



INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF KENYA

Asset Impairment Workshop
16th July to 17th July
Session Five: Financial Assets

Credibility

Professionalism

AccountAbility

Content



1. Recognition
2. Classification and Measurement
3. Impairment

IFRS 9 -Introduction



Businesses are normally financed using several tools i.e. can raise capital using new shares, issuing loans or buying goods and other assets on credit. The business can also lend if it has surplus funds or sell goods and other assets on credit. All these means of borrowing and lending are referred to as Financial Instruments.

IFRS 9 -Introduction



Due to complexity in their nature, accounting treatment is some how complex. As at now we have:

1. IAS 32 : Presentation
2. IAS 39 : Recognition and Measurement
3. IFRS 7: Disclosures
4. IFRS 9: To replace IAS 39 completely in 2018.

IFRS 9 - Scope



IFRS 9 does not apply to:

1. Subsidiaries, Assoc. & JV
2. Leases (though FA & FL)
3. Employee benefits
4. Insurance contracts (some gr)
5. Provisions, CL and CA
6. Share based payment

IFRS 9 - Recognition



Financial Instruments should be recognized in the statement of financial position when the entity becomes party to the contract (This includes Derivatives even though they are settled at a later date)

IFRS 9 - Classifications



Financial Assets are classified as:

Category	Examples
Amortized Cost	Where objective is to hold assets in order to collect contractual cash flows which arise from principal and interest on the principal outstanding. E.g. Investing in quoted bonds or giving customers loans.
Fair Value	Where the objective is to realize the fair value before its maturity rather than collect cash from contractual cash flows. This applies to some of the quoted bonds and all equities and derivatives must be classified here.

IFRS 9 - Classifications



IAS 39 had four categories

Category	Examples
Fair Value through P & L (FVPL) – Just Called Fair Value under IFRS 9	Investing in quoted shares/bonds with a short term perspectives. Derivatives also.
Held to Maturity (HTM) – Now called Amortized cost IFRS 9	Investing in a bond so with intention of receiving interest periodically and principal/par
Loans and Receivables (L/R) – Now called Amortized Cost	Giving customers loans and selling goods or providing services on credit
Available for sale (AFS) – Now just at Fair Value under IFRS 9	Investing in quoted shares, loans and also in private companies

IFRS 9 - Classifications



For Financial assets especially debt instruments we use:

1. Business model
2. Contractual cash flows model

IFRS 9 - Classifications



An entity can reclassify from one category to another except from or to FVPL.
Consider features. Derivatives always FVPL

IFRS 9 - Measurement



Category	Initial Measurement	Subsequent Measurement
Amortized Cost	For financial assets, At transaction price (TP) and transaction cost (TC). For Financial Liabilities measure at TP – TC.	Measured at Amortized cost with changes reported in the Income statements (Other than a change due to cash)
Fair Value	Those whose gains/losses will go to I/S only at TP (expense transaction costs) For FA Those whose gains/losses go to reserves (TP + TC)	Measure at Fair Value as guided by IFRS 13. Changes in Fair reported to reserves except for those held for trading.

IFRS 9 - Derecognition



De-recognize (remove) a financial asset when:

1. Contractual rights to the cash flows expire.
2. There is a substantial transfer of the risks and rewards of ownership.

IFRS 9 - Derecognition



De-recognize (remove) a financial liability when it is extinguished:

1. The obligation is discharged
2. Obligation is cancelled or it expires.

IFRS 9 - Derecognition



On de-recognition of a financial asset or liability, any gain or loss arising should be reported in the income statement. Any previous gain or loss in the reserve should also be reported in the income statement.

IAS 39 - Scope



IAS 39 will be replaced fully by IFRS 9 and the target year is 2018. IAS 39 covers aspects of impairment, Embedded derivatives and hedging.

IAS 39 - Impairment



For financial assets consider reducing them further and expense if they are impaired*. A financial asset is impaired if:

IAS 39 - Impairment



1. The borrower is in financial difficulty
2. Breach of contract
3. Borrower heading to bankruptcy
4. No active market

IAS 39 - Impairment



*For loans, we use a concept called “incurred loss” model.

I.e. only when an impairment indicator arises. For now IFRS 9 requires use of expected losses, by performing a three stage process (Some classification)

IAS 39 - Impairment



1. Performing debts: Not deteriorated in credit quality.
2. Under-performing: Deteriorated in credit quality
3. Non- Performing: Already impaired

IAS 39 - Impairment



For trade receivables and contract receivables of one year or less an entity should always recognize a loss allowance at an amount equal to lifetime expected credit losses

IAS 39 – Hedge Accounting



To determine deteriorating credit risk:

1. Use Historic Past Information
2. Rebuttable Presumption of past due by 30 days

IAS 39 – Hedge Accounting



To measure credit risk:

Use weighted average of present value of cash flows shortfalls.

For trade receivables of a short term period, discounting effects may be ignored.

IAS 39 – Hedge Accounting



Impairment disclosures:

Qualitative disclosures

- inputs, assumptions and techniques used to estimate expected credit losses (and changes in techniques)
- inputs, assumptions and techniques used to determine ‘significant increase in credit risk’ and the reporting entity’s definition of ‘default’
- inputs, assumptions and techniques used to determine ‘credit-impaired’ assets
- write-off policies, policies regarding the modification of contractual cash flows of financial assets
- a narrative description of collateral held as security and other credit enhancements.

IAS 39 – Hedge Accounting



Impairment disclosures:

- Quantitative disclosures

- reconciliation of loss allowance accounts showing key drivers for change
- explanation of gross carrying amounts showing key drivers for change
- gross carrying amount per credit risk grade or delinquency
- write-offs, recoveries and modifications
- quantitative information about the collateral held as security and other credit enhancements for credit-impaired assets.

IAS 39 and IFRS 9



Questions?