

# **Savings and Credit Cooperative Societies (SACCOs) Conference**

**(Select IFRS standards)**

**CPA Ferdinand Othieno**

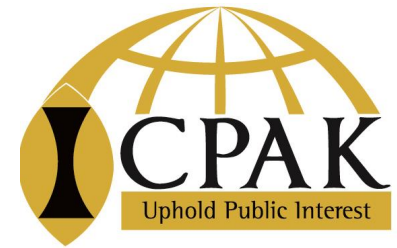
**30 July 2021**

**Credibility.**

**Professionalism.**

**AccountAbility**

# Agenda



## Issues in IFRS

- Investment property
- Provisions, Contingent Liabilities and Contingent Assets
- Employee benefits

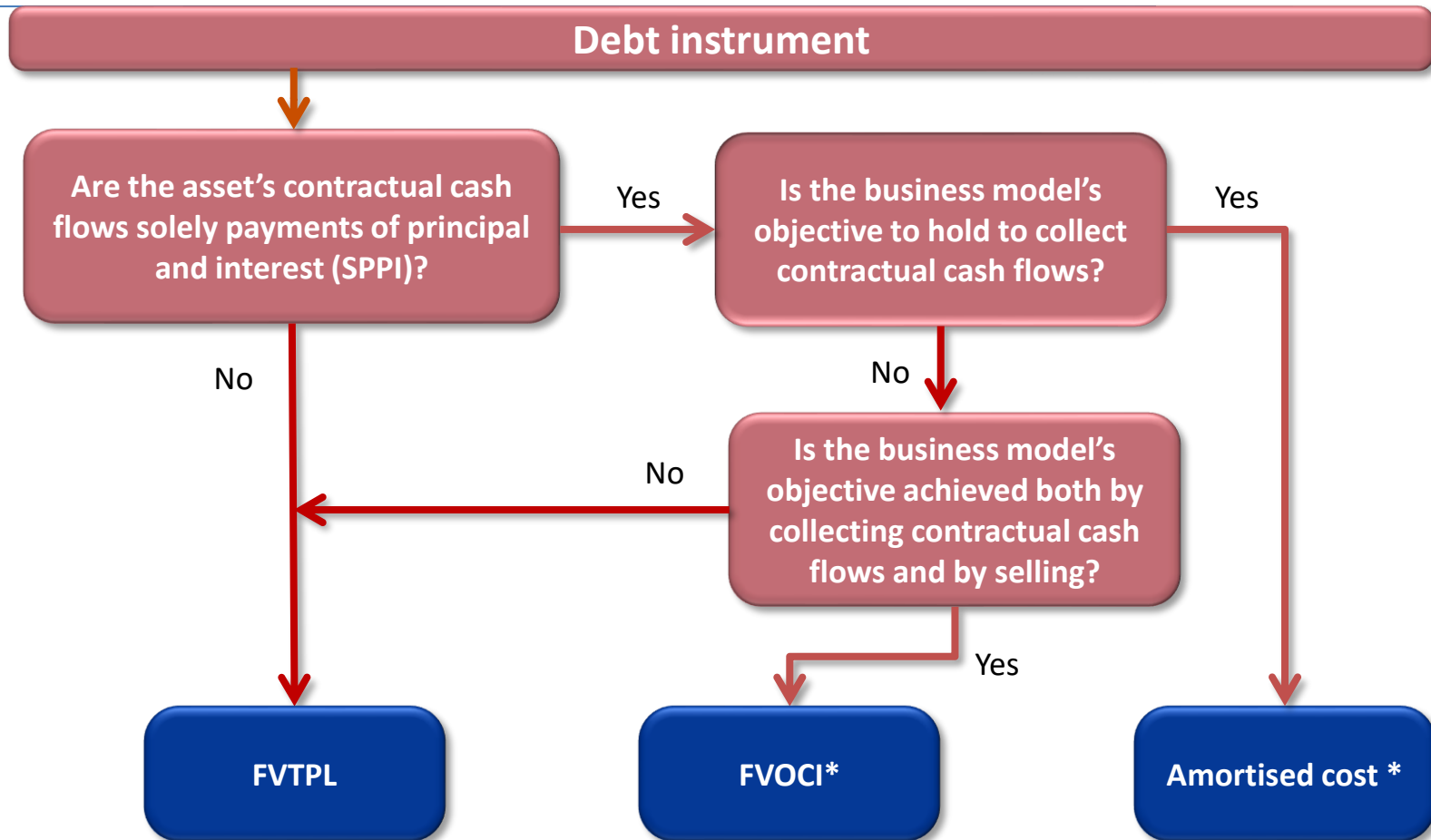
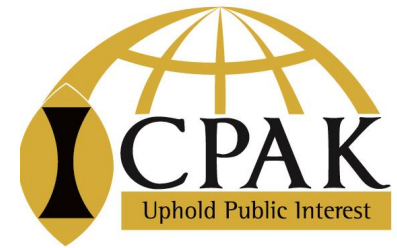


## Financial instruments

- Issues in IFRS 9
- Implementation experience
- Financial Instruments Disclosures

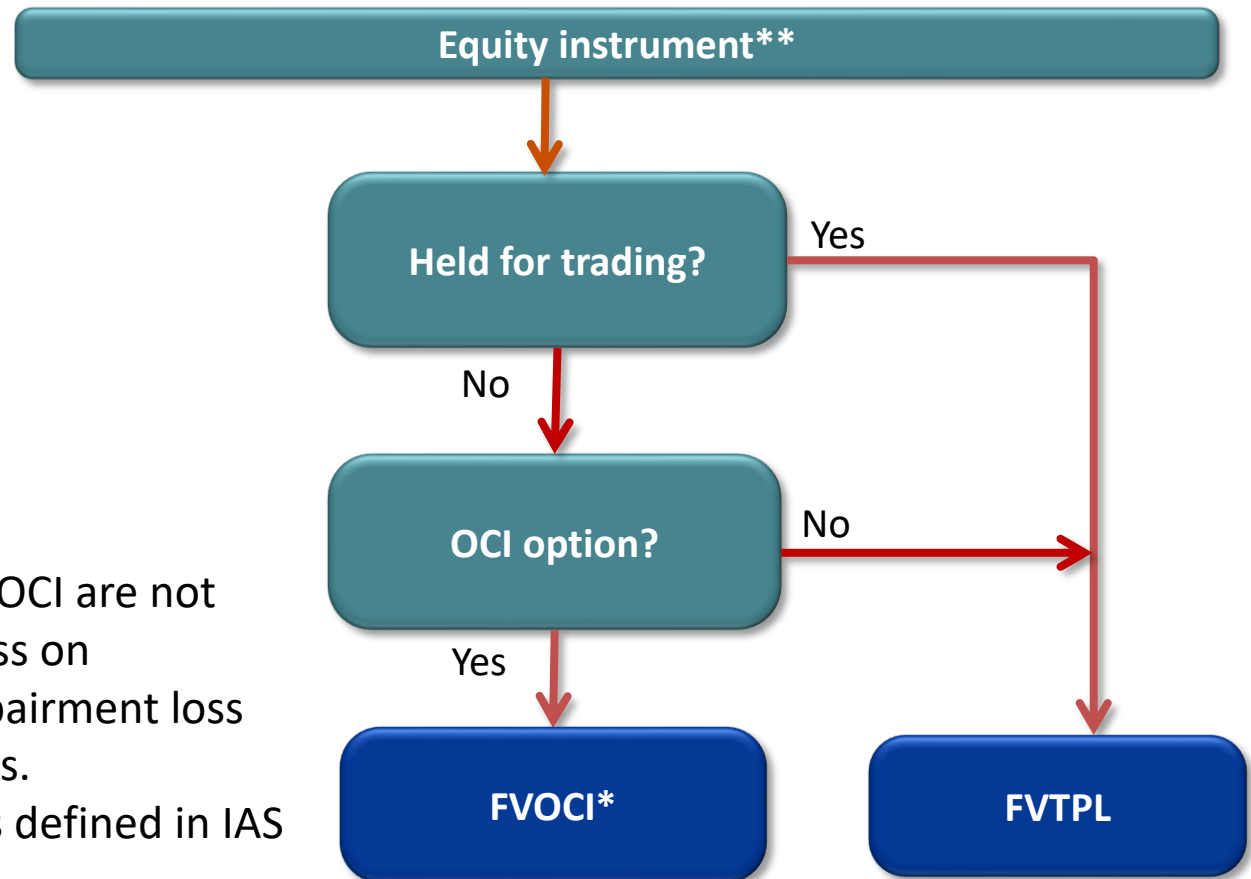
# **IFRS 9: Financial Instruments**

# Classification of Financial Assets – Debt Instruments



\* Subject to FVTPL designation option - if it reduces accounting mismatch

# Classification of equity instruments



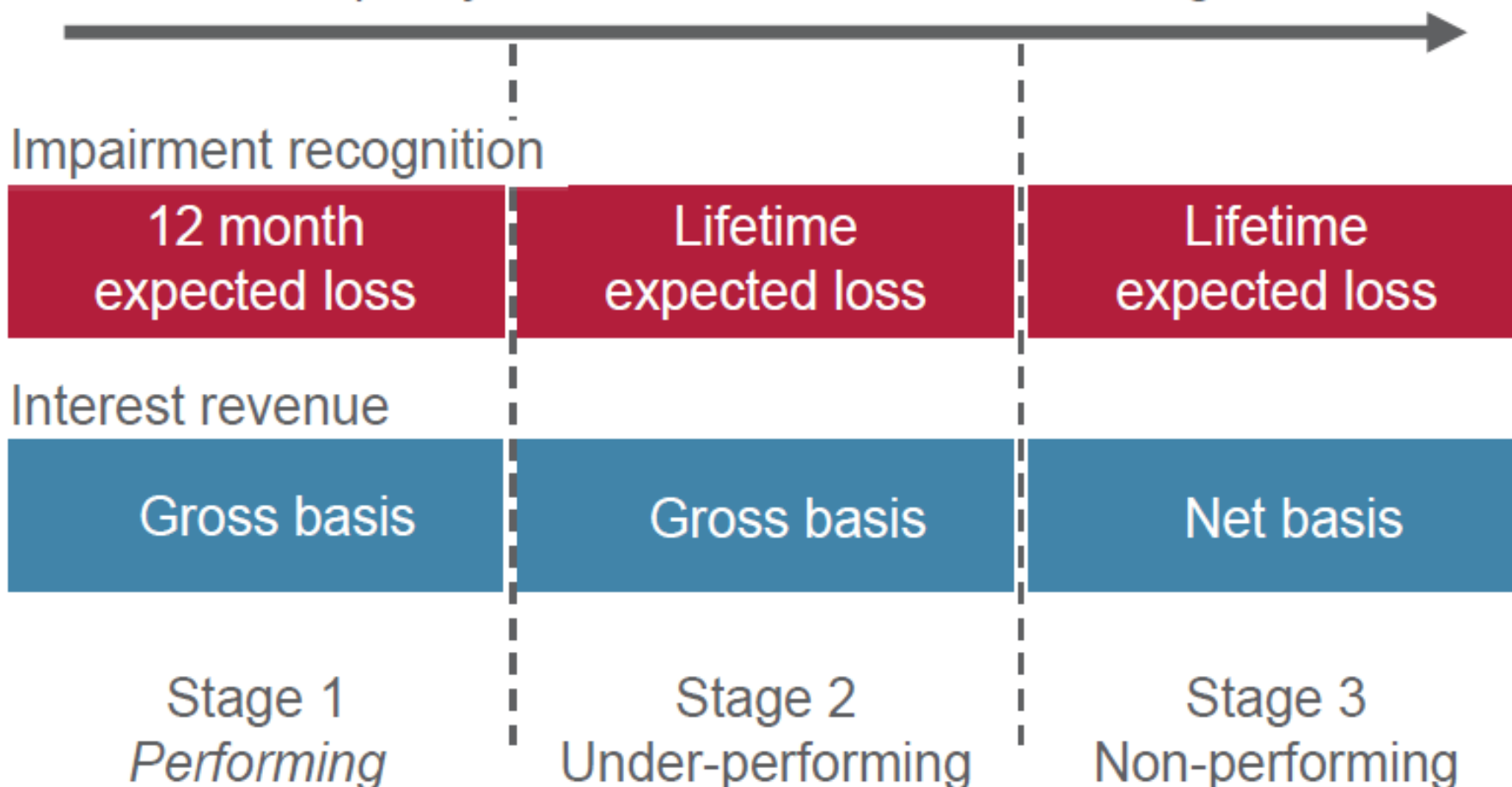
\* Amounts recognised in OCI are not reclassified to profit or loss on derecognition and no impairment loss recognised in profit or loss.

\*\* Equity instrument is as defined in IAS

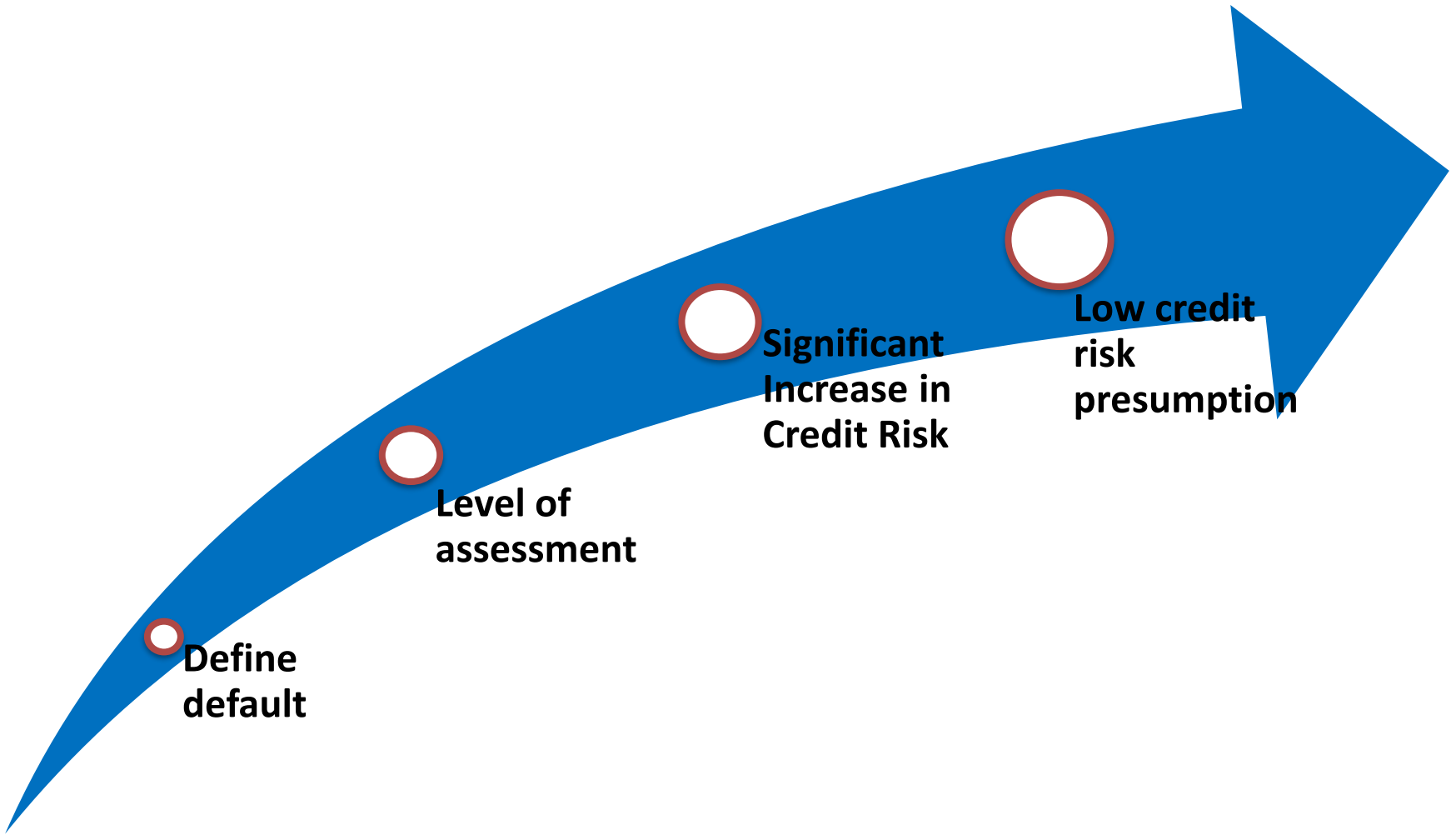
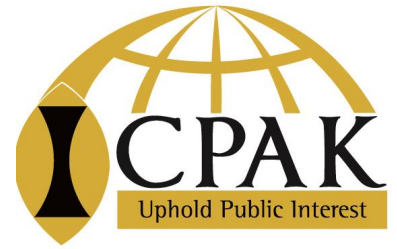
# Expected loss model – 3 stages



Credit quality deterioration since initial recognition



# IFRS 9 Impairment – Decision points



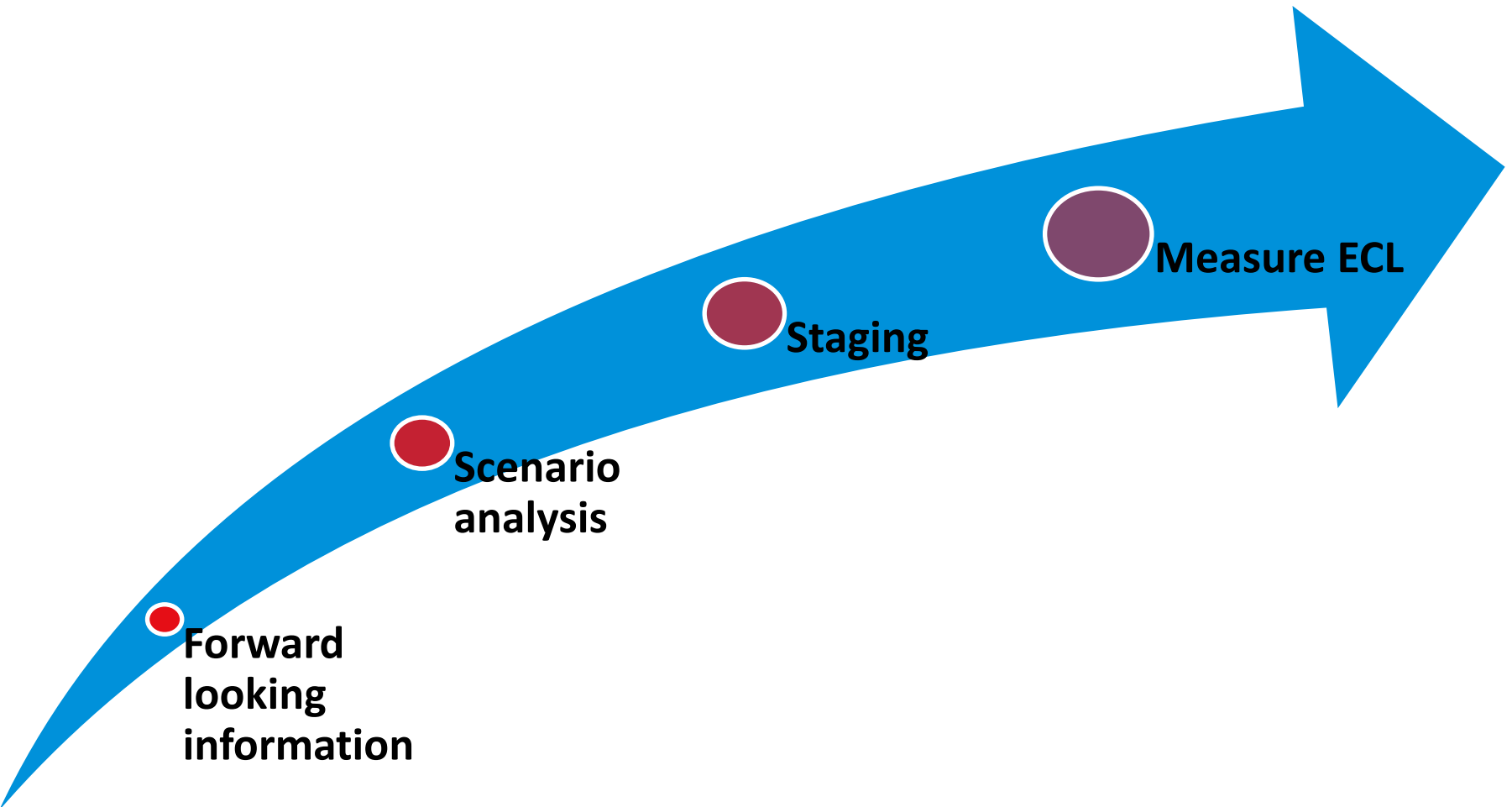
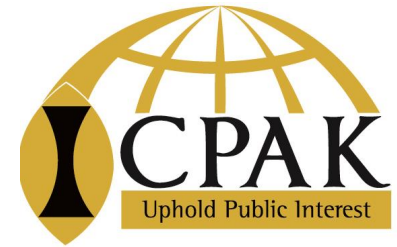
**Define default**

**Level of assessment**

**Significant Increase in Credit Risk**

**Low credit risk presumption**

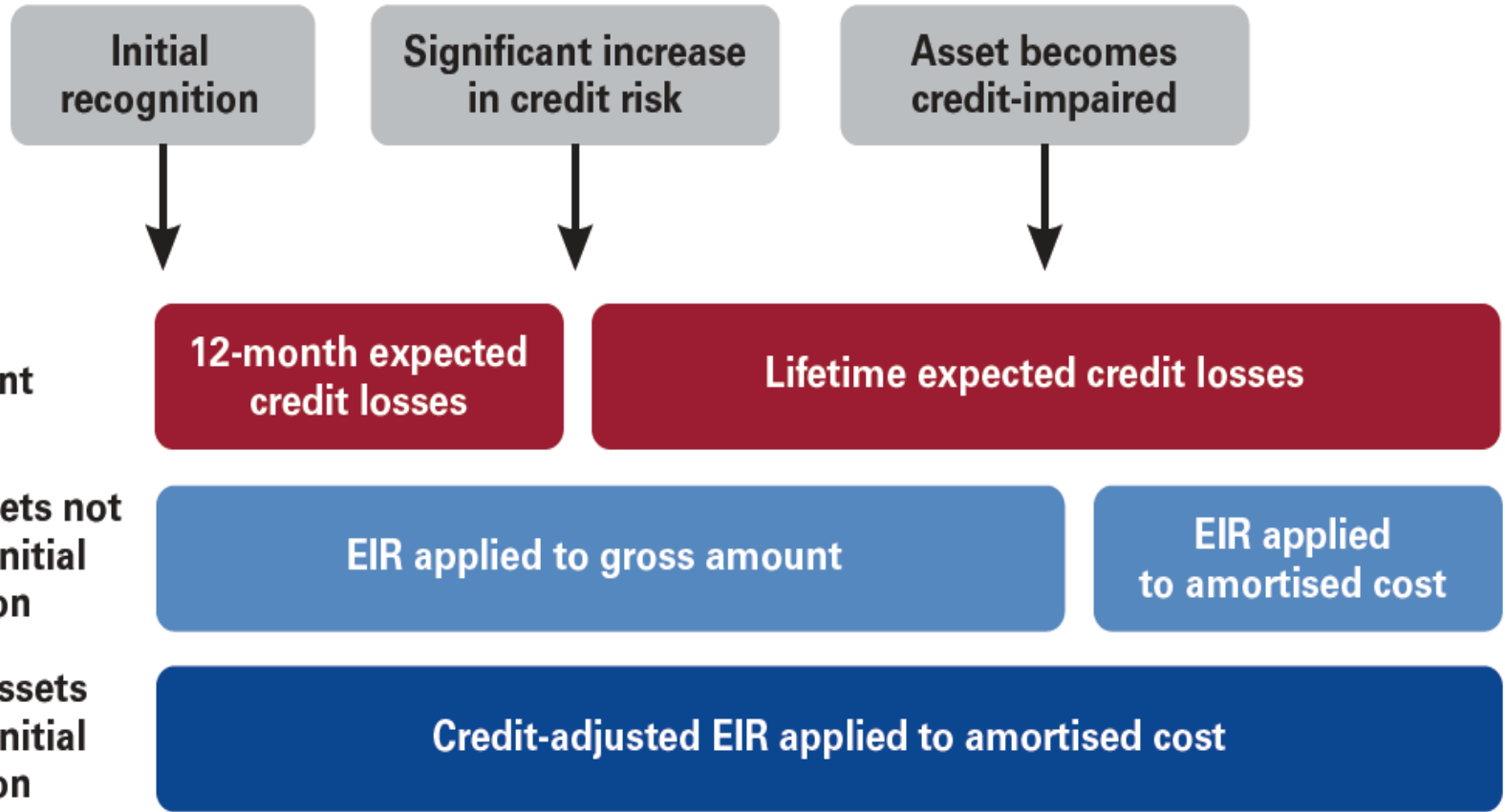
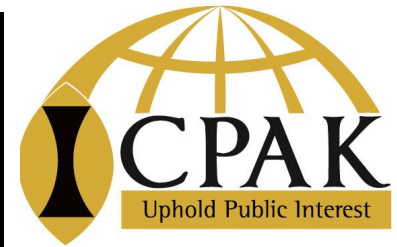
# IFRS 9 Impairment - Workstream



## Three building blocks

1. An **unbiased** and **probability weighted** amount that is determined by evaluating a **range of possible outcomes**
2. Discounting - The **time value of money**
3. **Reasonable** and **supportable information** about past events, current conditions and forecasts of future economic conditions.

# Interest Recognition



# Disclosures



## Quantitative disclosures

Reconciliation of opening to closing amounts of loss allowances showing key drivers of change

Reconciliation of opening to closing amounts of GCAs showing key drivers of change

GCAs by credit risk grade

Write offs, recoveries and modifications

## Qualitative disclosures

Inputs, assumptions and estimation techniques for estimating ECL

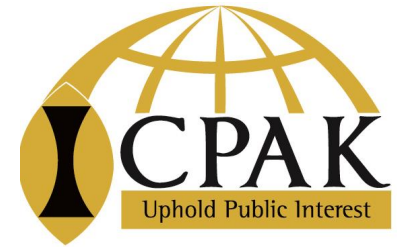
Inputs, assumptions and estimation techniques to determine significant increases in credit risk and default

Inputs, assumptions and techniques to determine credit-impaired assets

Wrote off policies, modification policies and collateral

# **IFRS 9: 3 Years In**

# IFRS 9 – Focus areas



SICR

Quality data

Forward looking  
information

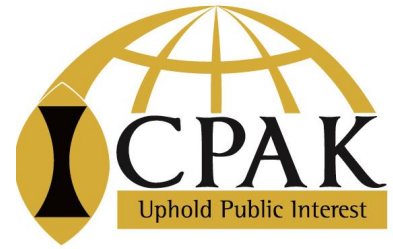
Derecognition

Practical expedients

etc...

Regulatory-  
driven  
prudence

# IFRS 9 – Focus areas...



Parameter

Estimation – PD, LGD,  
EAD, PV, r, T,

Statistical  
capacity issues

Time horizon

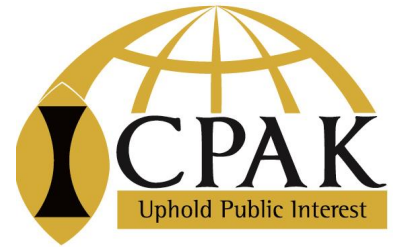
Model selection  
and fitting

Capacity building

EAD term structure

etc...

# IFRS 9 – People issues



Finance vs  
Risk

External  
audit

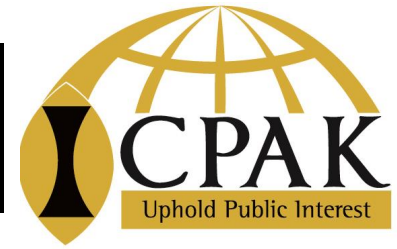
Composition of IFRS  
9 committees

Audit  
Committees

People  
change

etc...

# IFRS 9 – Time issues



Use of  
hindsight

Level of  
granularity of  
decisions

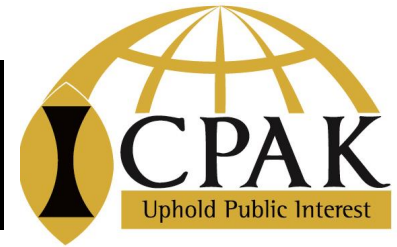
Decision  
compromises

Segmentation

Managing  
uncertainty

etc...

# IFRS 9 – into the future



Iterative  
decisions

Materiality  
judgements

Real time  
controls

Disclosures

Rethinking prior  
decisions?

Automation?

Managing  
uncertainty –  
under Covid 19

Future  
developments  
e.g. IBOR  
etc...

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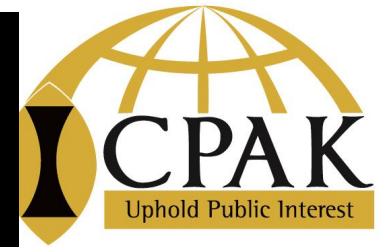
## **IAS 19:- Employee Benefits**

# IAS 19: Employee benefits



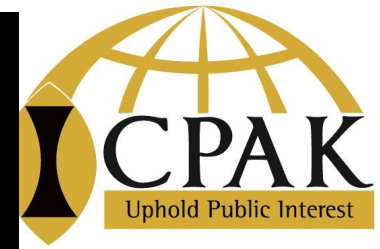
- The objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits.
- The standard requires an entity to recognize
  - **A liability** where an employee has **provided service** in exchange for employee benefits to be **paid in the future**; and
  - **An expense** when the entity **consumes the economic benefits** of employee service;
- Employee benefits are all forms of consideration given by an entity in exchange for services rendered or for the termination of employment.

# Employee benefits



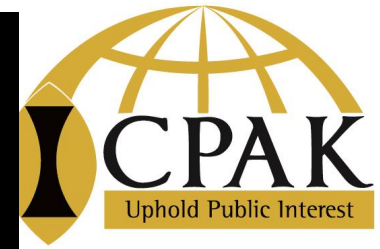
- Employee benefits
  - Short-term benefits
  - Post-employment benefits
  - Other long-term benefits
  - Termination benefits
  
  - IFRS 2 *Share-based Payment* – accounting for all share-based payment transactions

# IAS 19 Main principles



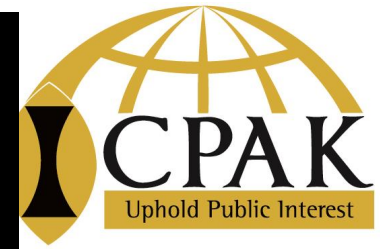
- Recognise employee benefits when service is rendered in exchange for those benefits
- Post-employment benefit plans are classified as defined contribution plans or defined benefit plans

# IAS 19 Main principles



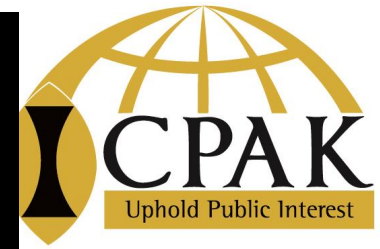
- **Defined contribution plans**
  - Cost of benefits = contribution paid or payable to the plan
- **Defined benefit plans:**
  - Cost of benefit = present value of entitlement earned
  - Many variable factors such as final or average pay levels
  - Involves relatively complex calculations
  - Plan assets measured at fair value

# Short term employee benefits



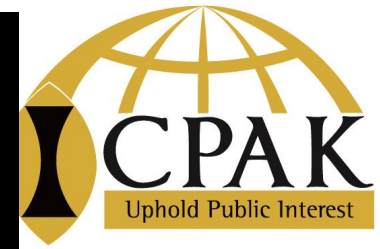
- Expected to be settled wholly within the 12 months after the reporting period end, in which the employee has rendered the related services.
- If the entity's expectations of the timing of settlement change temporarily, it need not reclassify a short-term employee benefit.
- Compensated absences
  - *Accumulating* – recognize expense when service that increases entitlement is rendered. e.g. leave pay
  - *Non-accumulating* – recognize expense when absence occurs.
- All short term benefits
  - Recognize the undiscounted amount as an expense / liability e.g. wages, salaries, bonuses, etc.

# Other long term employee benefits



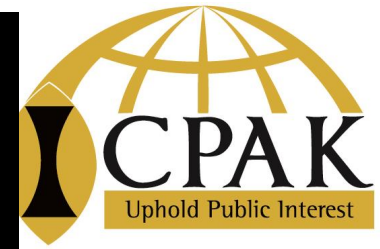
- Employee benefits other than short-term employee benefits, post-employment benefits, and termination benefits.
- Statement of financial position
  - Carrying amount of liability = present value of obligation minus the fair value of any plan assets
  - Actuarial gains and losses are recognized immediately in OCI in full
  - past service costs are recognized immediately in profit or loss in full r
- Statement of comprehensive income
  - Recognize the net total of: Current service cost + Net interest on net defined benefit liability/(asset) + remeasurement of the net defined benefit liability/(asset).

# Profit sharing and bonus schemes



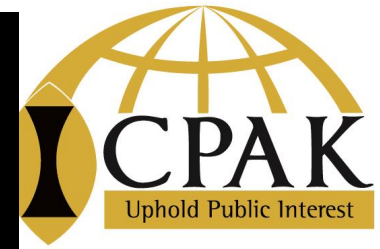
- Recognize the expense when entity has a present legal or constructive obligation to make payments; and a reliable estimate of the obligation can be made.

# Termination benefits



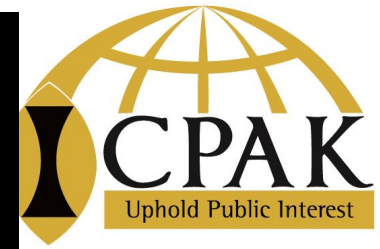
- Employee benefits provided in exchange for the termination of an employee's employment, as a result of either:
  - An entity's decision to terminate an employee's employment before the normal retirement date
  - An employee's decision to accept an offer of benefits in exchange for the termination of employment.
- Recognize liability and expense at the earlier of:
  - The date the entity can no longer withdraw the benefit or offer
  - The date the entity recognizes restructuring costs under IAS 37.

# Termination benefits



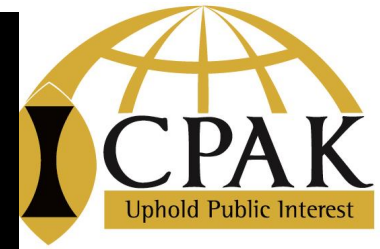
- If termination benefits settled wholly before 12 months from reporting date – apply requirements for short-term employee benefits
- If termination benefits are not settled wholly before 12 months from reporting date – apply requirements for other long term employee benefits.

# Post employment benefits



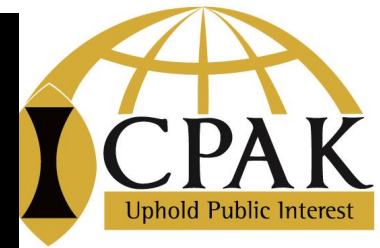
- Defined contribution plans
  - The entity pays fixed contributions into a fund and does not have an obligation to pay further contributions if the fund does not hold sufficient assets
  - Recognize the contribution expense /liability when the employee has rendered the service.

# Post employment benefits



- Defined benefit plans
  - These are post employment plans other than defined contribution plans.

# Post employment benefits - Definitions



- The net defined benefit liability (asset) is the deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.
- The deficit or surplus is:
  - The present value of the defined benefit obligation less
  - The fair value of plan assets (if any).

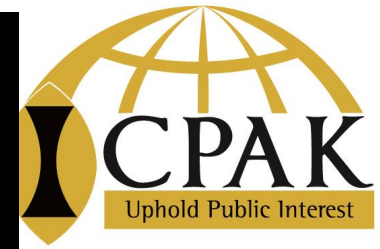
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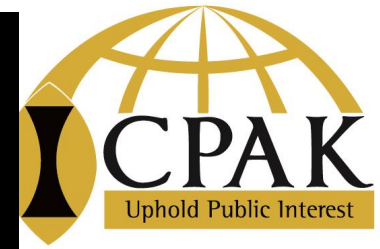
## **IAS 40:- Investment Property**

# IAS 40: Key principles



- Investment property is held for rentals or capital appreciation;
- Initial measurement is at cost;
- Subsequent measurement – cost or fair value model;
- Under the fair value model – fair value changes go through profit or loss;
- Under cost model, investment property is treated similar to PPE under IAS 16

# Investment Property - Definition



- Property = land or a building (or part of a building) or both
- Investment property is property held for
  - Rentals
  - Capital appreciation
- Not property held for
  - Use in production, supply of goods / services or for administration
  - Sale in ordinary course of business

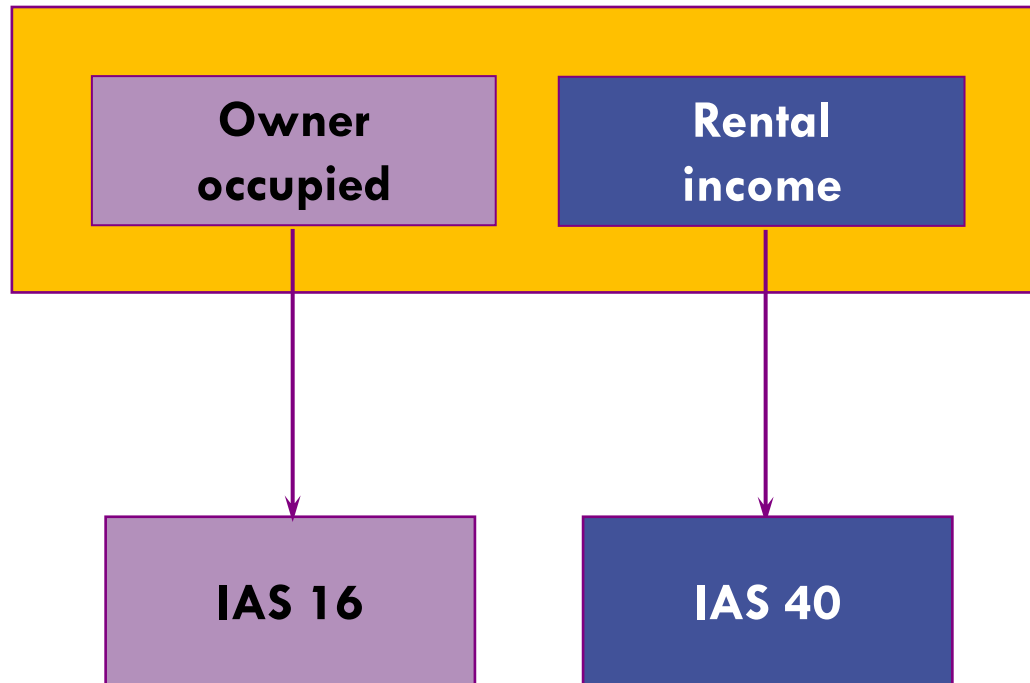
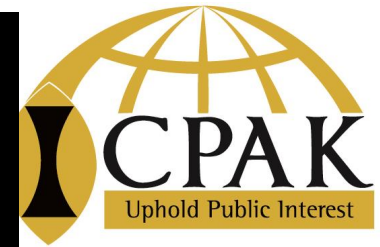
**Mandatory to classify  
under IAS 40 if criteria is  
met**

# Examples of investment property

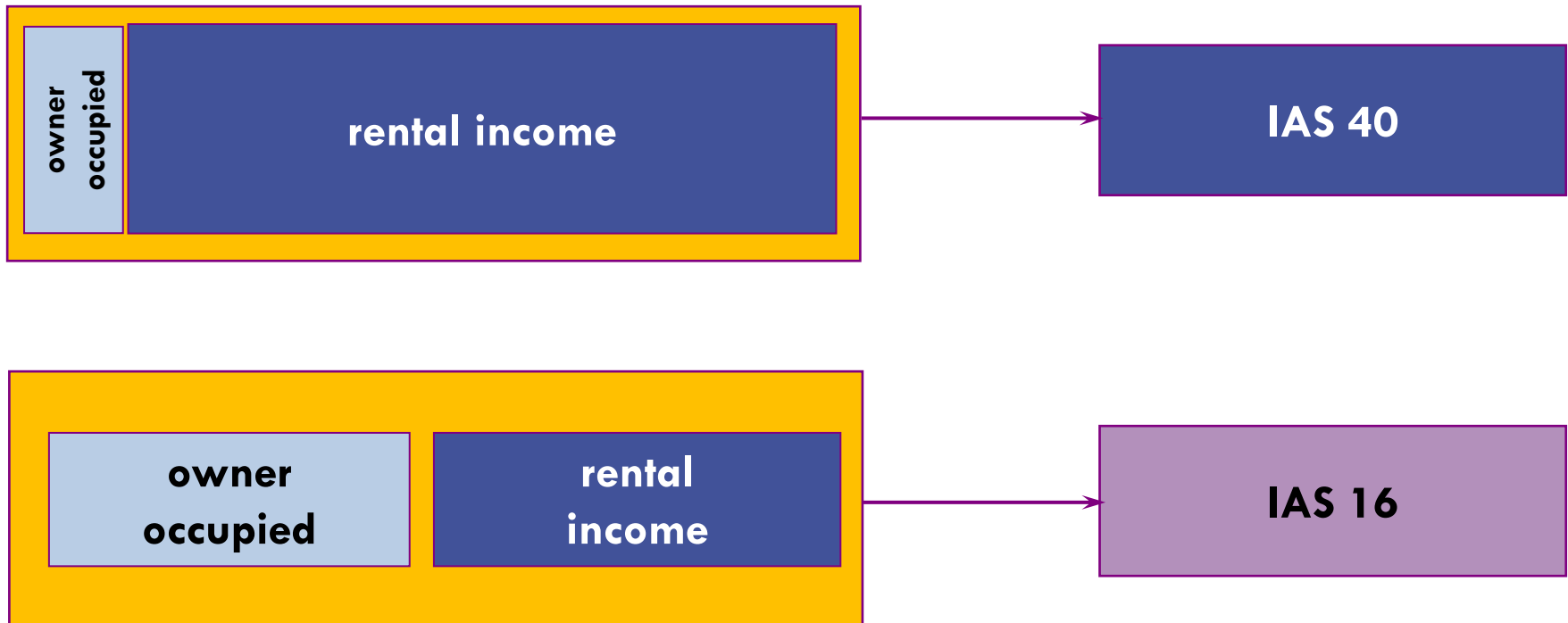
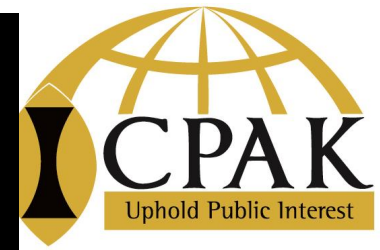


- Land held for long-term capital appreciation
- Land held for undetermined future use
- Building owned (or held under a finance lease) and leased out under operating lease
  - Including vacant building that will be leased out under operating lease
- Property under construction or development
  - For future use as investment property

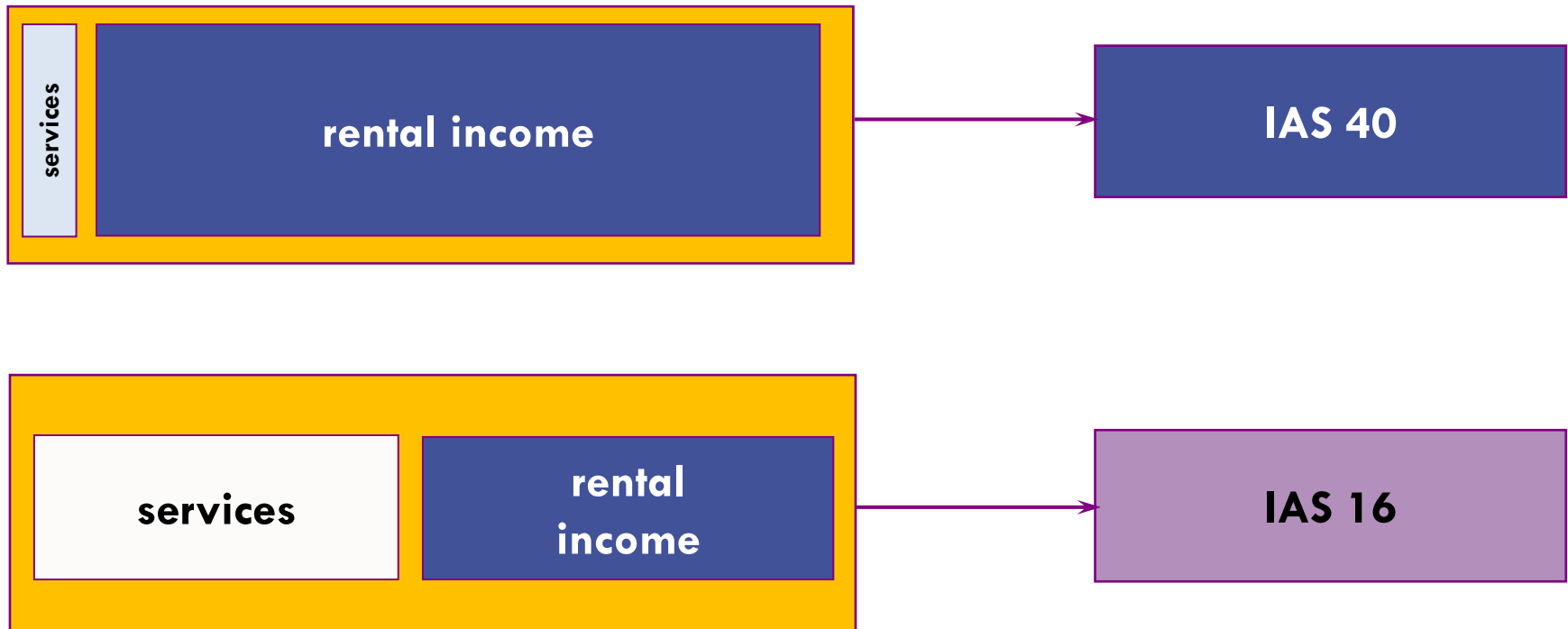
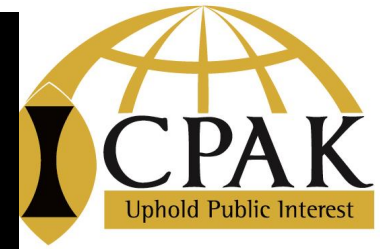
# Dual purpose – Able to split



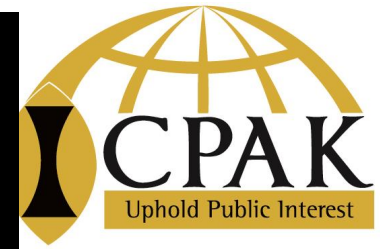
# Dual purpose – Unable to split



# Ancillary services



# Recognition



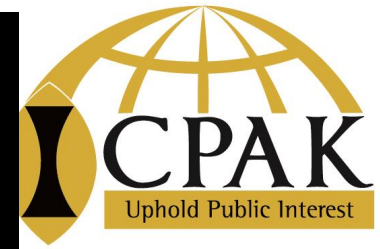
- Investment property recognised as an asset when:
  - It is probable that the future economic benefits associated with the investment property will flow to entity, and
  - The cost of the investment property can be measured reliably

# Initial measurement



- Initially, measured at cost (Include transaction costs):
- Purchased or self-constructed investment property:
  - Purchase price
  - Any directly attributable expenditure (e.g., professional fees for legal services, property transfer taxes)
  - Apply IAS 23 Borrowing Costs for investment property that is a qualifying asset unless investment property is measured at fair value

# Subsequent measurement (1)

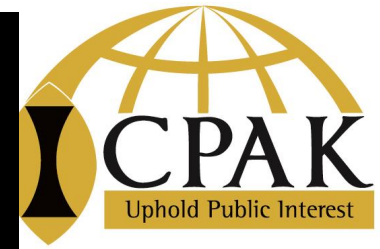


- Fair value
  - Changes in profit or loss
  - Exemption if cannot reliably determine on ongoing basis
- Cost model
  - As per IAS 16
  - Depreciate
  - Impairment losses

**Apply choice to all investment property**

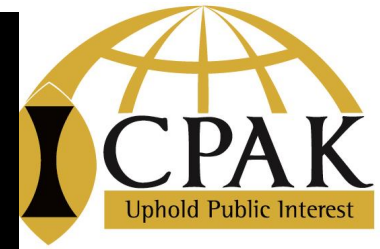
**Change from FV option to cost option difficult to justify**

## Subsequent measurement (2)



- Property under construction / development:
  - Fair value model
    - If fair value is determinable reliably, then it should be followed
    - If fair value is not determinable reliably but is expected to be so when construction is complete, then at cost until the fair value is determinable reliably or construction is complete (whichever is earlier)
  - Cost model
    - Follow IAS 16 requirements
    - Depreciation and impairment testing

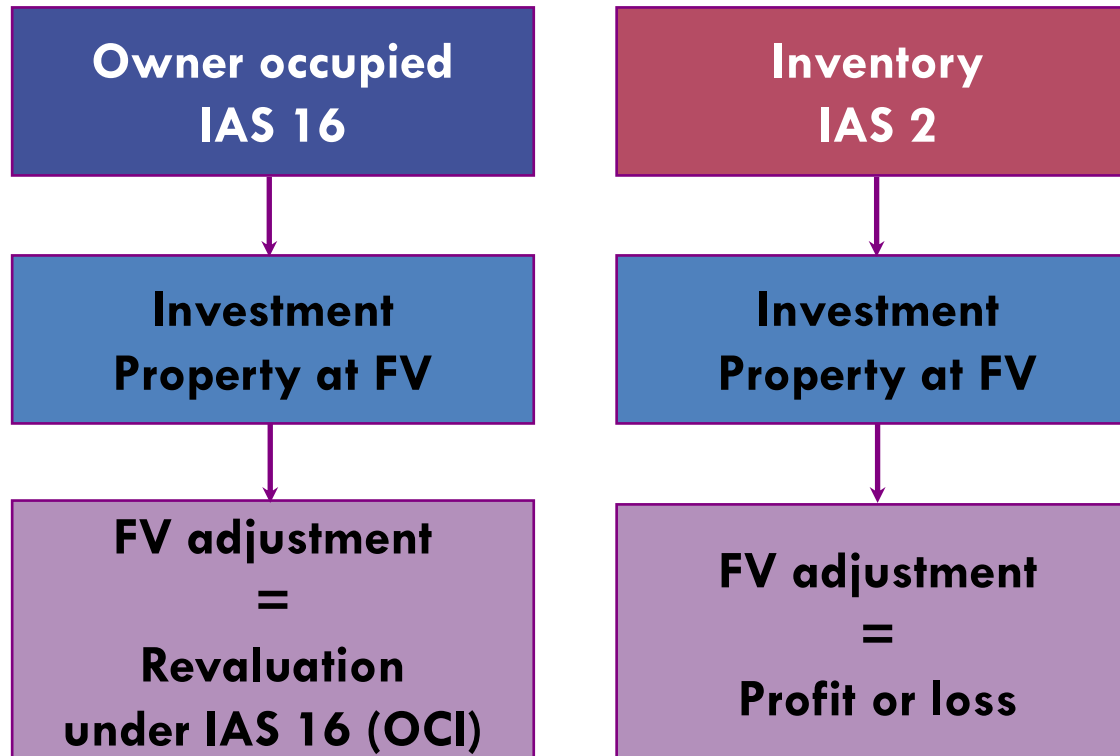
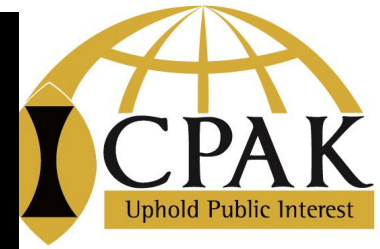
# Measurement of fair value



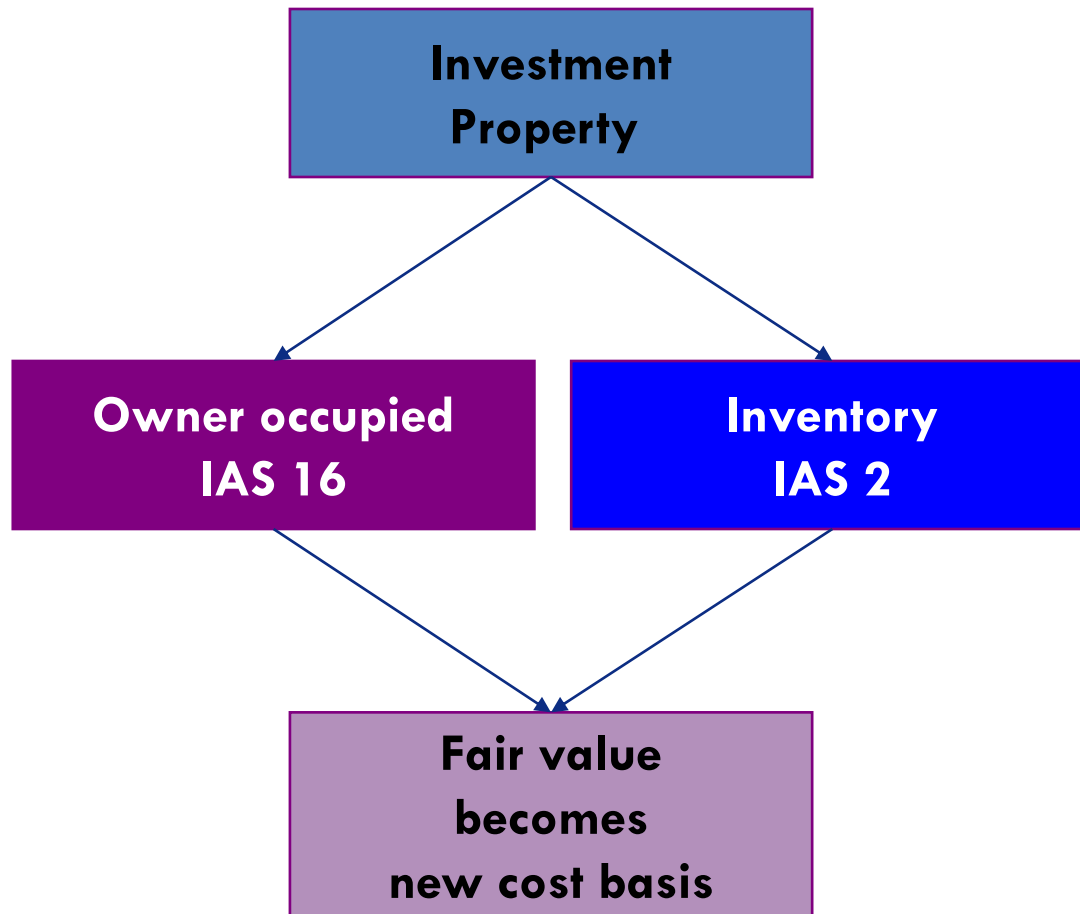
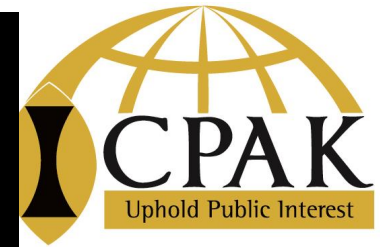
Consider:

- Actual current market rates for similar properties in similar locations
- Rental income from leases and market expectations regarding future lease terms
- Hypothetical knowledgeable and willing buyers and sellers
- Investor expectations

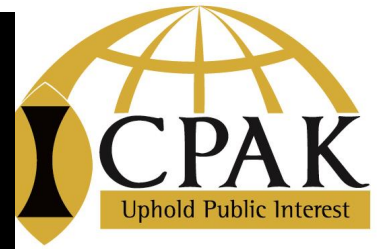
# Transfers to investment property carried at fair value



# Transfers from investment property carried at fair value



# Questions & comments



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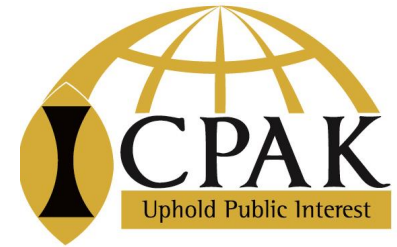
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**IAS 37:-**

**Provisions, Contingent Liabilities &  
Contingent Assets**

# Liabilities, accruals and provisions

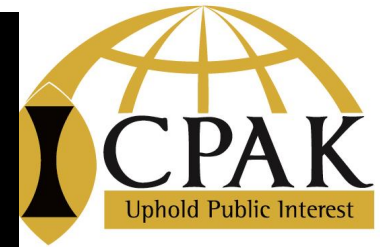


**Liabilities** - present obligations from a past event expected to result in an outflow of resources

**Accruals** - liabilities to pay for goods or services received or supplied but not yet paid or invoiced

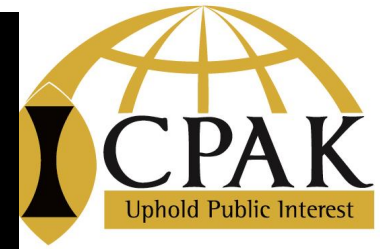
**Provisions** - liabilities of uncertain timing or amount

# Contingent liabilities and contingent assets



- Contingent liabilities:
  - Possible obligations arising from a past event to be confirmed by future events not wholly within the control of the entity, or
  - Present obligations arising from a past event
    - Of which the outflow of economic benefits is not probable, or
    - That cannot be measured reliably
- Contingent assets: possible assets arising from a past event to be confirmed by future events not wholly within control of entity

# Legal and constructive obligations



## Obligations

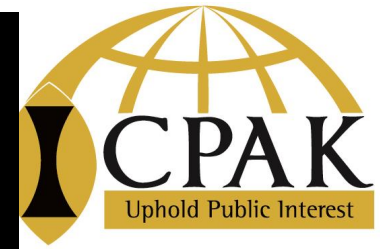
- Legal

- Contract
- Law / legislation

- Constructive

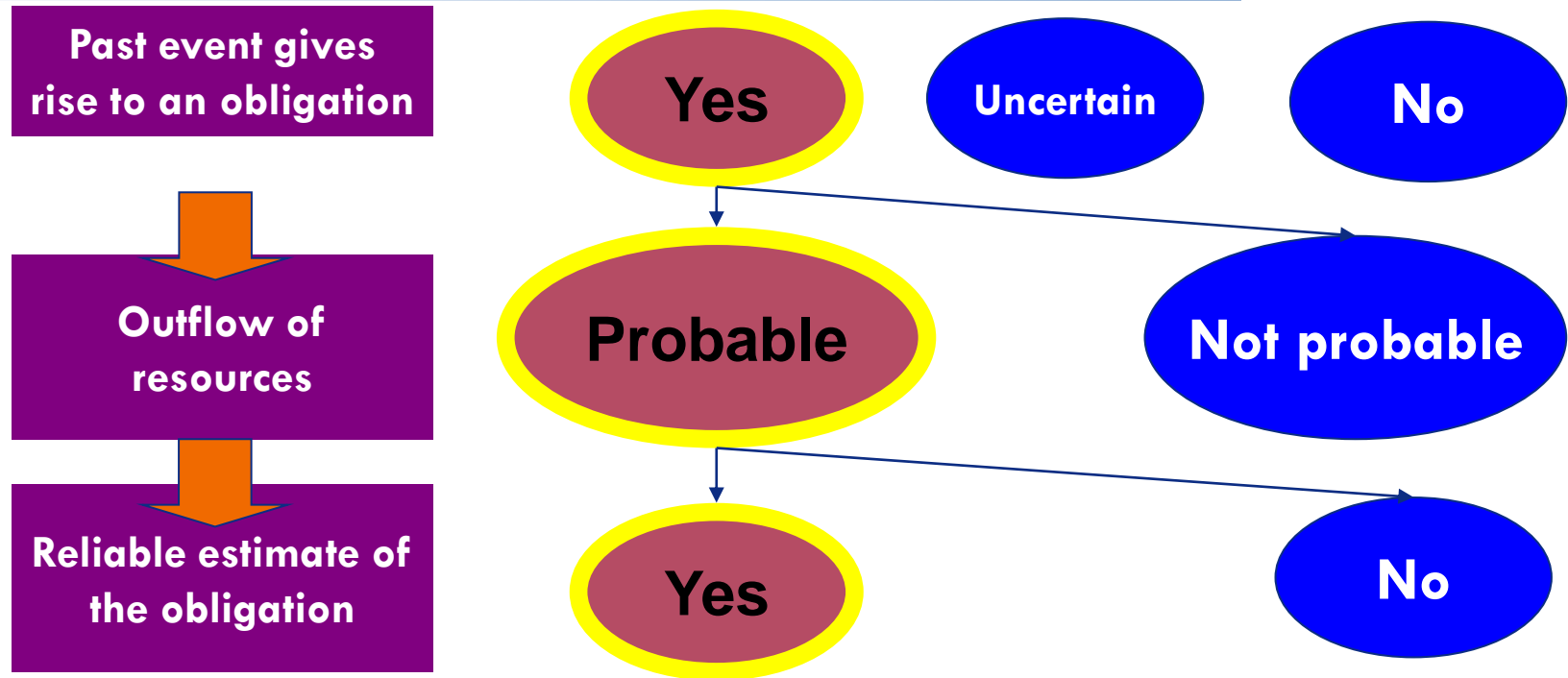
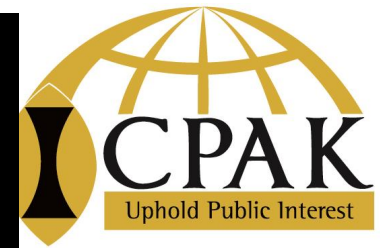
- Established pattern of past practice
- Published policies
- Sufficiently specific current statement
- Indication to other parties that certain responsibilities are accepted and creation of a valid expectation that they will be discharged

# Recognition criteria – Provisions



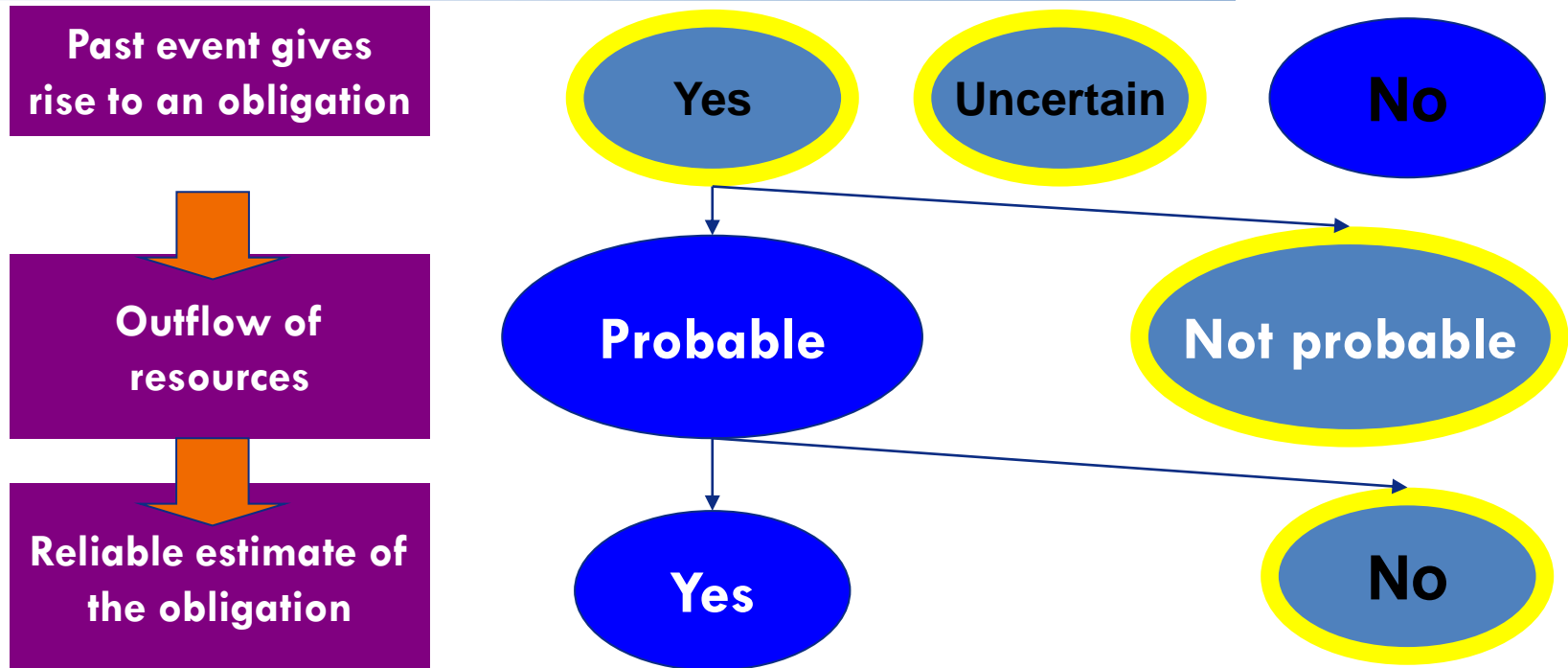
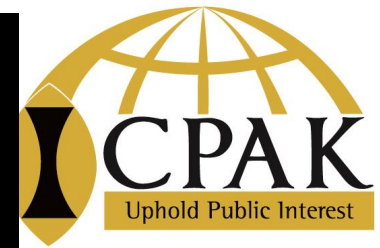
- Present obligation as a result of a past event
- Legal or constructive nature
- Probable outflow of economic benefits
- Estimated reliably

# Recognition criteria – Liabilities

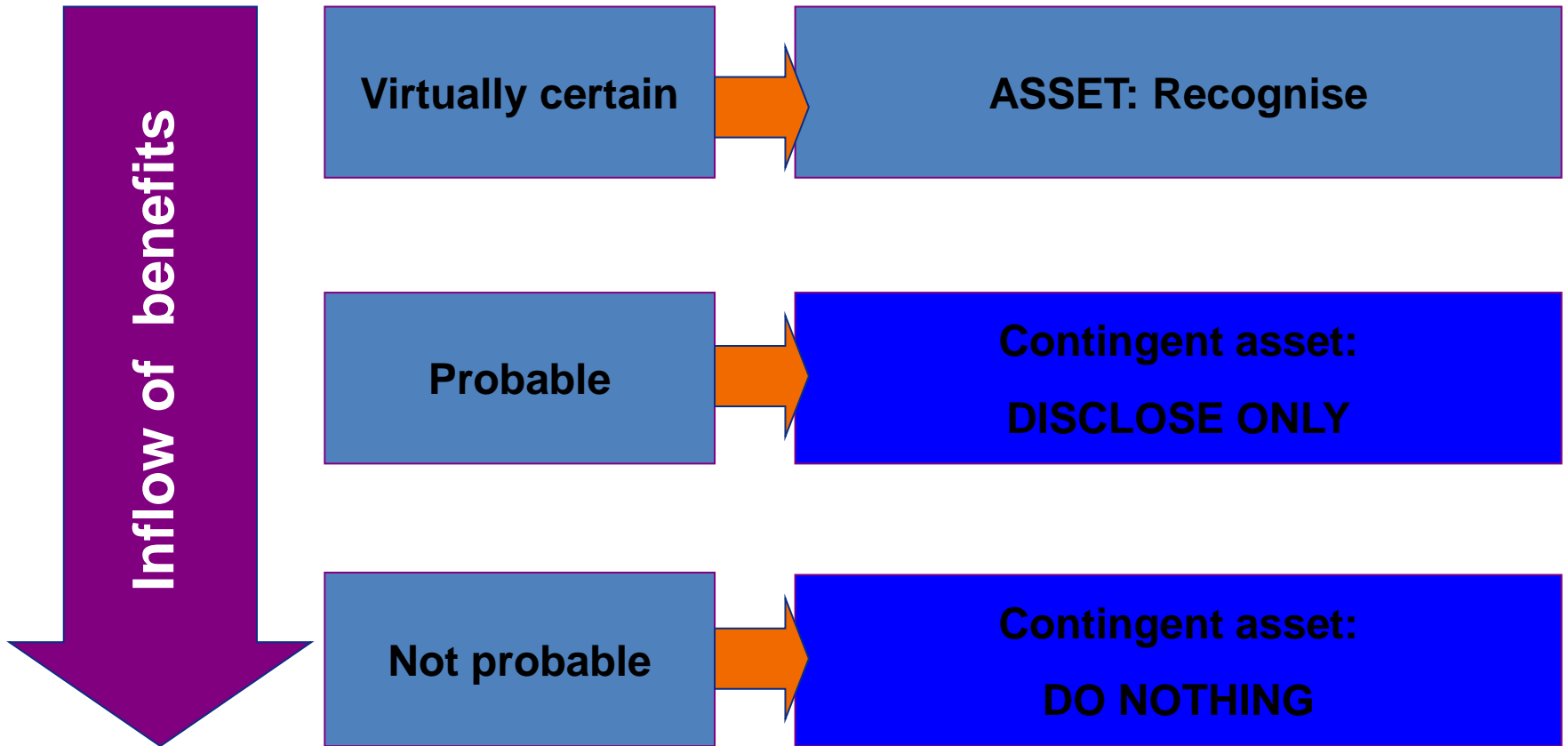
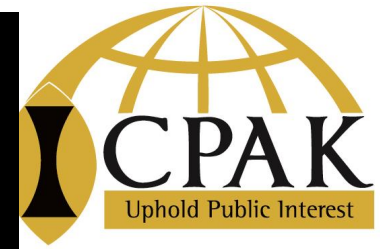


**Liability: Recognise & Disclose**

# Criteria – Contingent liabilities



# Criteria – Contingent assets



# Recognition criteria – Judgement

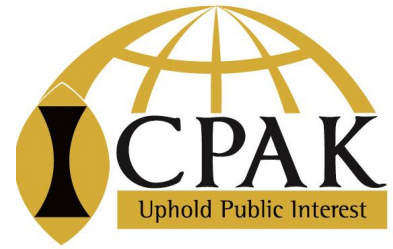


## Possible guidelines:

- Virtually certain:  $\geq 90\%$
- Probable (more likely than not):  $>50\%^*$
- Possible:  $\leq 50\%$
- Remote:  $\leq 10\%$

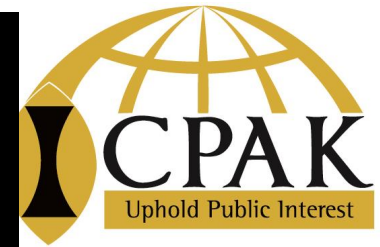
\* In the standard

# Recognition criteria – Derecognition of a provision



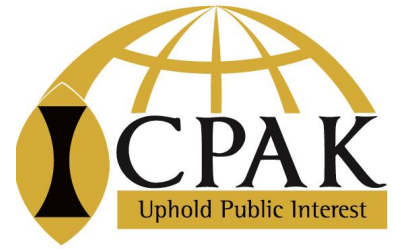
- Through use
  - Only for expenditures for which provision was recognised originally
  - As a result, expenditures do not affect profit or loss
- Through revision of estimate
  - If an outflow of economic benefits is no longer probable
  - Reversal affects profit or loss

# Measurement



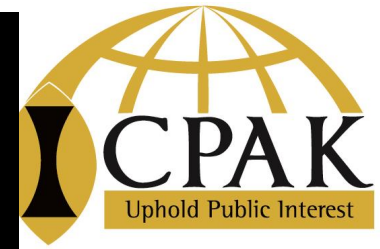
- Best estimate
  - Single item – most likely outcome
  - Large population of similar items – expected value
- Inherent risks and uncertainties to be considered
- Discounting required, when effect material
- Expected reimbursements ( $< / =$  provision) to be recognised as separate receivable, if virtually certain
- Expected gains from disposal of assets should not be recognised as reduction of provision

# Application: Prudence is not the ultimate virtue!



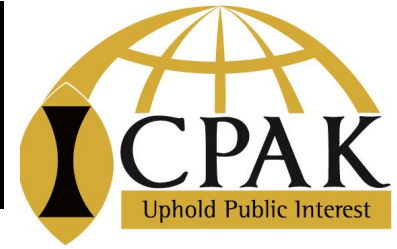
- Do not provide for...
  - Future operating losses (rainy days)
  - Currency risks
  - Political risks
  - Maintenance / refurbishment of own assets
  - General restructuring projects
  - General business risks

# Restructuring costs



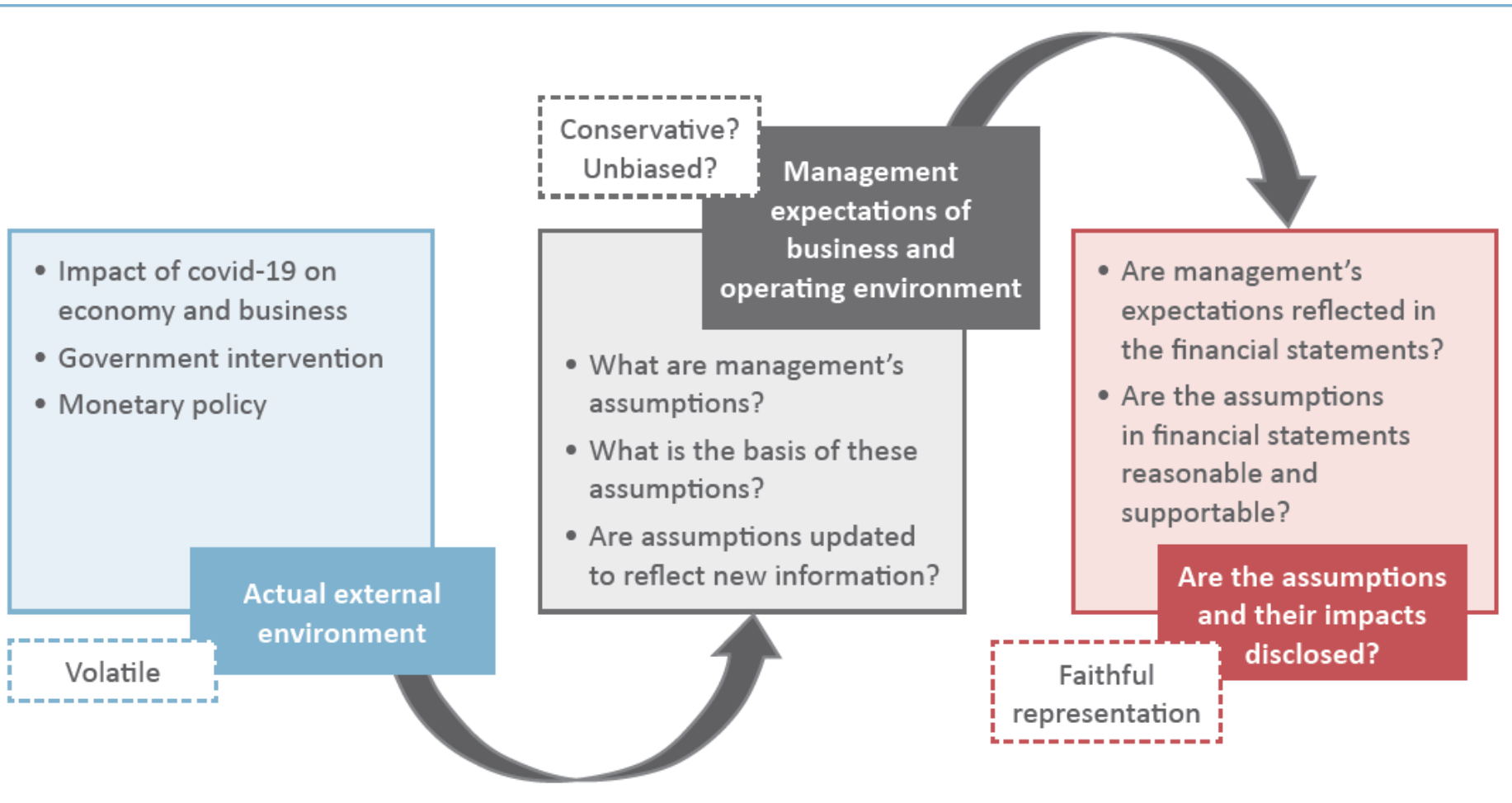
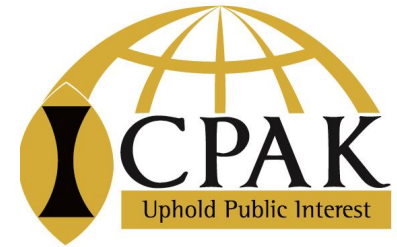
- Restructuring provisions require detailed formal plan or binding sale agreement
- Entity must illustrate a demonstrable commitment by either:
  - Starting to implement that plan; or
  - Announcing its main features to those affected
- Timing: begin/end in a timeframe that makes significant changes unlikely
- A board decision alone is not sufficient!

# Application: Details of a restructuring plan

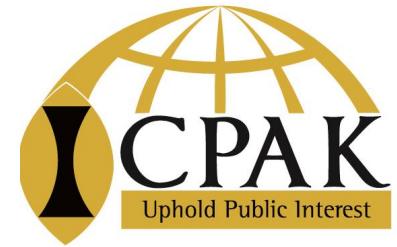


- Business or part of the business concerned
- Principal locations
- Location, function and approximate number of employees who will be compensated for termination
- Cost entailed by the restructuring and not associated with ongoing activities
- Timing of implementation

# Reporting under Covid 19



# Reporting under Covid 19



Clarity	Transparency	Context
<ul style="list-style-type: none"><li>• Tell it like it is</li><li>• Highlight changes from year end</li></ul>	<ul style="list-style-type: none"><li>• Consistency with basis for management decisions</li><li>• Focus on the big picture and whether the short term is indicative</li></ul>	<ul style="list-style-type: none"><li>• What assumptions have been made</li><li>• Level of uncertainty in assumptions</li><li>• Update for most current information</li></ul>

# Questions & comments

