

IFRS 9 – Impairment for corporates

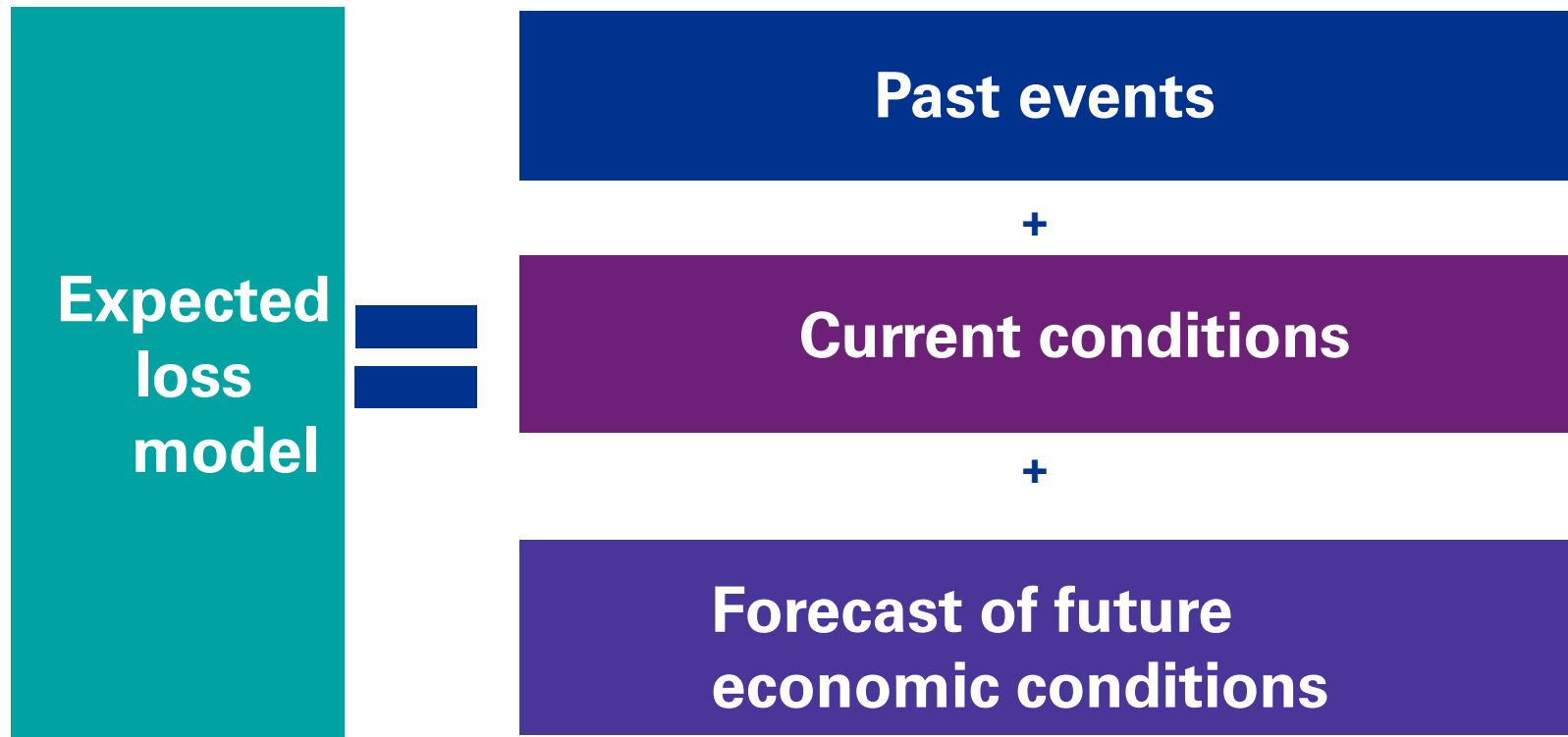
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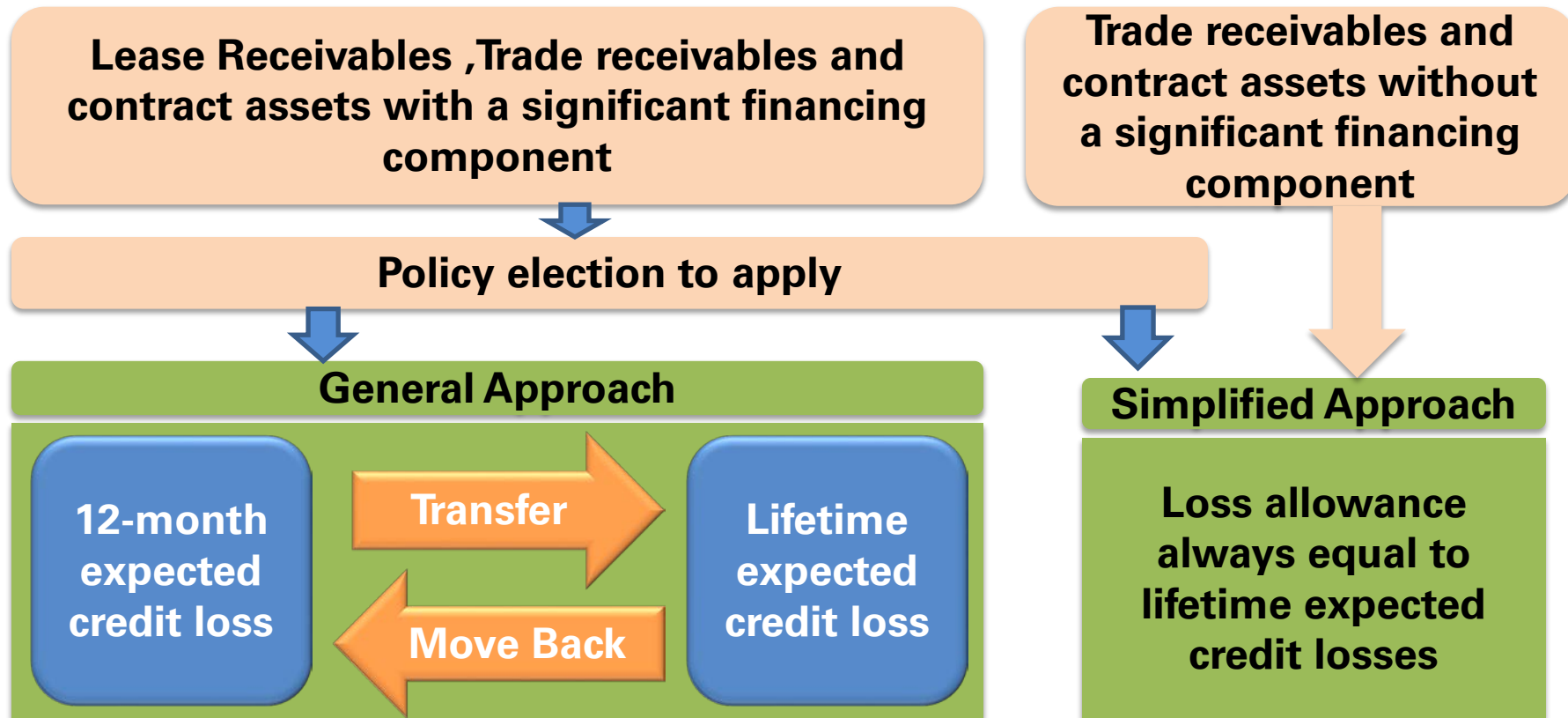
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Impairment (ECL) model



Impairment of lease receivables, trade receivables and contract assets



Constructing default rates



Historical loss-rate



Adjust future expectations



Management judgement overlay

COVID-19 impact on ECL



- ❑ COVID-19 has significantly impacted economic activities. The most significant impact of COVID-19 is the uncertainty around estimating ECL under IFRS 9.
- ❑ IFRS 9 does not set a bright line or a mechanistic approach to determining recognition of ECL.
- ❑ The determination of forward-looking scenarios when estimating ECLs is a matter of professional judgment.
- ❑ Entities should **NOT** continue to apply their existing ECL methodology mechanically

COVID-19 ECL considerations



- ❑ Whether the measurement appropriately captures customers particularly impacted by COVID-19;
- ❑ The impact of any assistance to borrowers from a government or regulator; and
- ❑ The impact of any actions planned by the company (e.g. modification, forbearance, limit increases) on the expected cash flows.

ECL -Simplified approach



- ❑ A loss allowance is based on lifetime ECL at each reporting date, staging based on significant increase in credit risk not required.
- ❑ ECL methodology must reflect a probability-weighted outcome and use reasonable and supportable information available without undue cost or effort at the reporting date.
- ❑ ECL is developed based on the best available information about past events, current conditions and forecasts of economic conditions.
- ❑ In assessing forecast conditions, consider effects of COVID-19 and significant government support measures undertaken.

COVID-19 ECL considerations



- ❑ Difficulty to incorporate specific effects of COVID-19 and government support measures on a reasonable and supportable basis.
- ❑ Changes in economic conditions should be reflected in macroeconomic scenarios and in weighting.
- ❑ If the effects of COVID-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered.
- ❑ The environment is subject to rapid change and updated facts and circumstances should continue to be monitored as new information becomes available.

COVID-19 Possible challenges



- ❑ Previous segmentation may no longer be relevant.
Segmentation based on stress faced by customers may be considered.
- ❑ Factoring the impact of time value of money due to extended credit terms.
- ❑ Uncertainties pertaining to rapid change in events and regulatory interventions may impact in-building macroeconomic conditions in models hence need for management overlays.
- ❑ Improve disclosures to explain the impact of COVID-19 on ECL computation, in particular, the assumptions used in ECL.

Steps in the simplified approach



- ❑ Step 1: –Segmentation of trade receivables. Entities may want to segment based on stress levels.
 - Minimal stress: segmenting customers who are not affected by the crisis, for instance, utilities, traders in essential goods, etc.
 - Short-term stress: segmenting customers who can bounce back into normal operations within three months.
 - Medium-term stress: segmenting customers who are expected to experience prolonged stress, i.e., beyond three months but are expected to return to normalcy within a year.
 - Long-term stress: segmenting customers who are expected to face a structural shift in their business outlook.

Steps in the simplified approach



- ❑ Step 2: Determine the period over which the data may be considered for determining the loss rates. Due to the uncertainty on account of COVID-19, the decision pertaining to the period over which data should be considered in future will require significant consideration.
- ❑ Step 3: Determine the ageing buckets and identify the default buckets.
- ❑ Step 4: Consider forward-looking macroeconomic factors and conclude on appropriate loss rates
- ❑ Step 5: Calculate expected credit losses

Provision matrix illustration

Example 1 – Simplified approach

Example of a provision matrix pre-COVID

Company T has a portfolio of trade receivables of KES 4,200,000 at the reporting date. None of the receivables includes a significant financing component. Company T only operates in one geographic region and has a large number of small clients. Company T uses a provision matrix to determine the lifetime expected credit losses for the portfolio. It is based on Company T's observed default rates, and is adjusted by a forward-looking estimate that includes the probability of worsening economic environment within the next year. The aging based on days past due is as follows in KES.

0-30 days	2,000,000
31-60 days	1,000,000
61-90 days	300,000
Over 90 days	900,000
Total	4,200,000



Example 1 – Provision Matrix



Step 1: Collect receivables aging and calculate the flow rate

In this step, the entity collects periodic receivables aging reports and calculates a flow /transfer rate. Flow rate represents the probability of a receivable moving into the next aging bucket in the subsequent period. This calculation is performed periodically in line with business practice.

Trade receivables aging (ETB)	M1	M2	M3	M4
0 – 30 days	20,000	19,750	23,500	21,250
31 – 60 days	10,340	9,800	8,750	10,100
61 – 90 days	5,120	4,300	3,900	4,150
91 + days	1,400	1,350	1,490	1,390

Flow rate	M1	M2	M3
0 – 30 days	49%	44%	43%
31 – 60 days	42%	40%	47%
61 – 90 day	26%	35%	36%
91+ days	100%	100%	100%

Example 1 – Provision Matrix



Step 2: Calculate the loss rate

A loss rate is calculated for each bucket. The calculated loss rate represents the probability that the receivables in a given bucket will reach the 91+ days category. This example assumes the write-off policy is after 90 days.

Flow rate	M1	M2	M3
0 - 30 days	49%	44%	43%
31 - 60 days	42%	40%	47%
61 - 90 day	26%	35%	36%
91+ days	100%	100%	100%

Loss rate	M1	M2	M3	Average
0 - 30 days	5%	6%	7%	6%
31 - 60 days	11%	14%	17%	14%
61 - 90 day	26%	35%	36%	32%
91+ days	100%	100%	100%	100%

Example 1 – ECL Computation



Calculation of the expected credit loss

The calculation of the expected credit loss is as illustrated below using both provision matrix and single loss rate approaches:

ECL computation illustration for provision matrices approach

Financial Asset	Bucket	Historical PD	Exposure at 31 Dec 2019	ECL
Trade receivables	0 - 30 days	6%	2,000,000	120,000
	31 - 60 days	14%	1,000,000	140,000
	61 - 90 day	32%	300,000	96,000
	91+ days	*100%	900,000	900,000
	Totals		4,200,000	1,256,000

*Write-off happens after 90 days hence 100% PD.

Example 2 – COVID-19 impact



- Same details as example 1
- Write-off policy updated to after 60 days due to trend associated with COVID-19 impact
- Company T is unable to establish a strong correlation between historical loss rate and macroeconomic factors
- However due to COVID-19 and increased credit risk, T has employed a management overlay based on stress levels below:

Aging	Stress level	Assessed overlay
0-30 days	Short-term	+5%
31-60 days	Medium-term	+10%
Over 61 days	Long term	n/a – written off



Example 2 – Provision matrix



Step 1: Collect receivables aging and calculate the flow rate

In this step, the entity collects periodic receivables aging reports and calculates a flow /transfer rate. Flow rate represents the probability of a receivable moving into the next aging bucket in the subsequent period. This calculation is performed periodically in line with business practice.

Trade receivables aging (ETB)	M1	M2	M3	M4
0 – 30 days	20,000	19,750	23,500	21,250
31 – 60 days	10,340	9,800	8,750	10,100
61 + days	6,520	5,650	5,390	5,540

Flow rate	M1	M2	M3
0 – 30 days	49%	44%	43%
31 – 60 days	55%	55%	63%
61+ days	100%	100%	100%

Example 2 – Provision matrix



Step 2: Calculate the loss rate

A loss rate is calculated for each bucket. The calculated loss rate represents the probability that the receivables in a given bucket will reach the 61+ days category. This example assumes a write-off policy of after 60 days.

Flow rate	M1	M2	M3
0 – 30 days	49%	44%	43%
31 – 60 days	55%	55%	63%
61+ days	100%	100%	100%

Loss rate	M1	M2	M3	Average
0 - 30 days	27%	24%	27%	26%
31 - 60 days	55%	55%	63%	58%
61+ days	100%	100%	100%	100%

Example 2 – ECL Computation



Calculation of the expected credit loss

The calculation of the expected credit loss is as illustrated below using both provision matrix and single loss rate approaches:

ECL computation illustration for provision matrices approach

Financial Asset	Bucket	Historical PD	Overlay	Adjusted PD	Exposure 31 Dec 2019	ECL
Trade receivables	0 - 30 days	26%	5%	31%	2,000,000	620,000
	31 - 60 days	58%	10%	68%	1,000,000	680,000
	61+ days	*100%	n/a	100%	1,200,000	1,200,000
	Totals				4,200,000	2,500,000

*Write-off policy is after 60 days hence PD=100%.

Key Disclosures



IFRS 7 and IAS 1 contain comprehensive disclosure requirements in respects of risks arising from financial instruments, accounting policies, judgements, assumptions, estimation uncertainties and changes in these areas.

Estimation uncertainty - changes to estimation techniques, assumptions and inputs for measuring ECLs.

New accounting policies, estimation techniques and disclosures

IAS 20 disclosures:

- **The accounting policy adopted**
- **The nature and extent of government grants recognized**
- **Unfulfilled conditions attaching to government assistance recognized.**
- **Government assistance**

Q&A



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