



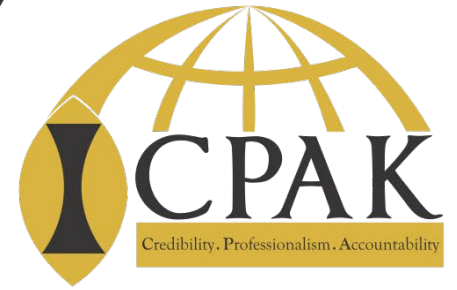
Updates on new and existing IFRSs

CPA Stephen Obock

sobock@kpmg.co.ke

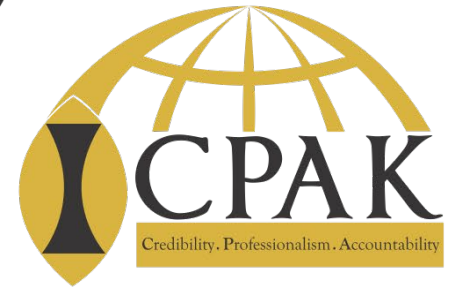
December 2021

Agenda



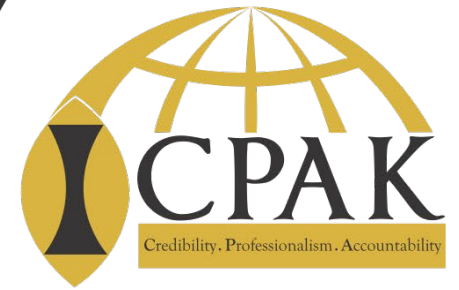
1. Introduction
2. IFRS 9 – ECL models
3. IFRS 16 – Lease concessions
4. New standards and interpretations not yet effective
5. Other critical Standards under current environment.

Introduction



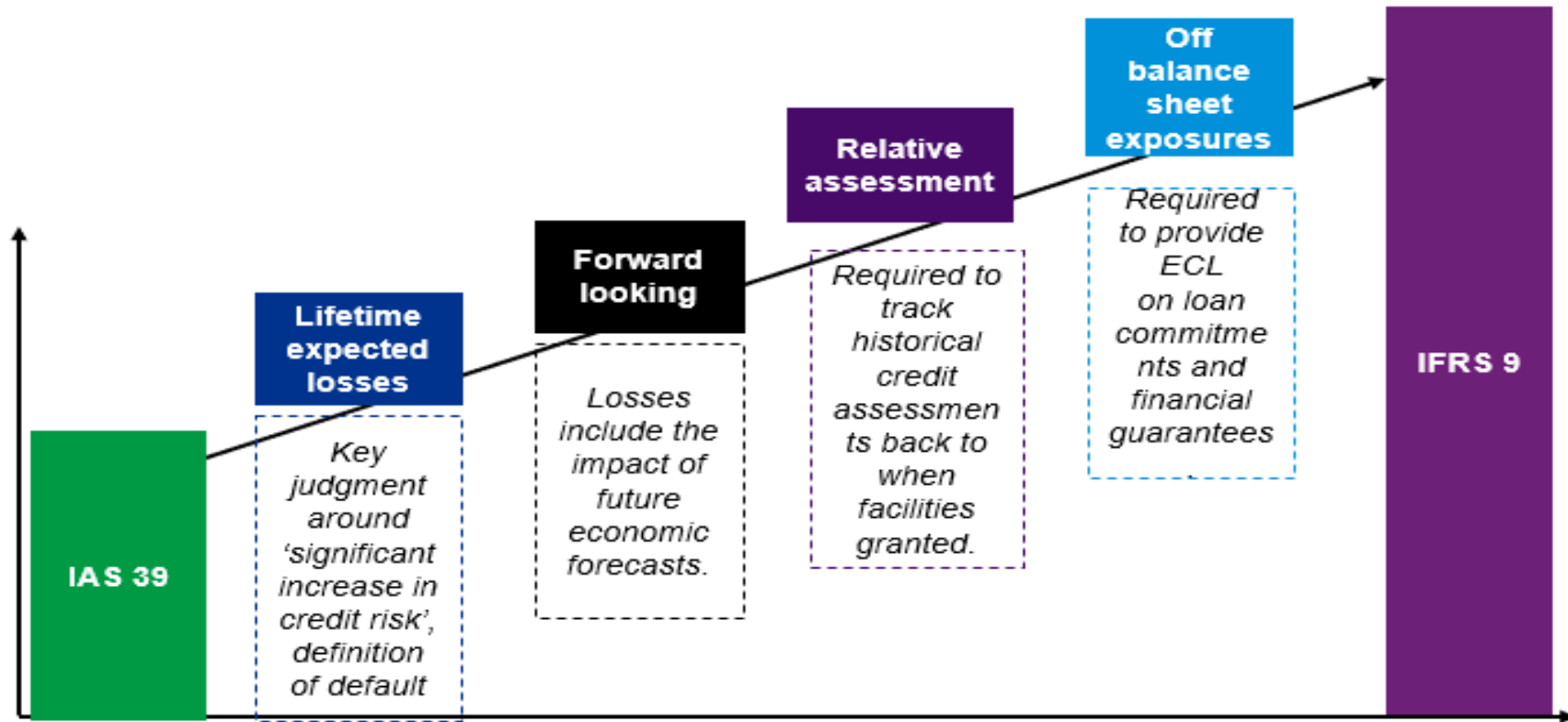
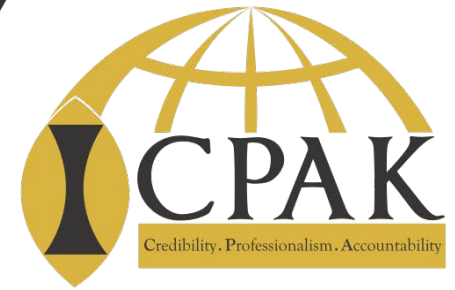
Recent updates have been informed by the need to consider the impact of Covid-19 on existing standards

Other updates aimed at making clarifications to existing standards (e.g. IAS 1 debt classification and IAS 12 on deferred tax recognition)

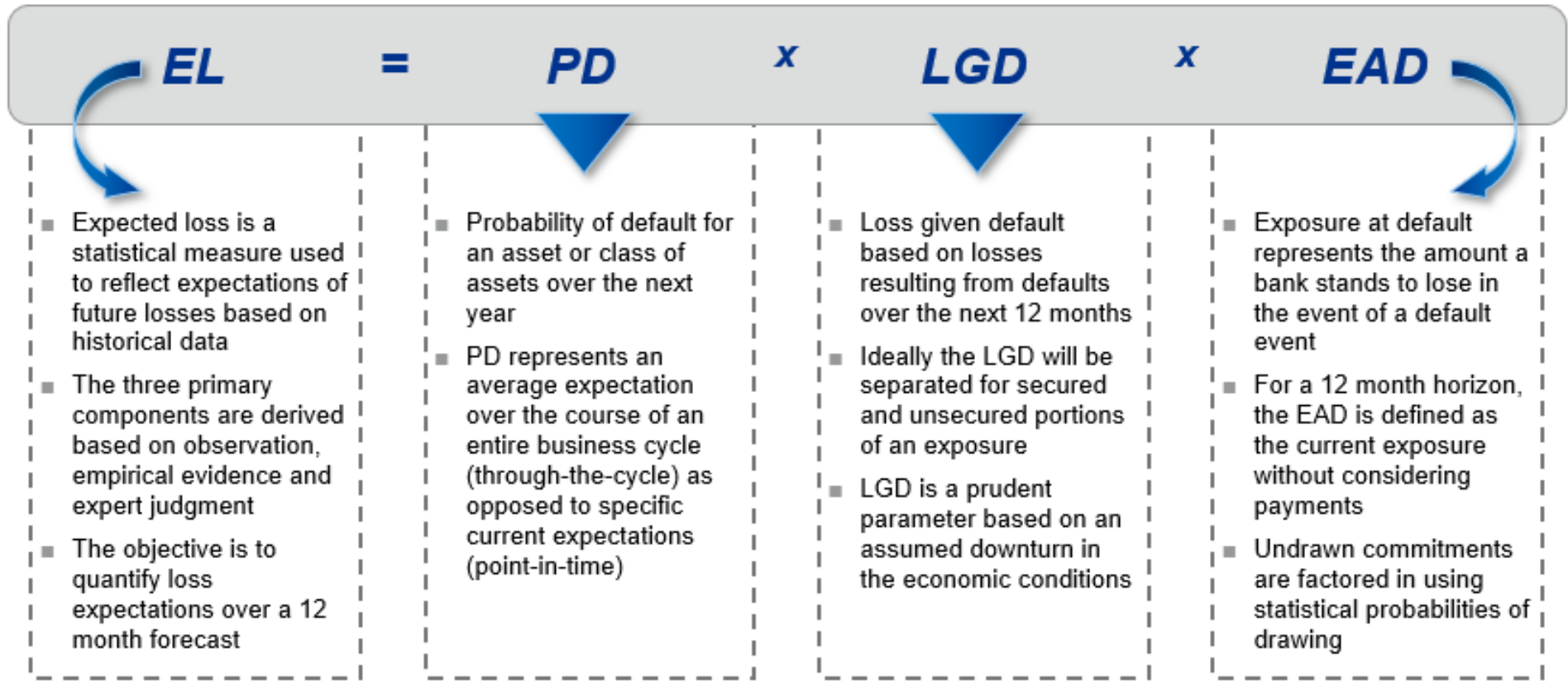


IFRS 9 - ECL model

Overview of the ECL model



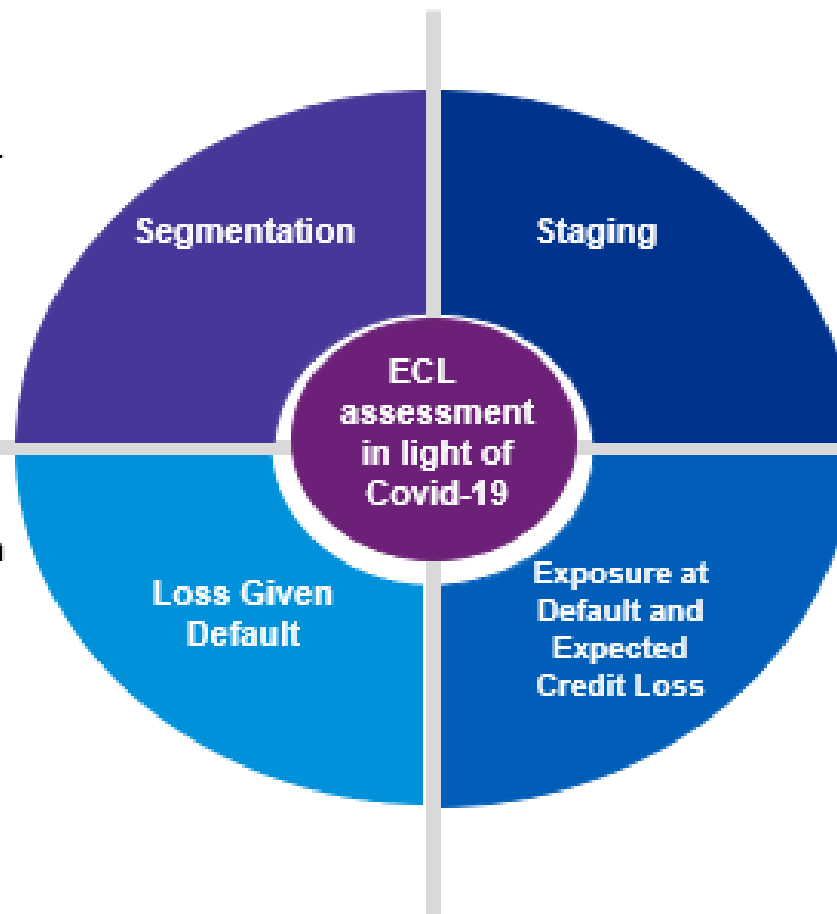
The Basel model used for ECL by banks



Changes to existing models are necessary to comply with lifetime expected credit loss (LECL) requirements

COVID-19 impact analysis on IFRS 9 ECL estimates

- Portfolio re – segmentation for collective SICR assessment.
- Individual SICR assessment depending on obligor – specific information.



- Assessment and incorporation of government relief/ stimulus in LGD assessment.
- Revision of recovery assumptions.
- Considerations on medium – term contractual revaluation.

- Staging considerations in light of contractual modifications, government relief/ stimulus programs, risk correlation and forward – looking qualitative impact analysis.

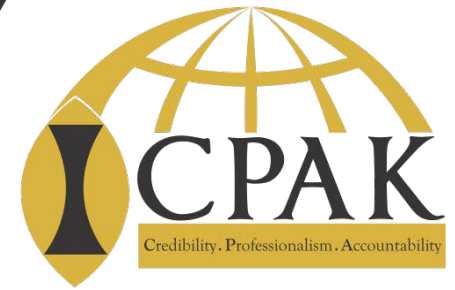
- Incorporation of contractual extensions (behavioural life) as well as expected increased draw – downs on credit limits.
- Extreme value modelling considerations conditioned on prevailing measures.

Macroeconomic and FLI analysis

- Revision of macroeconomic projections
- Greater emphasis on economic downturn scenario analysis.

- Revision of forward – looking LGD recovery assumptions to incorporate economic downturn.
- Incorporation of qualitative FLI adjustments in staging assessment.

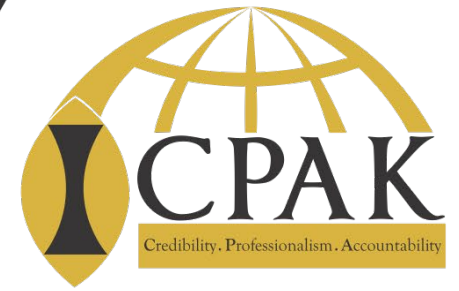
More than 30 days past due rebuttable presumption



- It may be possible for an entity to rebut the 30 days past due presumption where:
 - a borrower faces short-term liquidity constraints as a result of the COVID-19 pandemic; and
 - the lender has reasonable and supportable information that the borrower will receive assistance from the government or another third party that will resolve these constraints and there are no other indications of SICR in respect of the individual borrower.



EBA Guidelines: rebuttal “should be accompanied by a thorough analysis clearly demonstrating that 30 days past due is not correlated with a SICR. Such analysis should consider both current and reasonable and supportable forward-looking information that may cause future cash shortfalls to differ from historical experience.”



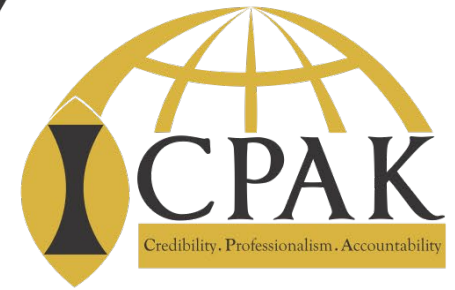
Updates to IFRS 16 *Leases*

COVID-19 Lease concessions



- Under IFRS 16 *Leases*, rent concessions often meet the definition of a lease modification. In a lease modification, the lessee may be required to recalculate lease liabilities using a revised discount rate and adjust right-of-use assets.
- The IASB issued amendments that introduced a practical expedient for lessees – i.e. a lessee is not required to assess whether eligible rent concessions that are a direct consequence of the COVID-19 pandemic are lease modifications.
- The rent concession in the form of a one-off reduction in rent, would be accounted for as a variable lease payment and be recognized in P&L without assessing whether the ROU asset needs to be adjusted.

Lease concessions



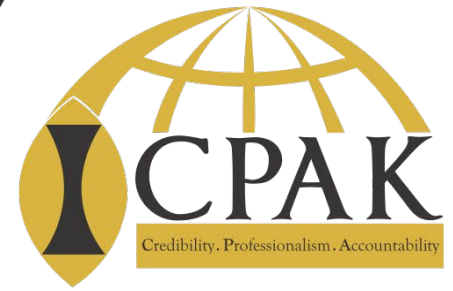
- Rent concessions are eligible for the practical expedient if they occur as a direct consequence of the COVID-19 pandemic and if all of the following criteria are met:
 - a) The change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
 - b) Any reduction in lease payments affects only payments originally due on or before 30 June 2021, extended to 30 June 2022; and
 - c) There is no **substantive change** to the other terms and conditions of the lease.

Concession related to rent forgiveness



- The right-of-use asset is not impaired unless no longer in use. Rent forgiveness is accounted for as follows:
 - DR: Lease liability**
 - CR: Income statement**
- Lessee continues to accrue interest on the lease liability at the unchanged incremental borrowing rate and hence record a debit to interest expense and a corresponding credit to the lease liability.
- Lessee effectively derecognizes the portion of the lease liability that has been extinguished by the forgiveness of rent and continues to depreciate the carrying amount of the right-of-use asset, which is unchanged as a result of the rent concession.

Deferral of lease payments



- Another common type of rent concession being negotiated during the COVID-19 pandemic is the deferral of lease payments. The concession granted may involve the reduction of lease payments in some periods with an increase in payments in other periods.
- When a rent concession involves deferred lease payments only, the lessee accounts for the change by recognising the impact in the period when no payment is made by continuing to reduce the lease liability.

Deferral of lease payments



- **Option 1** is to account for the rent deferral as if lessee is entitled to the deferral under the existing terms and conditions of the lease. Lessee remeasures the lease liability using the revised timing of the lease payments and an unchanged discount rate and recognizes the impact of the change in the present value of the lease liability in profit or loss on the date the rent concession is effective.
- **Option 2** is for lessee to account for the rent deferral by adjusting the timing of the future cash flows and, in effect, bifurcating the lease liability into two portions – one portion (based on the original payment schedule) that remains subject to interest and one that is not (the ‘interest-free’ deferral). This is necessary for the lease liability to amortize to zero by the end of the lease term. Under approach 2, there is no P&L impact.

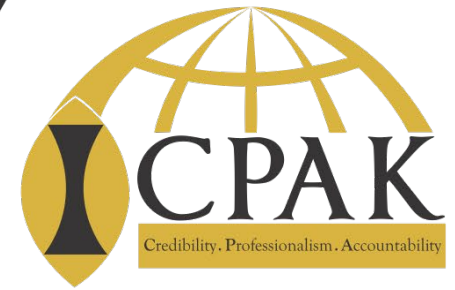
Disclosures – Covid-19 related



A lessee applying the practical expedient to disclose:

- That it has applied the practical expedient to all rent concessions that meet the conditions; or if some, information about the nature of the leases and/or concessions to which it has applied the practical expedient.
- Amounts recognised in profit or loss for the reporting period to reflect changes in lease payments arising from rent concessions.
- If the rent concession results in the adjustment of the carrying amount of the lease liability, then the lessee discloses this as a non-cash change in lease liabilities when disclosing changes in liabilities arising from financing activities under IAS 7.

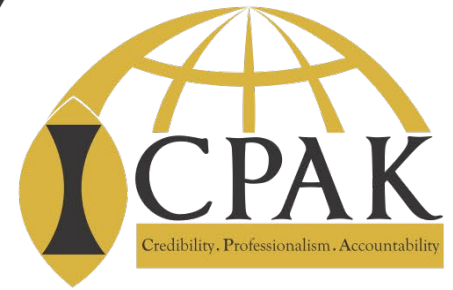
IAS 12 amendment



IAS 12 amendment - Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction

Effective for annual reporting periods beginning on or after **1 January 2023**, early application permitted

What's the issue under IAS 12?



- Diversity in practice when accounting for deferred tax (DT) on transactions that involve recognising both an asset and a liability with a single tax treatment related to both, e.g. **Leases**
- Diverse treatments include:

Apply the
initial
recognition
exemption
(IRE)

Recognize DT
on a net basis

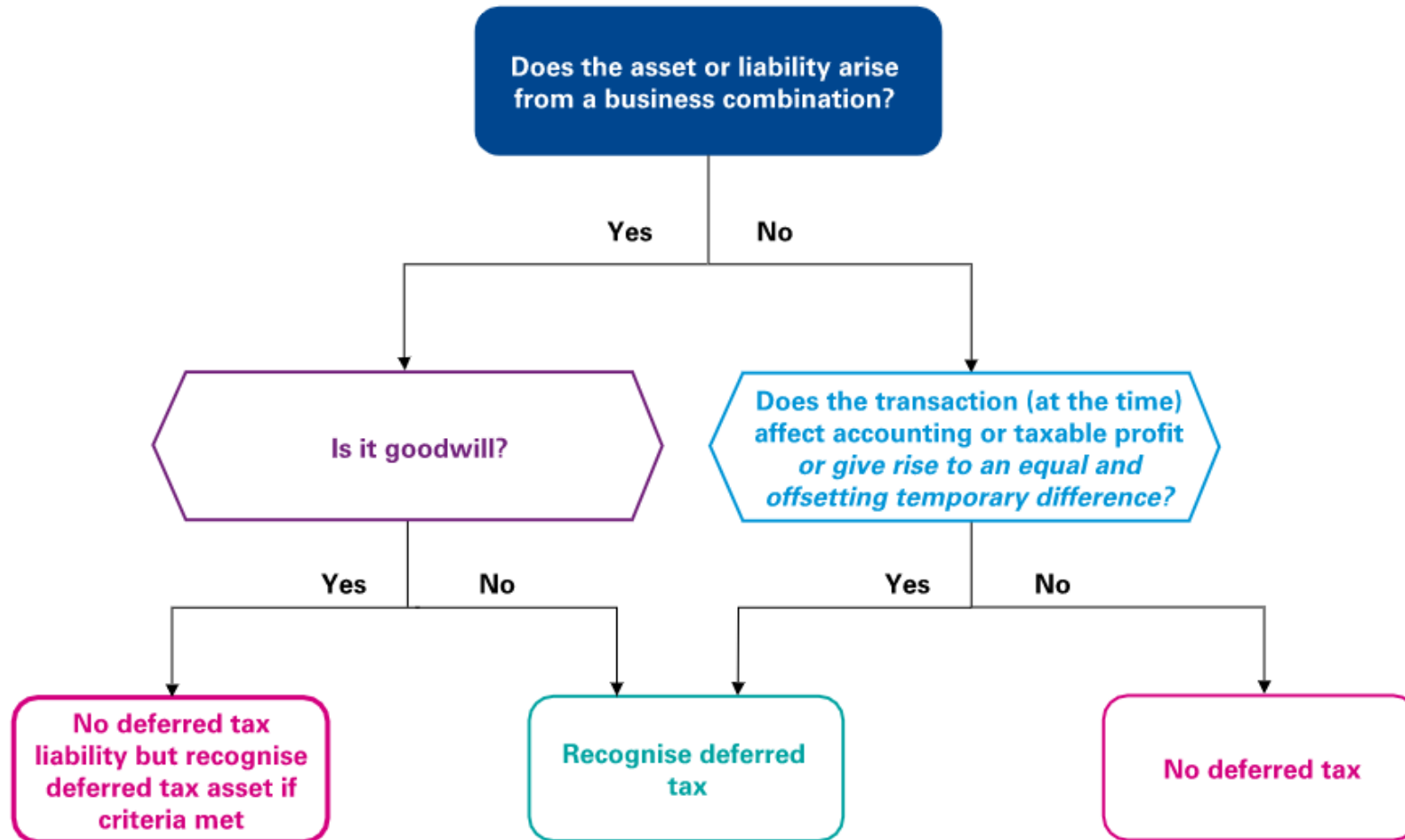
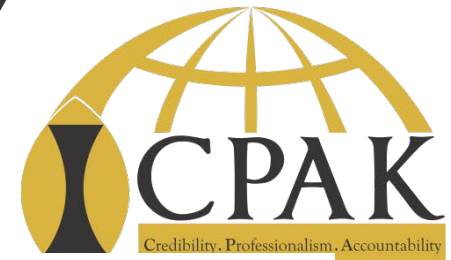
Choose not to
apply the IRE

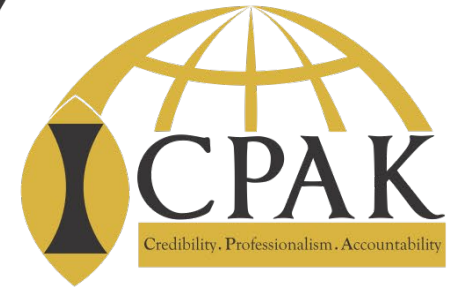
IAS 12 amendment



- The initial recognition exemption (IAS 12.15) has been narrowed.
- It does not apply to transactions in which equal amounts of deductible and taxable temporary differences arise on initial recognition.

IAS 12 amendment





New standards and interpretations not yet effective

For year ending 31 December 2021 onwards

New Standards and Interpretations



Onerous Contracts – Cost of Fulfilling a Contract (Amendments to IAS 37)

Effective 1 January 2022

- The amendment clarify the types of costs a company includes as the ‘costs of fulfilling a contract’ when assessing whether a contract is onerous.
- This will impact entities that currently apply ‘incremental cost’ approach.
- The amendments clarify that the ‘costs of fulfilling a contract’ comprise both:
 - a) the incremental costs – e.g. direct labour and materials; and
 - b) an allocation of other direct costs – e.g. an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract.

New Standards and Interpretations



Classification of liabilities as current or non-current (Amendments to IAS 1): effective 1 January 2023.

Under existing IAS 1 requirements, companies classify a liability as current when they do not have an *unconditional right* to defer settlement of the liability for at least twelve months after the end of the reporting period. As part of its amendments, the Board has removed the requirement for a right to be unconditional and instead, now requires that a right to defer settlement must have substance and exist at the end of the reporting period.

The Board has now clarified that a right to defer exists only if the company complies with conditions specified in the loan agreement at the end of the reporting period, even if the lender does not test compliance until a later date.

New Standards and Interpretations

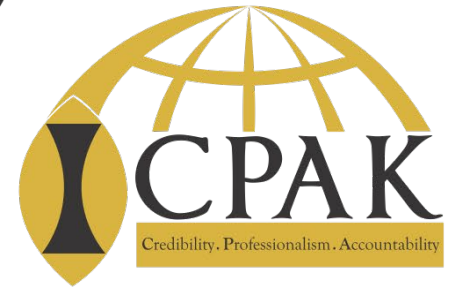


IFRS 17 Insurance Contracts

IFRS 17 Insurance Contracts sets out the requirements that an entity should apply in reporting information about insurance and reinsurance contracts. An entity shall apply IFRS 17 Insurance Contracts to:

- a) insurance contracts, including reinsurance contracts, it issues;
- b) reinsurance contracts it holds; and
- c) investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts

New Standards and Interpretations



IFRS 17 Insurance Contracts

IFRS 17 requires an entity that issues insurance contracts to report them on the statement of financial position as the total of:

- a) the fulfilment cash flows — the current estimates of amounts that the entity expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and
- b) the contractual service margin — the expected profit for providing insurance coverage. The expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided.

IFRS 17 requires an entity to recognise profits as it delivers insurance services, rather than when it receives premiums.

New Standards and Interpretations

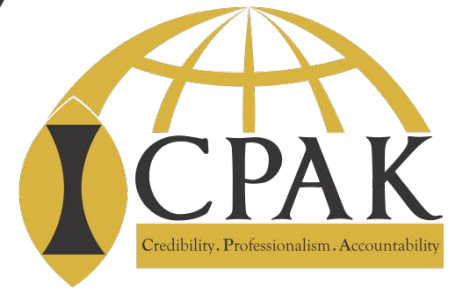


Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)

- Sale proceeds no longer deducted from the cost of PPE before its intended use.
- proceeds from selling items before the related item of PPE is available for use should be recognised in profit or loss, together with the costs of producing those items.
- IAS 2 *Inventories* should be applied in identifying and measuring production costs.
- Companies will therefore need to distinguish between costs associated with producing and selling items before the item of PPE is available for use; and costs associated with making the item of PPE available for its intended use.

Significant estimation and judgment involved.

New Standards and Interpretations



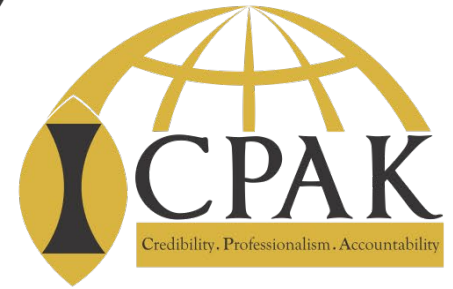
Annual Improvements to IFRS Standards 2018-2020. Effective 1 January 2022

IFRS 1 *First-time Adoption of IFRS*: simplifies the application of IFRS 1 for a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent. A subsidiary may elect to measure cumulative translation differences for all foreign operations at amounts included in the consolidated financial statements of the parent, based on the parent's date of transition to IFRS Standards.

IFRS 9 *Financial Instruments*: clarifies that – for the purpose of performing the “10 per cent test’ for derecognition of financial liabilities. In determining those fees paid net of fees received, a borrower includes only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf.

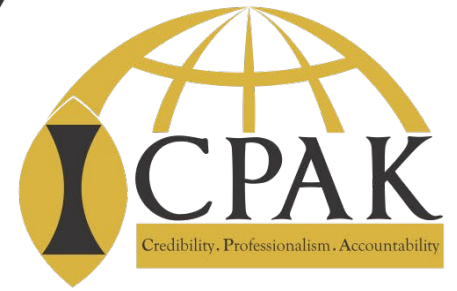
IAS 41 *Agriculture*: This amendment removes the requirement to exclude cash flows for taxation when measuring fair value. Brings alignment with IFRS 13.

Potential new standards and amendments



- **Better communication in financial reporting** - Better communication in financial reporting (BCFR) currently comprises three International Accounting Standards Board (the Board) projects:
 - ✓ primary financial statements.
 - ✓ the Disclosure initiative: principles-based disclosures. Pilot approach (IFRS 13 and IAS 19)
 - ✓ Management commentary: Investor-focused.
- **Regulatory assets and regulatory liabilities** - new accounting model under which a company subject to rate regulation that meets the scope criteria would recognize regulatory assets and liabilities.
- **Sustainability reporting** - A single sustainability reporting framework addressing environmental, social and governance (ESG) issues, including climate change regulation.

Other key IFRSs under the current environment



1. **IAS 36:** *Impairment of assets*
2. **IAS 37:** *Provisions, Contingent liabilities and contingent assets*
3. **IAS 40:** *Investment Properties*

