



**Institute of  
Certified Public Accountants  
of Kenya**

**TECHNICAL RELEASE ...../2008**

**ACCOUNTING FOR HORIZONTAL REPURCHASE AGREEMENTS**  
**(REPOSS)**

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**NAIROBI, KENYA**

## **ACCOUNTING FOR HORIZONTAL REPURCHASE AGREEMENTS (REPOSS)**

This technical release issued by the Institute of Certified Public Accountants of Kenya in September 2008 is intended to help members of the Institute account for Horizontal Repos.

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## **BACKGROUND**

### **Sale and repurchase agreements**

A repurchase agreement (Repos) is a combination of transactions whereby a security is sold and at the same time an agreement is made to buy back or 'repurchase' the same security at a later date at an agreed price usually very short-term e.g., overnight or one day), or on a date subject to the discretion of the seller and purchaser. In substance the buyer of the securities is extending a loan to the seller which is collateralized by the securities sold. The purchase and sale prices in Reposs may be identical, with the seller paying the buyer separately some specified rate of interest. Alternatively, the sale price may be different from the purchase price, thereby reflecting interest.

Repos are classified as secured short term money market instruments which offer a cheaper alternative to the unsecured inter-bank market. In the Repos market, the terminology buyer or seller refers to the security not the cash. The party that sells the security is said to perform a Repo, while the counterparty that purchases the security is said to perform a Reverse Repo.

Repos are mainly used by Central Banks to manage liquidity in the money markets. The Bank can supply funds to the market by buying securities from dealers (Repos) and conversely can drain

excess liquidity from the market by selling securities from its own portfolio (Reverse Repos). Privately negotiated Repos are also an effective and secure way to borrow or lend money.

In the Kenyan context, we have the vertical Repos that Central Bank uses for monetary policy operations and the proposed horizontal Repos to be used for inter-bank liquidity management. Questions have arisen on how to account for the horizontal Repos.

The Central Bank and the Institute aim at providing an interpretation that is consistent with the international accounting standards for both classic and sell/buy back Repos. Assuming same treatment in the books of sellers and buyers.

### **OBJECTIVE**

The objective of this technical release is to provide guidance on accounting for a repurchase agreement. This guidance presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement

The guidance also does addresses the frequently asked question on whether securities in a bank's "**Held To Maturity**" (HTM) holdings, can be used as Repos collateral, since a Repos is buy/sell transaction from a legal perspective, and a collateralized loan from an economic standpoint

### **ACCOUNTING FOR HORIZONTAL REPOS**

Accounting for Repos (repurchase agreements) under the accounting procedures for banks and certain financial institutions should conform to the ***International Accounting Standard 39 Financial Instruments: Recognition and Measurement***.

Sale and repurchase agreements are examples of off balance sheet finance and are covered under IAS 39 Application Guidance 51. Under IAS a Repo means providing or receiving financial assets in return for cash or other form of payment with a concurrent liability to receive or provide these financial assets as of a certain date for an amount equal to the original cash or other payment amount and interest.

#### **Types:**

1. Classic
2. Sell/Buy Backs

There is no significant economic difference between the two. However, the fundamental differences are more in the form in which the two are transacted than anything else.

CLASSIC REPOS		SELL/BUY BACKS	
<div>Seller (Repos)</div>	<div><div><div>←</div><div>Cash</div><div>→</div></div><div><div>→</div><div>Security</div><div>→</div></div><div><div>→</div><div></div><div>→</div></div><div><div><b>Cash+Interest</b></div></div><div><div>←</div><div></div><div>←</div></div><div><div></div><div>Security</div><div>←</div></div></div>	<div>Buyer (reverse Repos)</div>	
<div>1. Security is sold at current market value and repurchased at the same price with interest as a separate amount.</div>	<div>1. Security is sold at current market value but repurchased at an adjusted forward price inclusive of interest.</div>		
<div>2. Coupon payments received during the term of the Repos are paid over to the Repos seller.</div>	<div>2. Coupon payments received during the term of the Repos are kept by the Repos buyer.</div>		
<div>3. Normally regarded as one transaction.</div>	<div>3. Documented as two separate agreements.</div>		

### Cash and Securities flow for Classic Repos - (Bank to Bank)

Initial sale —————→  
Repurchase -----→

### Cash flow for a Classic Repos – Bank to Customer:

The cash and securities flow for the 'Bank to Customer' is same as that of a 'Bank to Bank'. However, the only difference is in the valuation of the security on the initial sale and the payment of interest on the repurchase of the security. This is because in most instances the customer is likely to be a tax paying entity and withholding tax on interest must therefore be recovered.

Bank to Bank	Bank to Customer
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1. Valuation of the security includes the clean market price + accrued interest.	1. Valuation of the security includes the clean market value + accrued interest LESS withholding tax.
2. Payment of interest on repurchase is done in full.	2. Payment of interest on repurchase is done LESS withholding tax.

**(a) Debtor's accounting treatment**

In the event of a classic Repos, where a security is sold and its repurchase is concurrently agreed, and the borrowing of a security secured through a cash transfer, an accounting entry is made on the loan received.

A security in the form of a financial asset, i.e., collateral provided as part of a Repo, is retained on the balance sheet and is recorded in separate subledger accounts pertaining to the relevant ledger accounts in which the respective item was recorded prior to its provision as part of the Repos, while applying the method for valuation used so far.

**(b) Creditor's accounting treatment**

In the event of a classic reverse Repos, where a security is purchased and its resale is concurrently agreed, and the lending of a security secured through a cash transfer, an accounting entry is made on the loan made.

Collateral received as part of a reverse Repos, is stated at fair value in an off - balance sheet as of the date of compiling regular, extraordinary or interim financial statements. Collateral subject to a short-term sale is not recorded on an off - balance sheet; such collateral is recorded within accounts payables from securities group.

A short sale agreed does not impact upon the results of operations (if charges associated with the settlement of the securities sold are left out of consideration).

Securities payable are measured at fair value, while any differences due to the valuation of these payables are recognized as a profit or loss.

A profit or loss from a short sale is reflected in the profit or loss during the course of a short sale and not after its termination, or is recognized as a profit or loss only upon the completion of a reverse Repos or the lending of a security, i.e., when the collateral is returned.

In the case of Repos, collateral may basically consist of any assets, even though the accounting procedures are only confined to financial assets. Since these procedures do not cover cases where collateral consists of tangible assets (inventory, movable items, etc.), an identical accounting procedure can be recommended in such instances.

## **RECOMMENDATIONS**

The international financial reporting standards recommend treating repos as collateralized loans, rather than as outright sales of securities. Securities remain in the balance sheet of the cash taker. A new financial assets is (loan/deposit) is recorded:

- Asset as cash provider
- Liability as cash taker

Securities sold under agreements to repurchase them at a specified future date (Repos) shall not be derecognized from the balance sheet. The corresponding cash received, including accrued interest shall be recognized on the balance sheet as cash collateral on securities lent and repurchase agreements, reflecting its economic substance as a loan to the bank. **IAS AG 519 (a)**

The difference between the sale and repurchase prices should be treated as interest expense and should be accrued over the life of the agreement using the effective interest rate method. Where the transferee has the right to sell or pledge the asset, the asset shall be recorded on the balance sheet as financial assets held for trading pledged as collateral.

Conversely, securities purchased under agreements to resell at a specified future date (reverse Repos) shall not be recognized on the balance sheet. The corresponding cash paid, including accrued interest shall be recognized on the balance sheet as cash collateral or securities borrowed and reverse repurchase agreements.

The difference between the purchase and resale is treated as interest income and is accrued over the life of the agreement using the effective interest rate method.

### **Cash collateral on securities borrowed / lent and reverses purchase / repurchase agreements**

	<b>Cash collateral on securities borrowed</b>	<b>Reverse repurchase agreement</b>	<b>Cash collateral on securities borrowed</b>	<b>Reverse repurchase agreements</b>
	2007	2006	2007	2006
<b>Assets</b>	Ksh 'm'	Ksh 'm'	Ksh 'm'	Ksh 'm'
Bank	xxx	xxx	xxx	xxx
Others	xxx	xxx	xxx	xxx
<b>Total</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>

As part of the revenue repurchase and securities borrowing agreements, the bank has received securities that it is allowed to sell or repledge. The fair value of the securities accepted under these terms as at 31<sup>st</sup> December 2007 amounts to Ksh. XXXM (2006 Ksh XXX M) of which kshs XM (2006 Kshs XM) has been sold or repledged to third parties in connection with financing activities or to comply with commitments under short sale transactions. **IFRS 7 paragraphs 15 (a), (b) and (c),**

	<b>Cash collateral on securities borrowed</b>	<b>Reverse repurchase agreement</b>	<b>Cash collateral on securities borrowed</b>	<b>Reverse repurchase agreements</b>
<b>Liabilities</b>	2007	2006	2007	2006
Bank	Ksh 'm'	Ksh 'm'	Ksh 'm'	Ksh 'm'
Other	xxx	xxx	xxx	xxx
<b>Total</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>

### **Securities lending and borrowing**

Securities lending and borrowing transactions are usually collateralized by securities or cash. The transfer of the securities to counterparties shall be reflected on the balance sheet only if the risk and rewards of ownership are also transferred.

Cash advanced or received as collateral shall be recorded as an asset or a liability. Securities borrowed should not be recognized on the balance sheet unless they are sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value with any gains or losses included in 'Net Trading Income'

For Repos and security lending, if the counterparts has the right to sell or repledge the securities transferred, the securities shall be presented separately on the balance sheet.

### **RESPONSIBILITIES**

#### **Assets pledged as security for liabilities**

Liabilities of the group amounting to KSHS52,244 million (2005: KSHS42,887 million) and of the Bank amounting to KSHS27,554 million (2005: KSHS22,664 million) are secured by the deposit of assets, including assets pledged in respect of sale and repurchase agreements, to cover short positions and to facilitate settlement processes with clearing houses.

The amount of assets pledged by the group to secure these liabilities is KSHS58, 807 million (2005: *KSHS50, 647 million*) and by the Bank is KSHS32, 803 million (2005: *KSHS29, 922 million*). These assets comprise treasury bills, debt securities and deposits.

In respect of reverse repo and stock borrowing transactions, the fair value of collateral held by the group which were permitted to be sold or repledged amounted to KSHS91,206 million (2005: *KSHS79,490 million*), and by the Bank of KSHS83,302 million (2005: *KSHS68,667 million*). The fair value of such collateral actually sold or repledged by the group amounted to KSHS40,549 million (2005: *KSHS40, 405 million*) and by the Bank of KSHS32,646 million (2005: *KSHS29,581 million*).