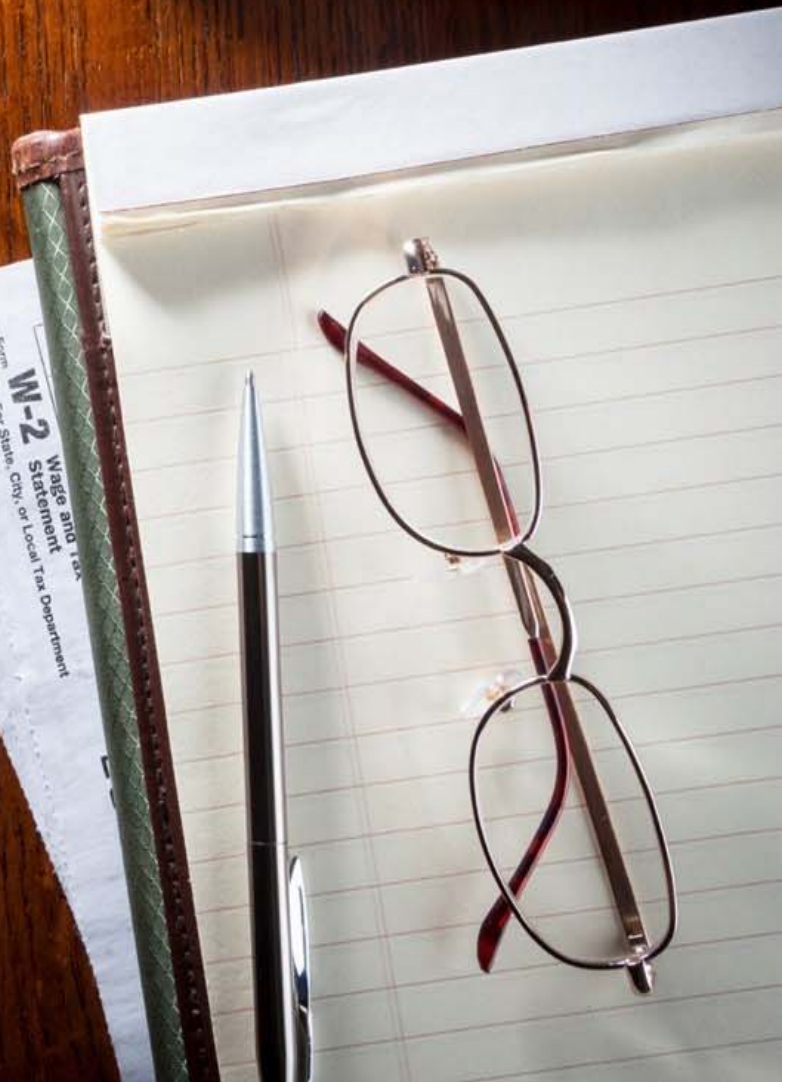
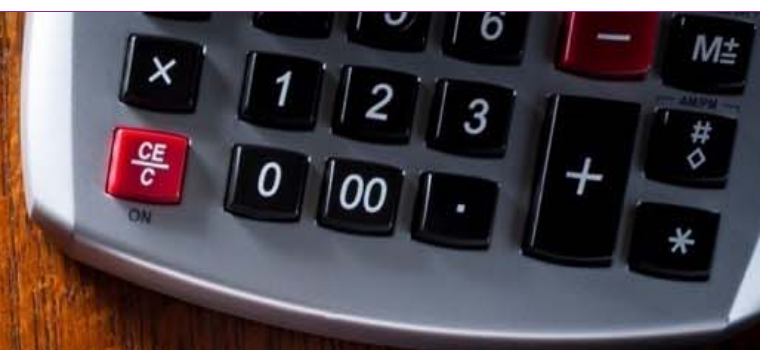




IFRS 9 Financial Instruments

26 October 2018



Agenda

- Overview of requirements of IFRS 9
- Incorporation of forward looking information
- Considerations for modelling
- Changes in accounting policies and disclosures
- Are you ready? - Way forward



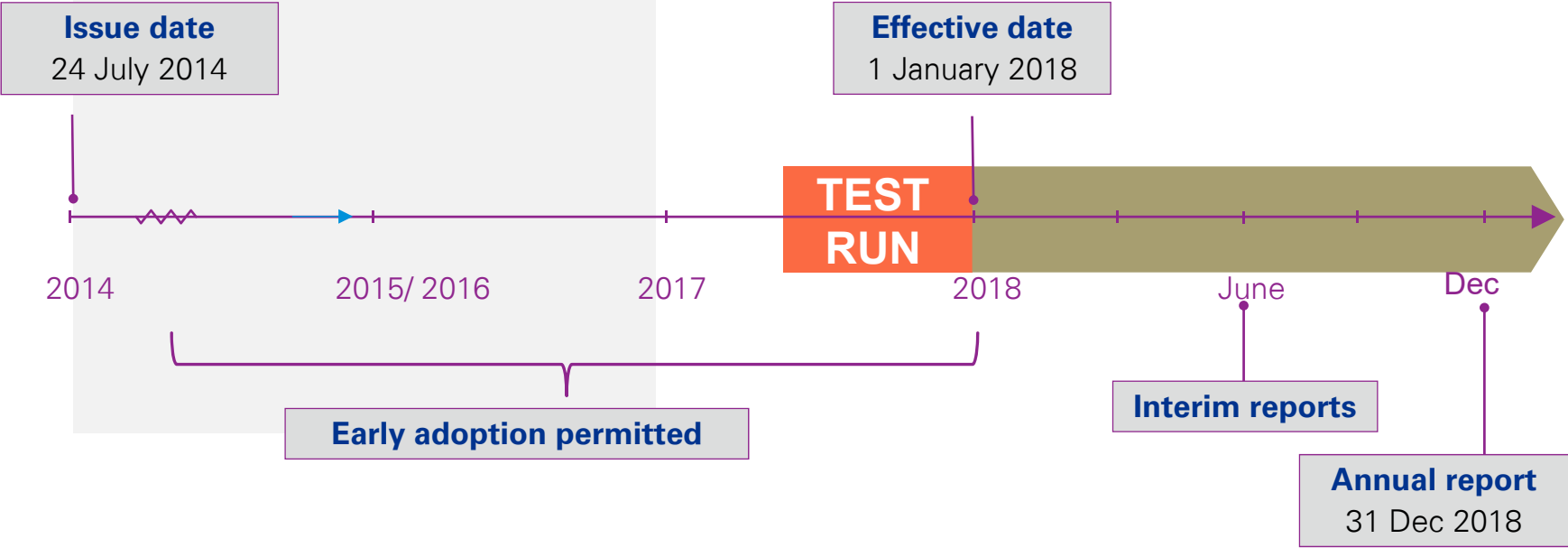


Overview of IFRS 9

Effective date

Impact assessment & Considerations:
Operating model
Expected loss model
Data/systems and controls
Disclosures and reporting

No requirement to restate. Restate only if no hindsight



Overview - Classification & Measurement

IFRS 9 introduces a two-step approach to determine the classification of financial assets:

1. Business model assessment and
2. Solely payments of principal and interest ('SPPI') assessment

Business model



- Considers how financial assets are managed to generate cash flows
- Assessed at portfolio level (not instrument level)
- Sub-division of portfolios may be appropriate

Examples of key challenges:

- Assessment of impact of sales activity
- Data needed for analysis of historical sales
- Prospective view
- Securitisation activities



SPPI

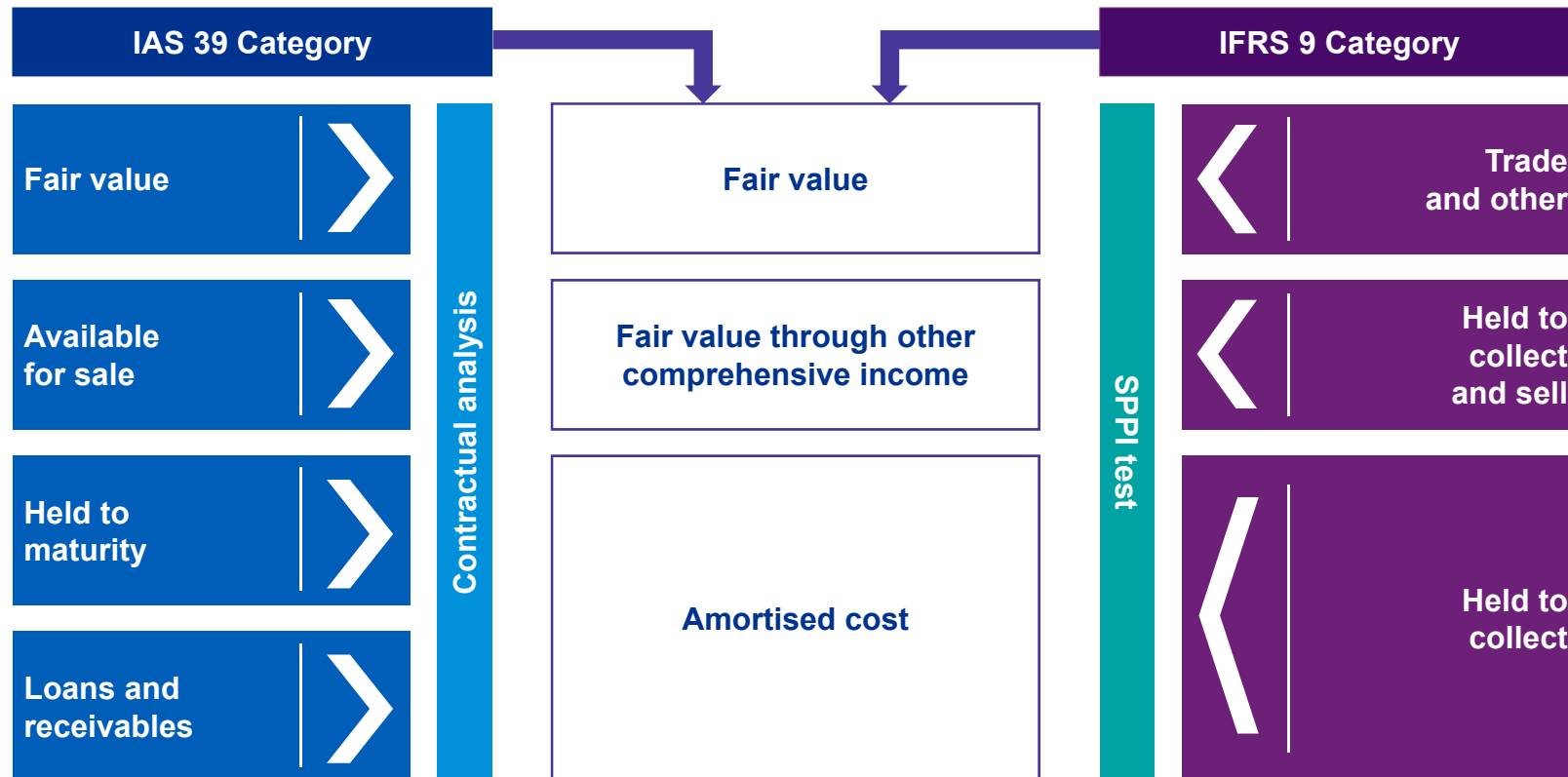


- Considers whether contractual cash flows are consistent with a basic lending arrangement
- Principal = initial fair value of financial asset
- Interest = consideration for time value of money and credit risk

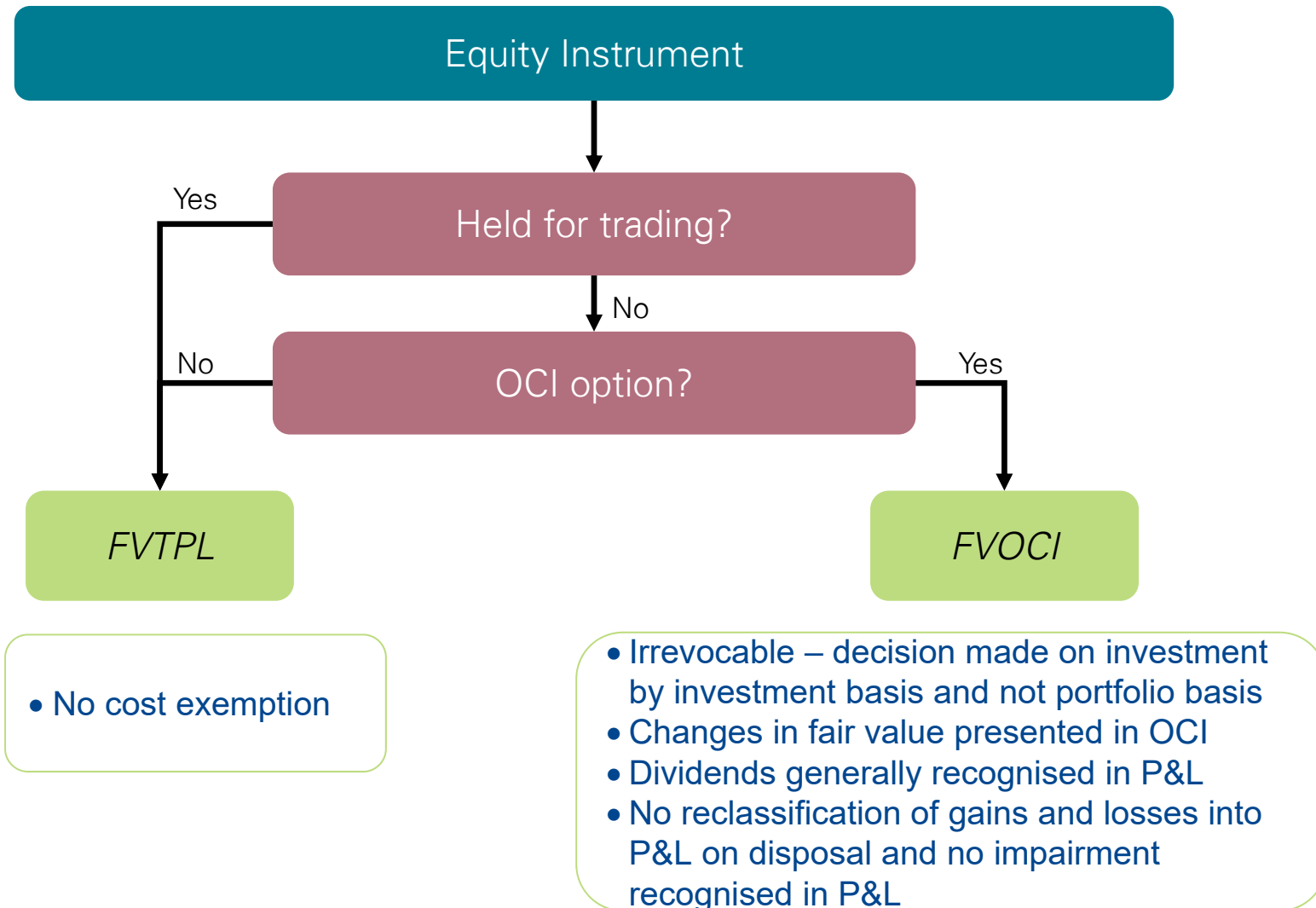
Judgemental aspects:

- Prepayment/extension options
- Receivables with significant financing component
- Leverage
- Contractually linked instruments

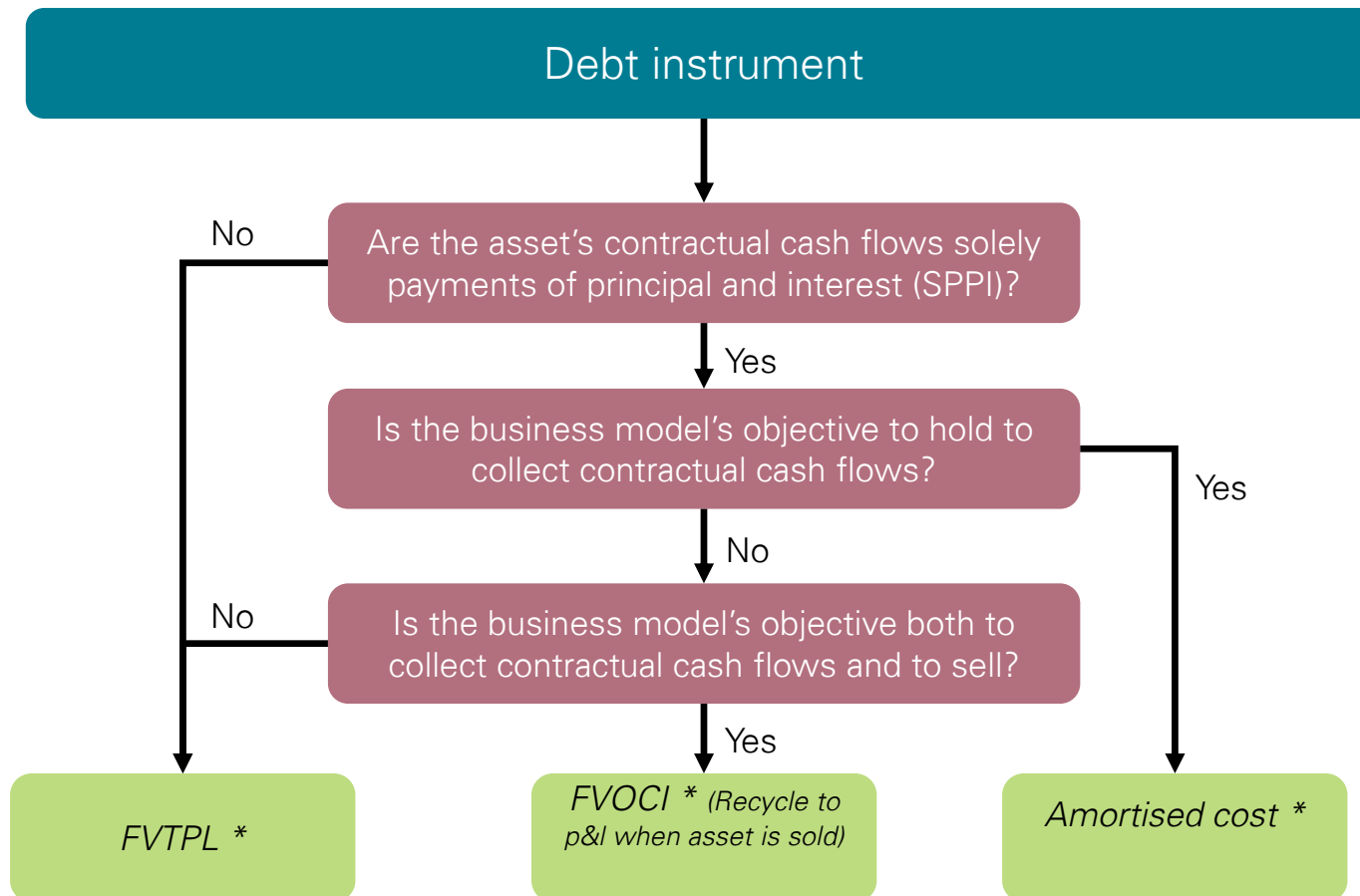
C&M: IAS 39 versus IFRS 9



Financial asset – Equity & Derivatives

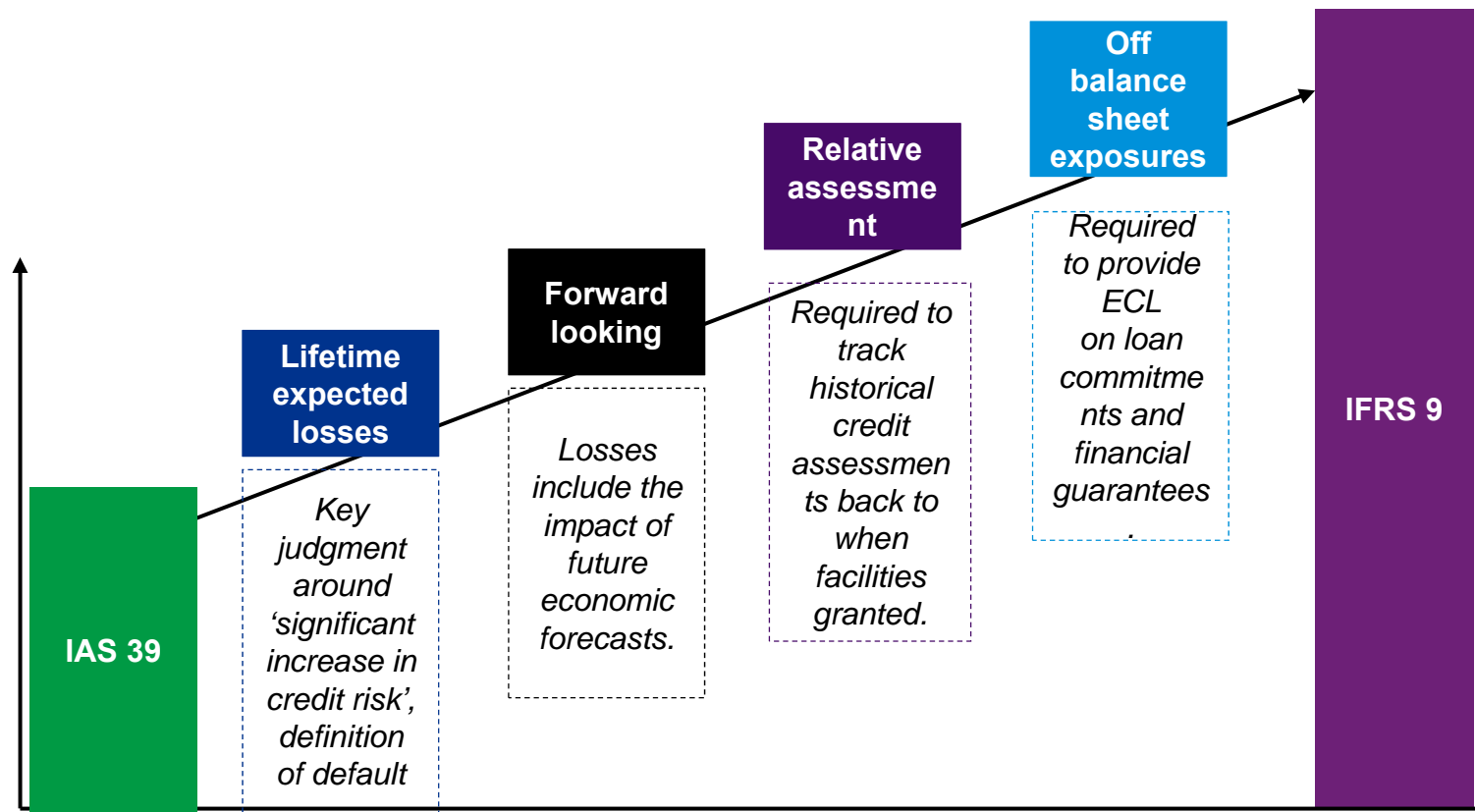


Financial asset classification - Debt instruments

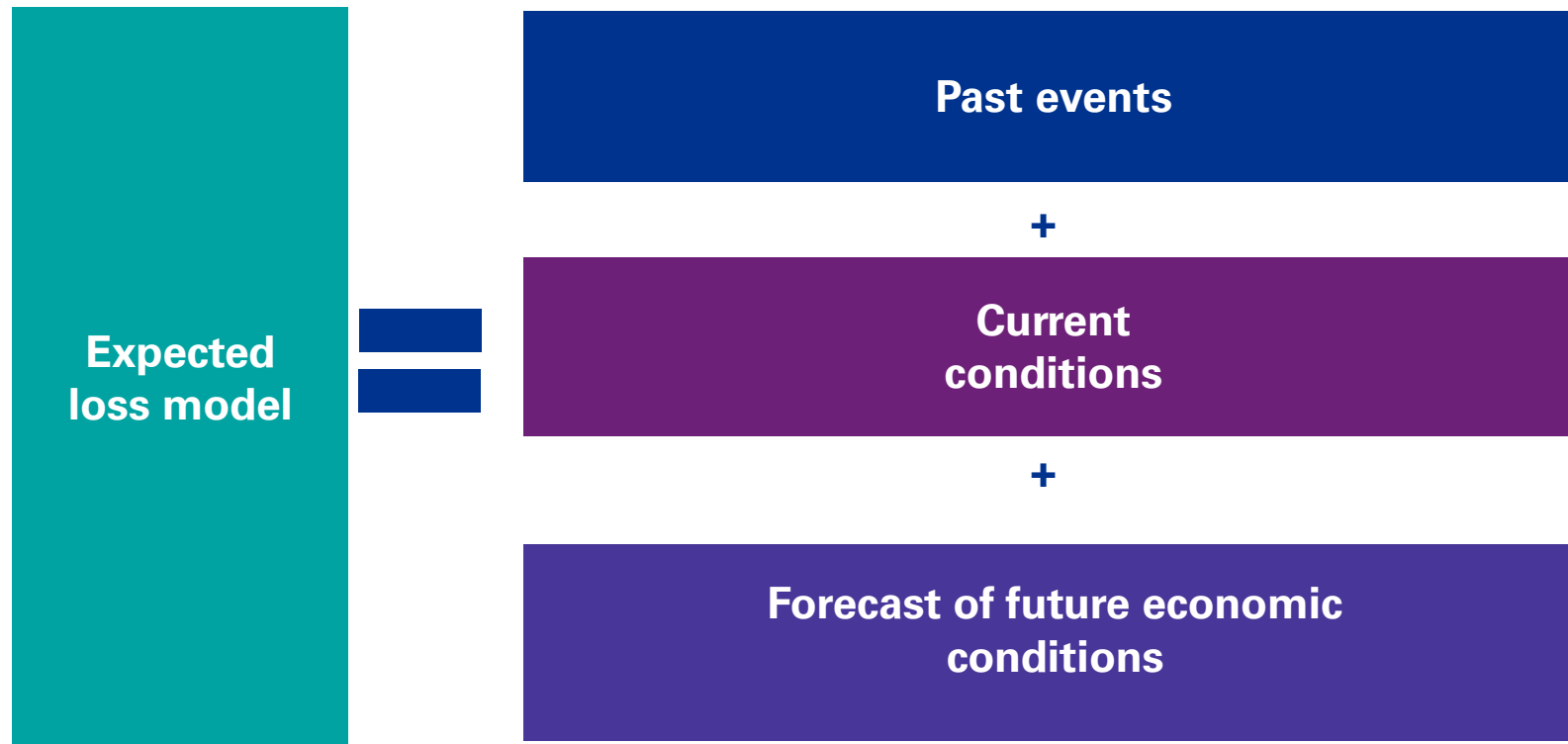


* FVTPL is available to eliminate or significantly reduce accounting mismatch

Overview - IFRS 9 Expected Credit Loss



Impairment - the new model

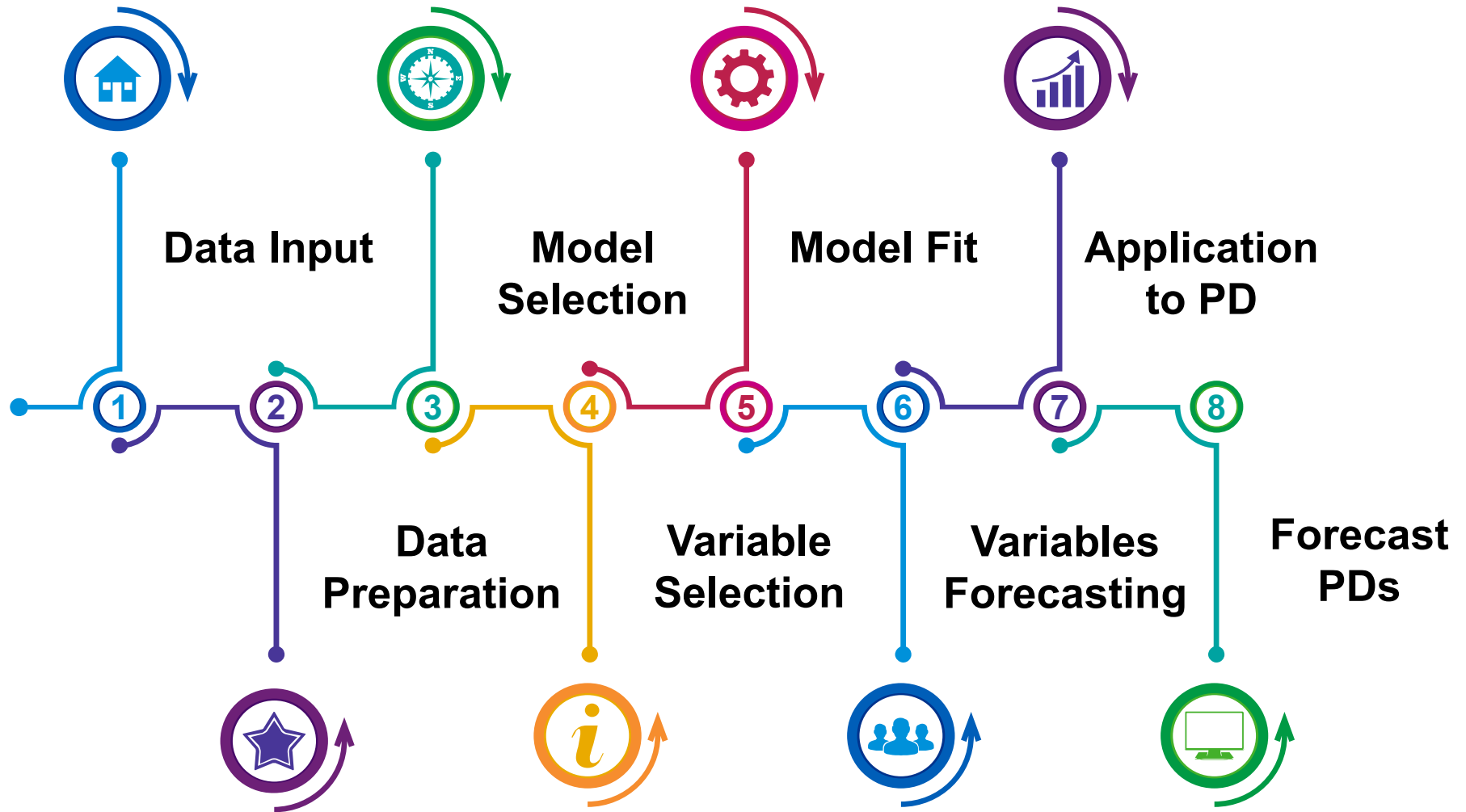


Reasonable & supportable information that is available without undue cost or effort



Forward looking information

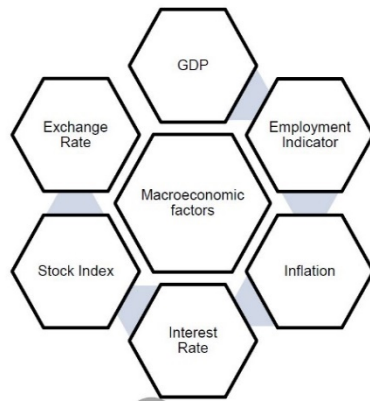
Incorporating forward looking information



Incorporating forward looking information

1

Identify the relevant macro-economic factors and obtain the historical figures



2

Assess the how the modelled historical loss rates have changed relative to the change in each of the relevant macroeconomic factors

| Year | Loss rates | Δ GDP | Δ FX rate | Δ Interest rate |
|------|------------|--------------|------------------|------------------------|
| 1 | 0.31% | 1.70% | 2.04% | 2.94% |
| 2 | 0.18% | 1.40% | 1.68% | 2.42% |
| 3 | 0.55% | 3.70% | 4.44% | 6.39% |
| 4 | 0.08% | 0.50% | 0.60% | 0.86% |
| 5 | 0.47% | 1.10% | 1.32% | 1.90% |

4

Maintain only variables with significant coefficients and expected sign expected under the working hypotheses

3

Estimate an empirical, statistical relationship between the portfolio loss rates and macroeconomic variables.

Forward looking information

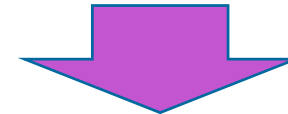
5

Forecast the statistically significant macroeconomic factors over a 12 month period from the reporting date.



6

Using the empirical equation, compute the applicable forward – looking adjustment based on the forecasted macroeconomic factors



7

Apply the computed adjustments to the baseline PD / loss rate to obtain the forecasted loss rate.

Impairment Modelling

IFRS 9 provisioning for receivables

IFRS 9 includes the following simplifications for impairment of trade receivables, contract assets and lease receivables:

| Situation | Proposed Approach |
|---|---|
| Trade receivables and contract assets of one year or less or those without a significant financing component. | Recognize a loss allowance at an amount equal to lifetime expected credit losses. |
| Trade receivables and contract assets without a significant financing component. | Simplified approach of recognizing lifetime expected loss. |
| Lease receivables | Accounting policy choice to measure the loss allowance at an amount equal to lifetime expected credit loss. |

NB: Entities are not required to determine whether credit risk has increased significantly since initial recognition.

IFRS 9 provisioning for receivables

IFRS 9 standard does not prescribe how an entity should estimate lifetime expected credit losses (ECL) for receivables but proposes a provision matrix approach.

Provision Matrix

- Ageing of receivables
- Segmentation (optional)
- Development of a provision matrix
- Incorporation of forward looking information.

Single loss rate approach

- Determine an average historical loss rate as a proportion of uncollected amounts to the total balance of trade receivables
- Incorporation of forward looking information.

Provision matrix/flow rate matrix approach

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) | Q1 | Q2 | Q3 | Q4 |
|-------------------------------|--------|--------|--------|--------|
| 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 | Q2 | Q3 | Q4 |
|--------------|------|------|------|
| 0 - 30 days | 49% | 44% | 43% |
| 31 - 60 days | 42% | 40% | 47% |
| 61 - 90 day | 26% | 35% | 36% |
| 91+ days | 100% | 100% | 100% |

Provision matrix/flow rate matrix approach

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 that the 91+ days balance is equal to the actual historical loss.

| Flow rate | Q2 | Q3 | Q4 |
|--------------|------|------|------|
| 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 | Q2 | Q3 | Q4 | 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% |

Expected credit loss 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 | FLI Adjustment | Adjusted PD | Exposure as on 31 Dec 2017 | ECL |
|-------------------|--------------|---------------|----------------|-------------|----------------------------|---------|
| Trade receivables | 0 - 30 days | 6% | -1.05% | 5.94% | 2,000,000 | 118,800 |
| | 31 - 60 days | 14% | -1.05% | 13.85% | 1,000,000 | 138,500 |
| | 61 - 90 day | 32% | -1.05% | 31.67% | 300,000 | 95,010 |
| | 91+ days | 100% | | 100.00% | 900,000 | 900,000 |

The expected credit loss model above assumes a write-off threshold of 90 days.

Single loss rate approach

Step 1: Define an appropriate default trigger

For the simplified approach, it is critical to have a default definition that is in line with internal business practices.

Step 2: Calculate loss rate/ recovery rate per period

Depending on the data, there are two ways of computing the loss rate per period. A loss rate may be computed as the ratio of outstanding invoice amounts beyond the default period and raised invoices at the beginning of each period.

In the case where payments are available, the recovery rate may be computed as a ratio of payments made on bills raised per time period **before** the default date. The loss rate is then obtained as **1 – Recovery rate**. A common approximation is to cap recovery rates at 100% where payments exceed invoice amounts.

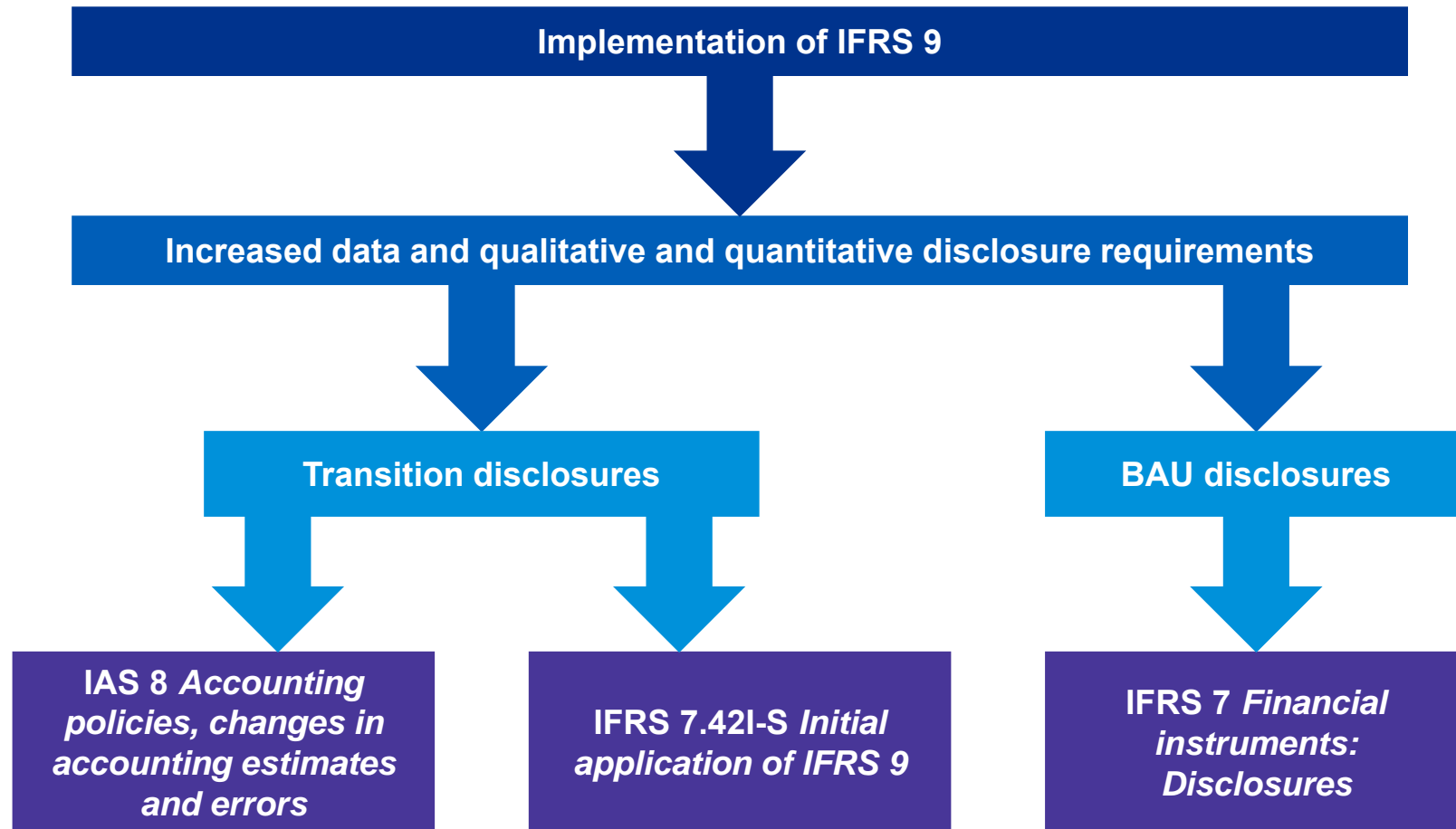
| Origination month | Bills | Payments |
|-------------------|--------------|--------------|
| 201201 | 1,000,000.00 | |
| 201202 | 2,000,000.00 | 900,000.00 |
| 201203 | 1,500,000.00 | 1,400,000.00 |
| 201204 | 1,800,000.00 | 1,100,000.00 |
| 201205 | 1,200,000.00 | 1,750,000.00 |
| 201206 | 1,900,000.00 | 1,000,000.00 |

| Recovery rate | Loss rate |
|---------------|-----------|
| 90.00% | 10.00% |
| 70.00% | 30.00% |
| 73.33% | 26.67% |
| 97.22% | 2.78% |

The single loss rate is computed as a simple average of all loss rates per period.

Changes in accounting policies and disclosures

Disclosures



Transition disclosures

| Type | Examples |
|---------------------------------|---|
| Quantitative disclosures | <ul style="list-style-type: none"> — For each class of financial assets and liabilities: <ul style="list-style-type: none"> - Original measurement category and carrying amount as per IAS 39 - New measurement category and carrying amount as per IFRS 9 - Amount in the SOFP that were previously designated as measured at FVTPL but were no longer so designated — Amount of the adjustment for each financial statement line affected, and for basic and diluted EPS for current period and each prior period presented — Amount a change in accounting estimate has an effect in the current period or is expected to have an effect in future periods — Reconciliation of the ending impairment allowances under IAS 39 and the provisions under IAS 37 to the opening loss allowances under IFRS 9 |
| Qualitative disclosures | <ul style="list-style-type: none"> — The title of the IFRS — Nature of the change in accounting policy — Description of the transitional provisions — How it applied the classification requirements in IFRS 9 to those financial assets whose classification has changed as a result of applying IFRS 9 — The reasons for any designation or de-designation of financial assets or financial liabilities measured at FVTPL |



Questions





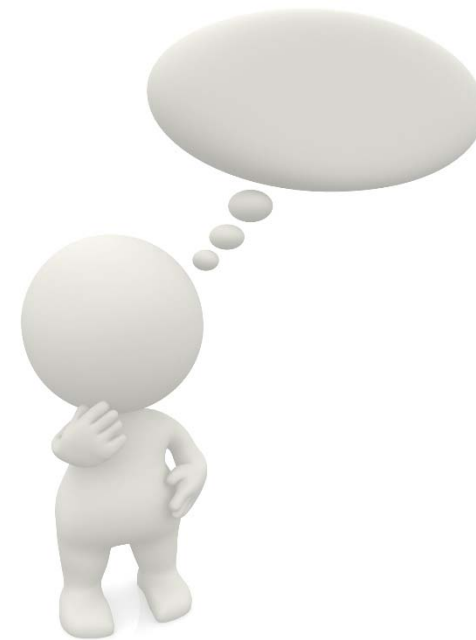
IFRS 16 Leases

26 October 2018



Why is this important?

- **Most companies lease assets.**
- **Under IFRS 16, lessees will bring all leases on balance sheet.**
- **New lease definition becomes the new on/off-balance sheet test.**
- **Changes many financial ratios.**
- **Your stakeholders/investors will want to understand the impact on your business.**



Agenda

1. Major impacts for lessees
2. New definition, new accounting
3. Next steps
4. Key points to remember



Major impacts for lessees

Lessees face major changes

Leases on balance sheet

Balance sheet

Asset

= 'Right-of-use' of underlying asset

Liability

= Obligation to make lease payments

P&L

Lease expense

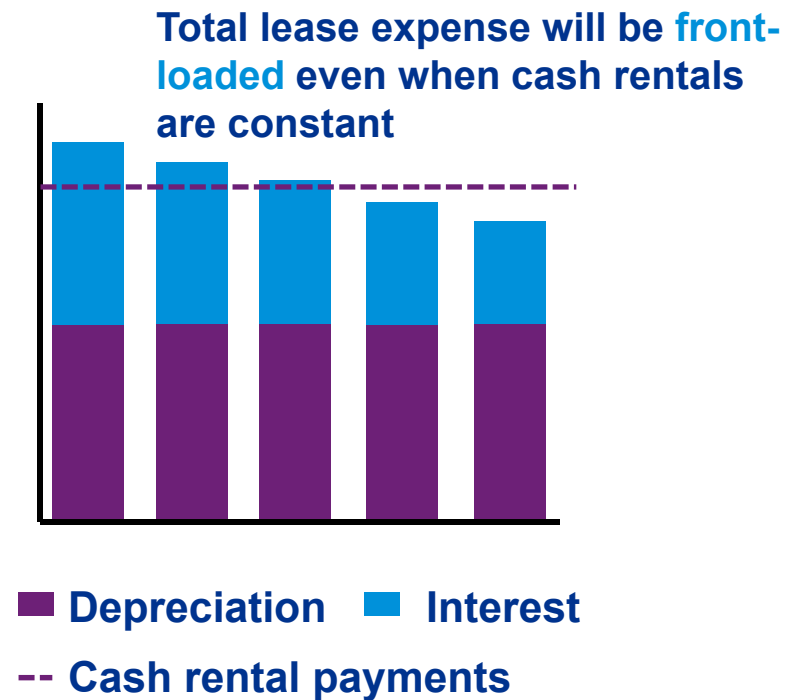
Depreciation

+ Interest

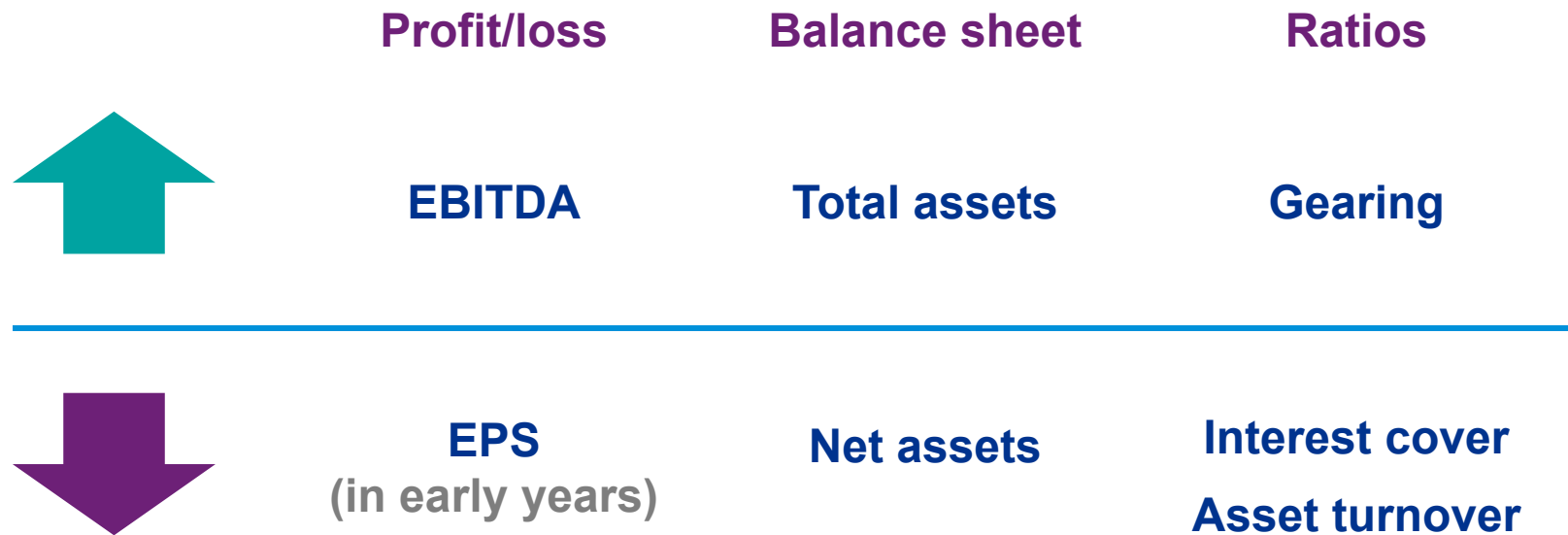
= Front-loaded total lease expense

Operating leases previously off-balance sheet will now be on balance sheet

Impact on Balance sheet and profit or loss



Impact on financial ratios





New definition,
new accounting

Lease definition

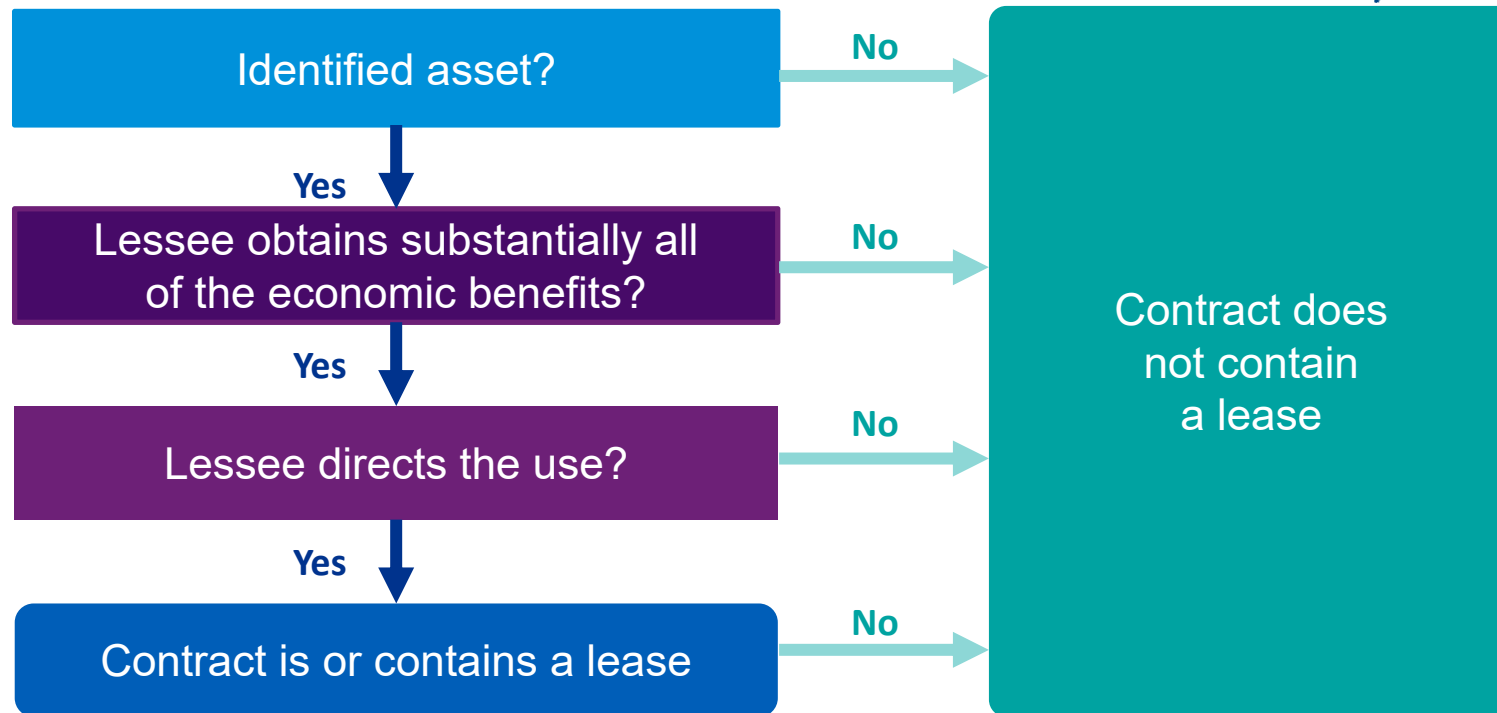
The new on/off-balance sheet test for lessees – a key judgement area



Lease definition - overview

A lease is a contract that conveys the right to use an asset for a period of time in exchange for consideration.

Assessed
at
inception



Definition focuses on control over the use of an identified asset

Lease definition - Exemptions

Two major optional exemptions make the standard easier to apply



Short term leases

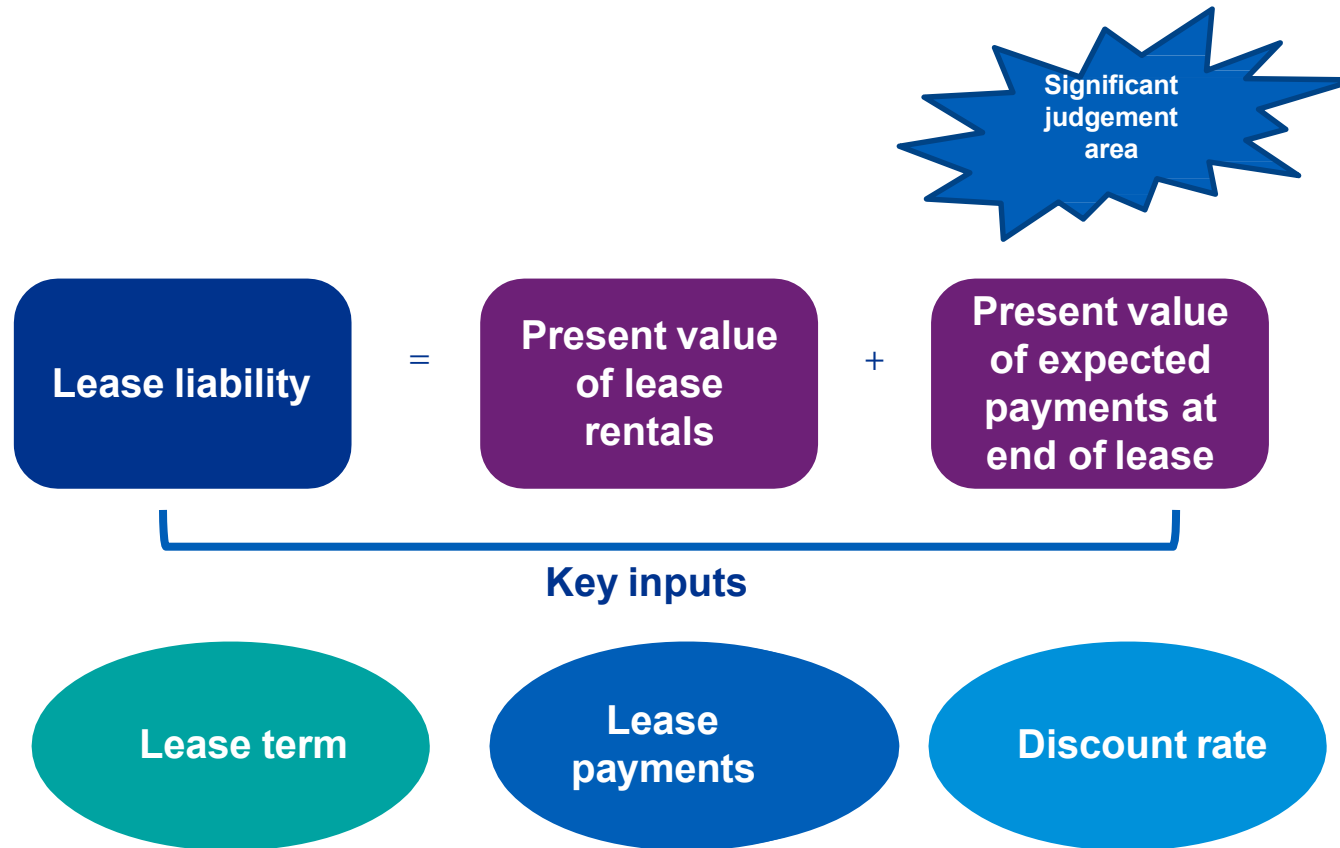
≤ 12 months



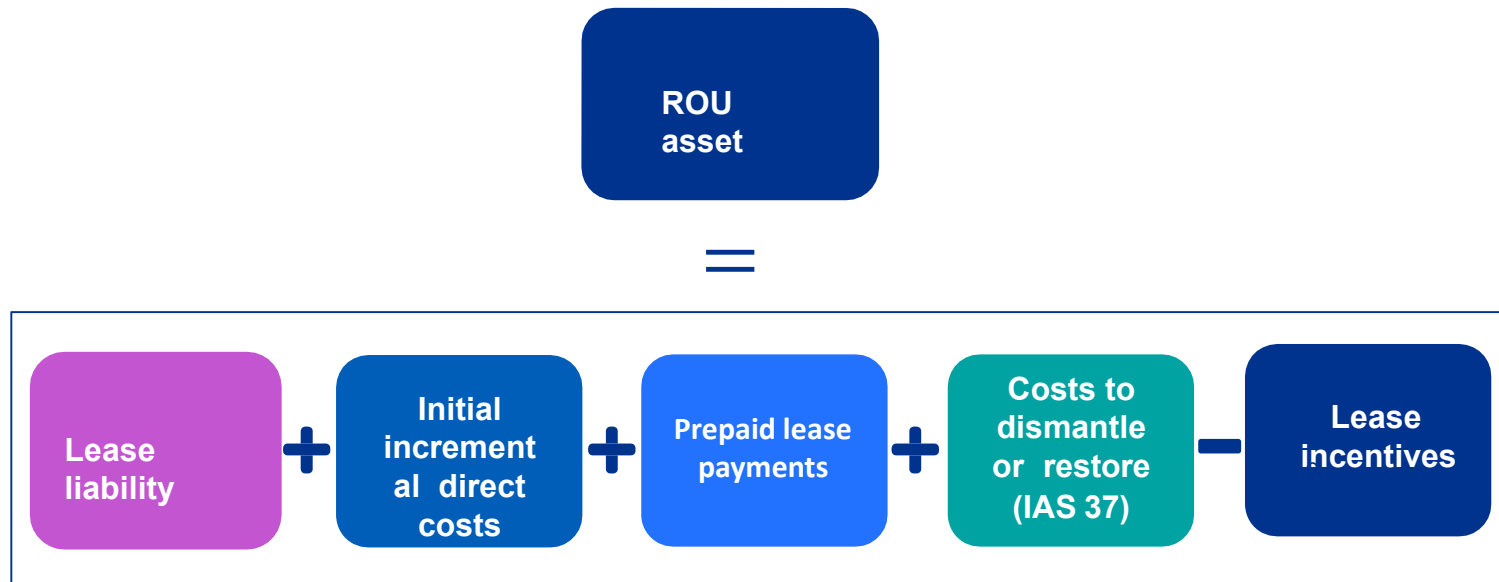
Leases of low value items

Judgement!!

Measuring the lease liability



Measuring the right-of-use (ROU) asset



Lessor accounting

Lessor accounting remains similar to current practice (IAS 17)

but lacks consistency with new lessee accounting model

Lease classification test



Finance leases and operating leases

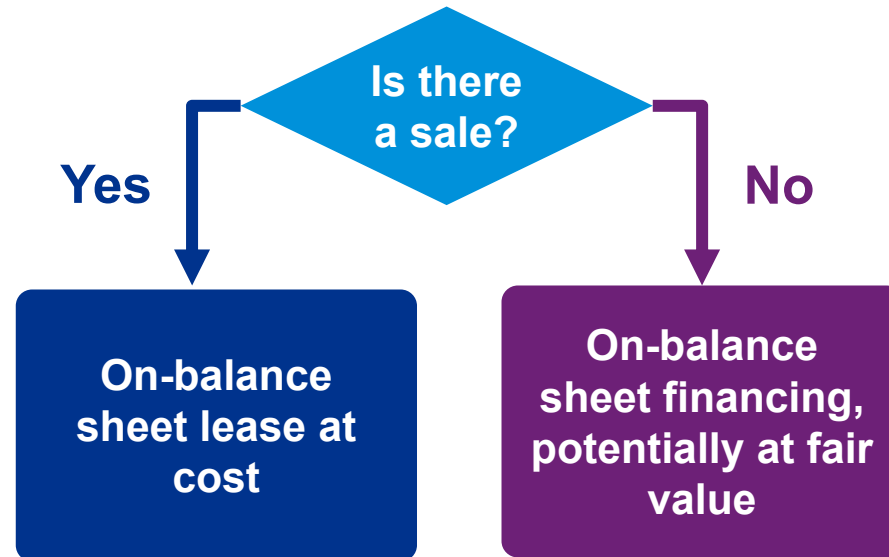


Consistent accounting model for lessors and lessees



Sale-and-leaseback

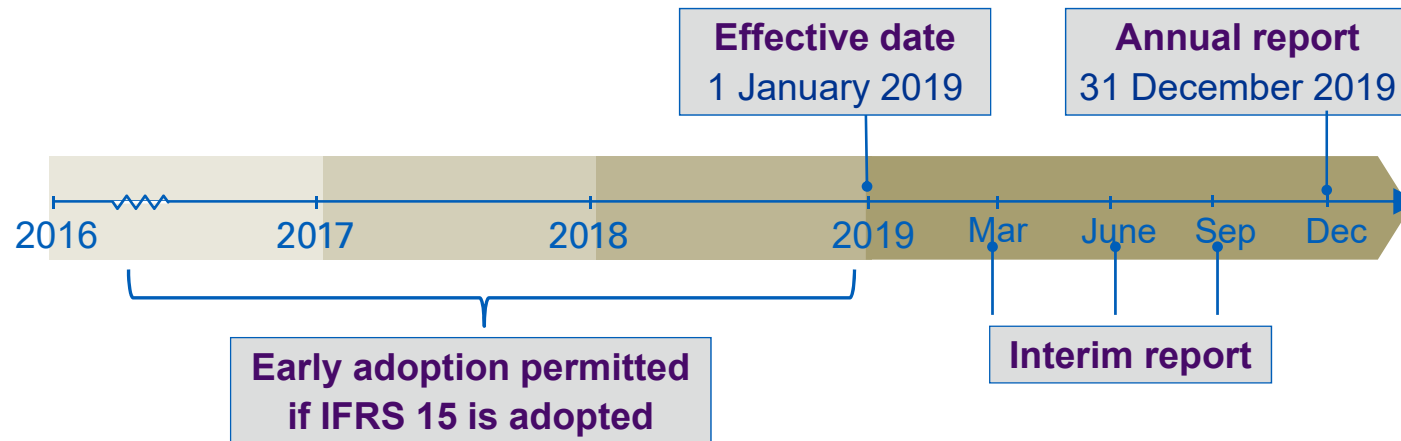
IFRS 16 essentially kills sale-and-leaseback as an off-balance sheet financing structure



If it is a sale:

- Measure ROU asset at the retained portion of the previous carrying amount of the asset
- Recognise a gain or loss related to the rights transferred to the lessor

Effective date



Next steps

Initial discussion points

- Discuss initial thoughts on the expected impact of IFRS 16.
- Highlight non-accounting areas potentially affected.
- Planned communications with external stakeholders.

Next steps



Start impact
assessment

Early
adoption?

Transition
approach?

Disclosure prior to effective date

- IAS 8.30 disclosure — known/reasonably estimable possible impact of IFRSs issued but not yet effective.

Considerations



- Pre-adoption disclosures progressing in level of detail as your application date approaches?
- Pre-adoption disclosures meeting external stakeholder expectations?

Key points to remember

Key points to remember

- **New leases standard will impact most companies.**
- **Process of assessing impact should start now.**
- **KPMG has set up a team to assist companies implement the standard.**





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