IFRS accounting for *Financial Instrument asset impairments*

Date: June 2023

Addis Ababa

Accounting and Audit Board of Ethiopia

የኢትዮጵያ የሂሳብ አያያዝ እና ኦዲት ቦርድ

Established under proclamation no 847/2006

The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

Disclaimer

Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are the IFRS Standards as issued by the IASB that are applicable on or after 1 January 2023

Aims

Deepen your understanding of IFRS 9 impairment

- Scoping
- Deterioration model
- Simplified model

Impairment of financial instruments

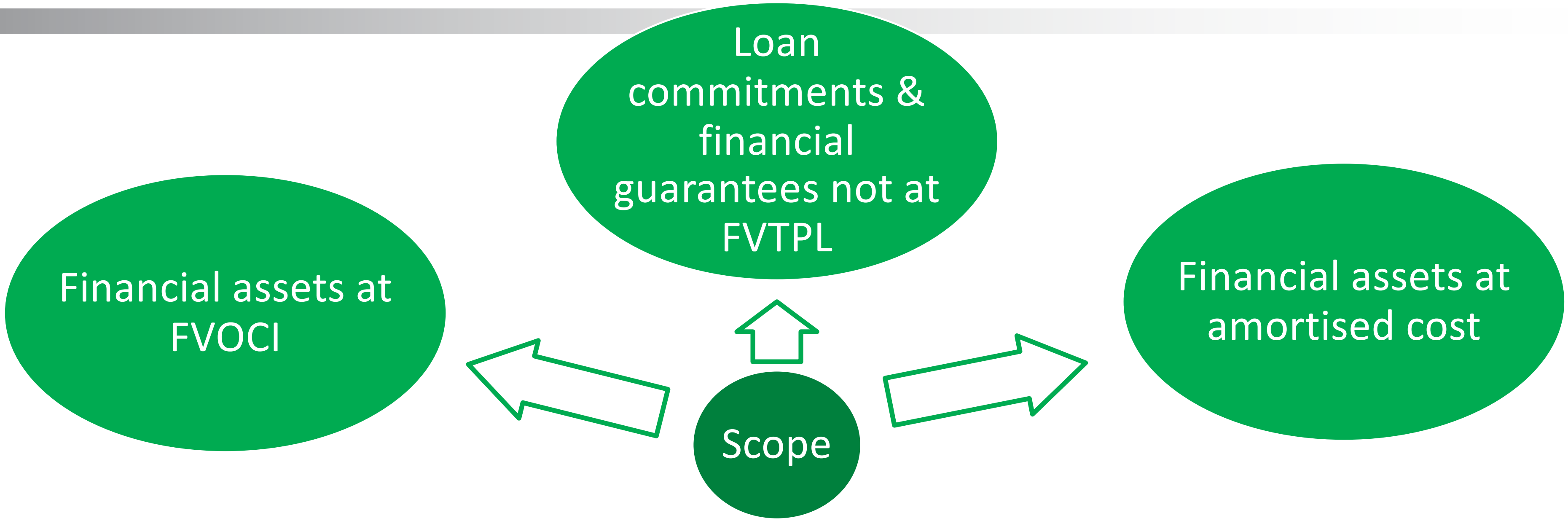
Objective

» Credit margin on financial instruments should reflect initial credit loss expectations

» When expected credit losses increase, an economic loss is suffered because credit margin is insufficient

» IFRS 9 reflects this by measuring impairment considering changes from inception

Scope



Supplier loans Staff loans Bank balances	Trade receivables Lease assets

Deterioration model

Overview of the model

Credit quality deterioration since initial recognition

Impairment recognition

12 month expected loss	12 month PD x LGD

Interest revenue

Gross basis	Balance x EIR

Stage 1
Performing

Overview of the model

Credit quality deterioration since initial recognition →

Impairment recognition	12 month EL 12m PD x LGD	Lifetime expected loss	Lifetime expected PD x LGD
Interest revenue	Gross basis Balance x EIR	Gross basis	Balance x EIR
	Stage 1 *Performing*	Stage 2 Under-performing	

Overview of the model

Credit quality deterioration since initial recognition

	Stage 1	Stage 2	Stage 3
Impairment recognition	12 month EL 12m PD x LGD	Lifetime EL Lifetime PD x LGD	Lifetime EL Lifetime PD x LGD
Interest revenue	Gross basis Balance x EIR	Gross basis Balance x EIR	Net basis Discount on recovery
	Performing	Under-performing	Non-performing

Simplified impairment requirements

Mandatory in Scope

Trade receivables or contract assets from transactions that are in scope of IFRS 15

» that do not contain a significant financing component, **or**

» where the entity applied the IFRS 15 practical expedient not to adjust for significant financing , and

» entity expects at inception that the credit period will be one year or less

[A significant financial component exists] if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. (IFRS 15.60)

IFRS 9.5.5.15 and IFRS 15.60 and 63

Example
Loans to suppliers

- » SWC makes agricultural loans to suppliers
- » The loan bears interest at 10% per annum (market related)
- » The loan is repayable in full after harvest (less then one year)

Does the loan fall under the mandated simplified approach?

1. Yes, it is less then one year
2. No, IFRS 15 does not apply
3. Depends whether optional expedient is applied
4. SWC can choose

Example
Loans to suppliers

» SWC makes agricultural loans to suppliers

» The loan bears interest at 10% per annum (market related)

» The loan is repayable in full after harvest (less then one year)

Does the loan fall under the mandated simplified approach?

1. Yes, it is less then one year
2. No, IFRS 15 does not apply
3. Depends whether optional expedient is applied
4. SWC can choose

Example
Sales on credit to suppliers

» SWC sells coffee beans to local coffee shops

» It provides interest free credit up to 120 days

» SWC elects to apply the practical expedient not to adjust for significant financing

Does the credit fall under the mandated simplified approach?

1. Yes, it is less then one year
2. No, IFRS 15 does not apply
3. SWC must apply the simplified approach
4. SWC can choose

Example
Sales on credit to suppliers

» SWC sells coffee beans to local coffee shops

» It provides interest free credit up to 120 days

» SWC elects to apply the practical expedient not to adjust for significant financing

Does the credit fall under the mandated simplified approach?

1. Yes, it is less then one year
2. No, IFRS 15 does not apply
3. SWC must apply the simplified approach
4. SWC can choose

Optional in Scope

Accounting policy choice:

» Trade receivables or contract assets from transactions that are in scope of IFRS 15, and contain a significant financing component

» Lease receivables from transactions that are in scope of IFRS 16

» Accounting policy choice can be separately applied for each type of asset (but applies to all assets of a particular type)

IFRS 9.5.5.15

Example
Loans to suppliers

» SWC makes agricultural loans to suppliers

» The loan bears interest at 10% per annum (market related)

» The loan is repayable in full after harvest (less then one year)

<u>Is the loan eligible for the simplified approach?</u>

1. Yes, it is less then one year
2. No, Neither IFRS 15 nor IFRS 16 apply
3. Depends whether optional expedient is applied
4. SWC can choose

Example
Loans to suppliers

» SWC makes agricultural loans to suppliers

» The loan bears interest at 10% per annum (market related)

» The loan is repayable in full after harvest (less then one year)

Is the loan eligible for the simplified approach?

1. Yes, it is less then one year
2. No, Neither IFRS 15 nor IFRS 16 apply
3. Depends whether optional expedient is applied
4. SWC can choose

Example
Sales on credit to suppliers

» SWC sells manufacturing equipment to farmers

» It provides a 5 year instalment loans for the equipment

Is the loan eligible for the simplified approach?

1. Yes, it is less then one year
2. No, IFRS 15 does not apply
3. SWC must apply the simplified approach
4. SWC can choose to apply the simplified approach

Example
Sales on credit to suppliers

» SWC sells manufacturing equipment to farmers

» It provides a 5 year instalment loans for the equipment

Is the loan eligible for the simplified approach?

1. Yes, it is less then one year
2. No, IFRS 15 does not apply
3. SWC must apply the simplified approach
4. SWC can choose to apply the simplified approach

Measurement

» Requires or allows entities to always measure the loss allowance as lifetime expected losses

» An example of an allowed method is a provision matrix:

  » Use historical credit loss experience (**adjusted** as appropriate for current events)

  » specify fixed provision rates depending on the number of past due

  » depending on diversity of loss patterns for different customer segments an entity would **use appropriate groupings**

IFRS 9.5.5.15 and IFRS 9.B5.5.35

Example of ‘approach’ that may be followed

» Step 1 Determine groups of receivables with similar historical loss patterns

» Step 2 Determine average historical loss rates

» Step 3 Consider whether adjustment is necessary for macro-economic factors

» Step 4 Calculate the expected credit losses

Example
Provision matrix

» SWC sells agricultural equipment on credit

» At yearend, it has trade receivables of Br30 million

» SWC reviews its most recent history of equipment loans

For loans that are:	Current	Days past due			
		1-30	31-60	61-90	> 90
2021 Defaults	0.35%	1.7%	3.8%	6.9%	10.9%
2022 Defaults	0.3%	1.6%	3.6%	6.6%	10.6%
2023 Defaults	0.25%	1.5%	3.4%	6.3%	10.3%
Average defaults	**0.3%**	**1.6%**	**3.6%**	**6.6%**	**10.6%**

IFRS 9 Illustrative example 12

Example
Provision matrix

For loans that are:	Current	Days past due			
		1-30	31-60	61-90	> 90
2021 Defaults	0.35%	1.7%	3.8%	6.9%	10.9%
2022 Defaults	0.3%	1.6%	3.6%	6.6%	10.6%
2023 Defaults	0.25%	1.5%	3.4%	6.3%	10.3%
Average defaults	**0.3%**	**1.6%**	**3.6%**	**6.6%**	**10.6%**

Can SWC use the average historic default as expected default?

1) Yes, because it is based on real history, 2) No, because circumstances always change, 3) Maybe

IFRS 9 Illustrative example 12

Example
Provision matrix

For loans that are:	Current	Days past due			
		1-30	31-60	61-90	> 90
2021 Defaults	0.35%	1.7%	3.8%	6.9%	10.9%
2022 Defaults	0.3%	1.6%	3.6%	6.6%	10.6%
2023 Defaults	0.25%	1.5%	3.4%	6.3%	10.3%
Average defaults	**0.3%**	**1.6%**	**3.6%**	**6.6%**	**10.6%**

Can SWC use the average historical default as expected default?

1) Yes, because it is based on real history, 2) No, because circumstances always change, 3) Maybe

IFRS 9 Illustrative example 12

Example
Provision matrix

» It reviews existing trade receivables for past due status:

	Current	Days past due			
		1-30	31-60	61-90	> 90
Gross carrying amount	15 000 000	7 500 000	4 000 000	2 500 000	1 000 000

» It concludes that this is consistent with historical patterns, and that the market is behaving in line with norms

» Consequently SWC **concludes it can use the average default rates**

IFRS 9 Illustrative example 12

Example
Provision matrix

» It therefore applies the provision matrix.

	Current	Days past due			
		1-30	31-60	61-90	> 90
Gross carrying amount	15 000 000	7 500 000	4 000 000	2 500 000	1 000 000
Default rate	0.3%	1.6%	3.6%	6.6%	10.6%
Lifetime ECL allowance	45 000	120 000	144 000	165 000	106 000
Total allowance					Br580 000

IFRS 9 Illustrative example 12

Questions