12 months for loans in Group X and three for loans in Group Y.
- It estimates that the present value of the observed credit loss per client will remain consistent with the historical

Illustration 3

- On the basis of the expected life of the loans, Bank A determines that the expected increase in defaults does not represent a significant increase in credit risk since initial recognition for the portfolios.
- On the basis of its forecasts, Bank A measures the loss allowance at an amount equal to 12-month expected credit losses on the 1,000 loans in each group amounting to CU750 and CU675 respectively.
- This equates to a loss rate in the first year of 0.375 per cent for Group X and 0.225 per cent for Group Y.

Illustration 3

	Number of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Expected defaults	Estimated total gross carrying amount at default	Present value of observed loss	Loss rate
Group	A	B	C = A × B	D	E = B × D	F	G = F ÷ C
X	1,000	CU200	CU200,000	5	CU1,000	CU750	0.375%
Y	1,000	CU300	CU300,000	3	CU900	CU675	0.225%

Bank A uses the loss rates of 0.375 per cent and 0.225 per cent respectively to estimate 12-month expected credit losses on new loans in Group X and Group Y originated during the year and for which credit risk has not increased significantly since initial recognition

…for more information ☺

- Obtain a copy of IFRS 9 and read through the details!

End