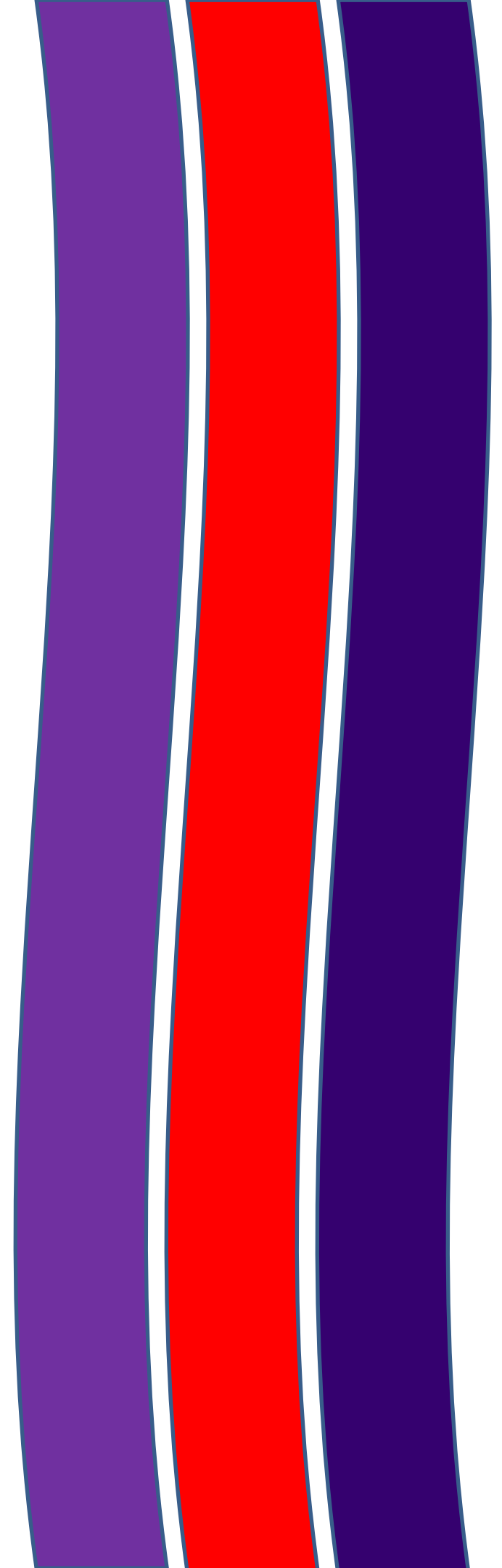


IPSAS 41 Financial Instruments

CPA Stephen Obock
sobock@kpmg.co.ke
8 December 2022



Agenda

1. Introduction

2. Classification and measurement

3. Impairment

4. Q&A

Introduction

The IPSASB concluded that the authoritative IFRS 9 principles are appropriate for the public sector and that no significant departures from those principles were warranted.

IPSAS 41 is applicable for annual periods beginning on or after 1 January 2023 and earlier application is permitted.

An entity shall apply IPSAS 41:

- a) Retrospectively in accordance with IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* (Restate only if possible without use of hindsight) OR
- b) Recognise the difference between previous carrying amount and the carrying amount on application of IPSAS 41 in the accumulated surplus or deficit

Introduction

IPSAS 41 key aspects

Credit losses	Recognised using the expected credit loss model. The model considers, past events, current events and impact of future events on credit losses.
Classification & measurement	Financial assets are classified based on management model and cash flow characteristics.
Disclosures	Extensive new disclosures than those in the previous standard (IPSAS 29).
Effective date	Periods beginning 1 January 2023

Classification Changes

IPSAS 41	IPSAS 29
Fair Value through Surplus or Deficit	Fair Value through Surplus or Deficit
Amortised cost	Loans and receivables Held to Maturity
Fair Value through Nets Assets/Equity	Available for sale
<ol style="list-style-type: none"> 1. Classification based on entity's management model and contractual cash flow characteristics of the financial asset 2. Classification determines recognition and measurement requirements 	

Financial Assets Measured at Amortized Cost

A financial asset is measured at amortized cost if both of the following conditions are met:

- a) The financial asset is held within a management model whose objective is to hold financial assets in order to collect contractual cash flows and
- b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial Assets Measured at Fair Value through Net Assets/Equity

A financial asset is measured at fair value through net assets/equity if both of the following conditions are met:

- a) The financial asset is held within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
- b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial Assets Measured at Fair Value through Surplus or Deficit

A financial asset shall be measured at fair value through surplus or deficit unless it is measured at amortized cost or at fair value through net assets/equity.

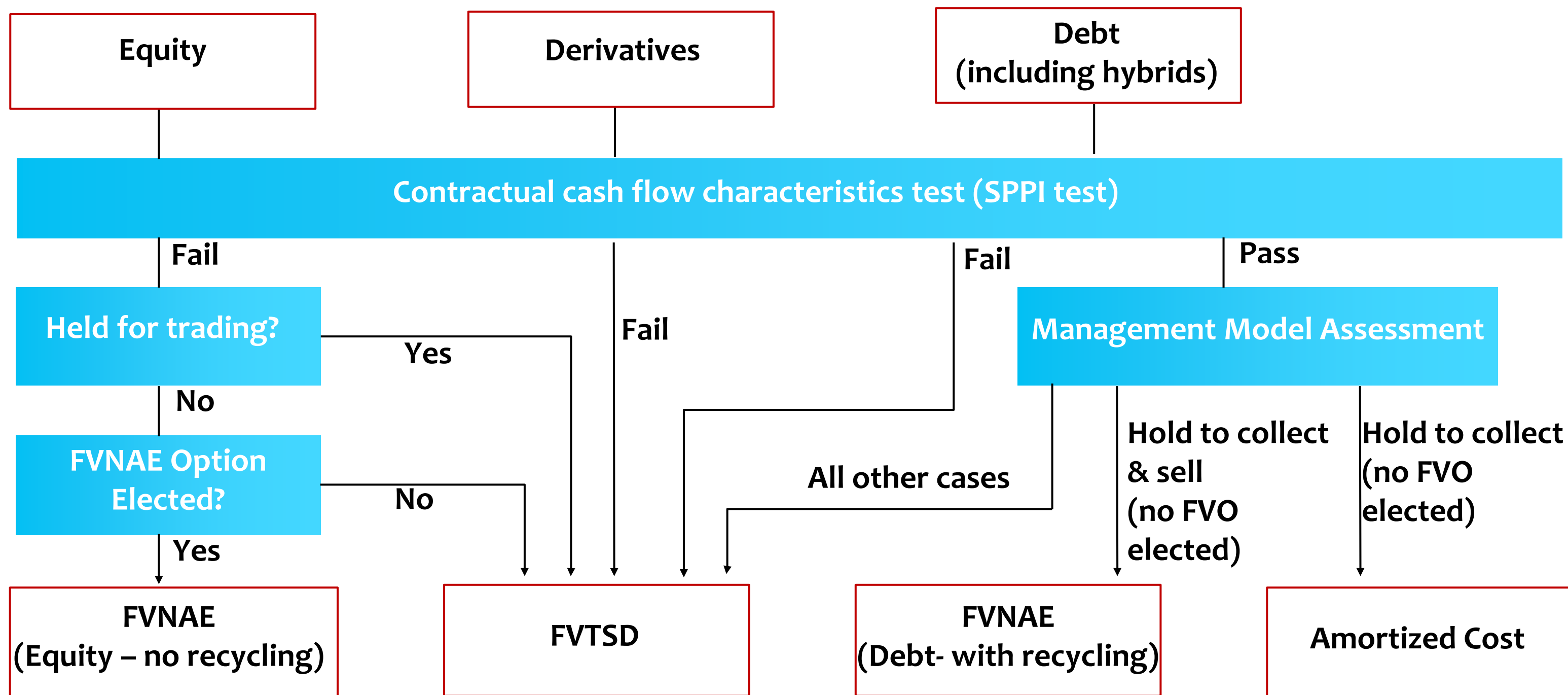
Entity may:

- Designate a financial asset as measured at fair value through surplus or deficit
- Elect for particular investments in equity instruments that would otherwise be measured at fair value through surplus or deficit to present subsequent changes in fair value in net assets/equity

Classification and Conditions - Summary

Class	Conditions:
Amortised cost	<ul style="list-style-type: none"> ▪ Management model objective is to hold the asset and collect contractual cash flows; and ▪ Contractual terms gives rise to cash flows that are solely payment of principle and interest on the outstanding amounts
Fair value through net assets/equity	<ul style="list-style-type: none"> ▪ Management model objective is to both collect contractual cash flows and sell the financial asset; and ▪ Contractual terms gives rise to cash flows that are solely payment of principle and interest on the outstanding amounts
Fair value through surplus or deficit	<ul style="list-style-type: none"> ▪ A financial asset shall be measured at fair value through surplus or deficit unless it is measures at amortised cost or fair value through net assets/equity.

Financial Asset Classification Summary



Classification of Financial Liabilities

An entity classifies all financial liabilities as subsequently measured at amortized cost, except for:

- a) Financial liabilities at fair value through surplus or deficit
- b) Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition
- c) Financial guarantee contracts
- d) Commitments to provide a loan at a below-market interest rate
- e) Contingent consideration recognized by an acquirer in a public sector combination

Amortized Cost

Amount at initial recognition

- Minus principal repayments
- Plus or minus the cumulative amortization of any difference between initial amount and maturity amount using effective interest method
- Minus any reduction for impairment or valuation allowance

Initial Measurement

- Except for short-term receivables and payables, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability
- Exception if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price
- An entity may measure short-term receivables and payables at the original invoice amount if the effect of discounting is immaterial

Subsequent Measurement – Financial Assets

- Financial Assets are subsequently measured according to their classification:
 - Amortized Cost
 - Fair Value through Net Assets/Equity
 - Fair Value through Surplus or Deficit
- Financial assets measured at amortized cost or fair value through net assets/equity are reviewed for impairment

Subsequent Measurement - Financial Liabilities

Financial liabilities are subsequently measured at amortized cost, except for:

- a) Financial liabilities at fair value through surplus or deficit
- b) Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition
- c) Financial guarantee contracts
- d) Commitments to provide a loan at a below-market interest rate
- e) Contingent consideration recognized by an acquirer in a public sector combination

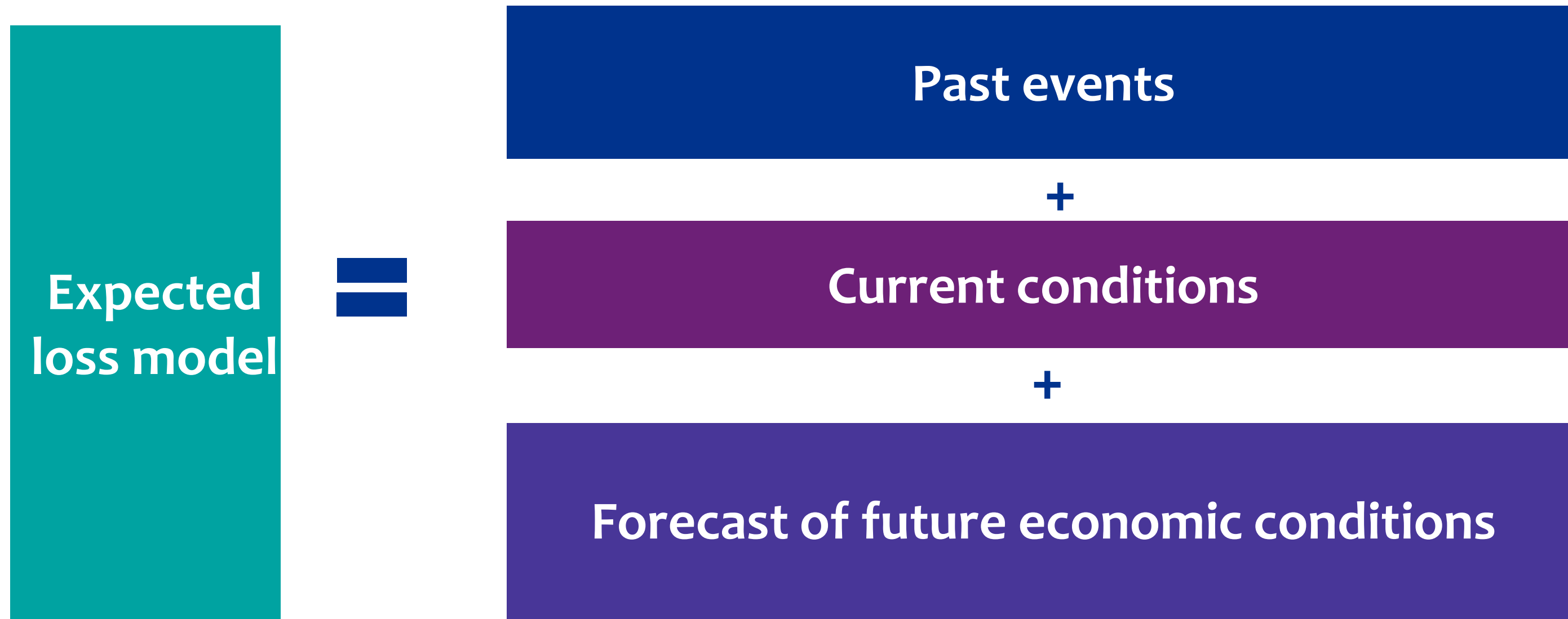
Impairment of Financial Assets

- An entity shall recognize a loss allowance for expected credit losses on a financial asset that is measured at amortized cost or at fair value through net assets/equity
- Loss allowance:
 - 12-month expected credit losses if the credit risk has not increased significantly since initial recognition
 - Lifetime expected credit losses if the credit risk has increased significantly since initial recognition
- Only recognize the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets.

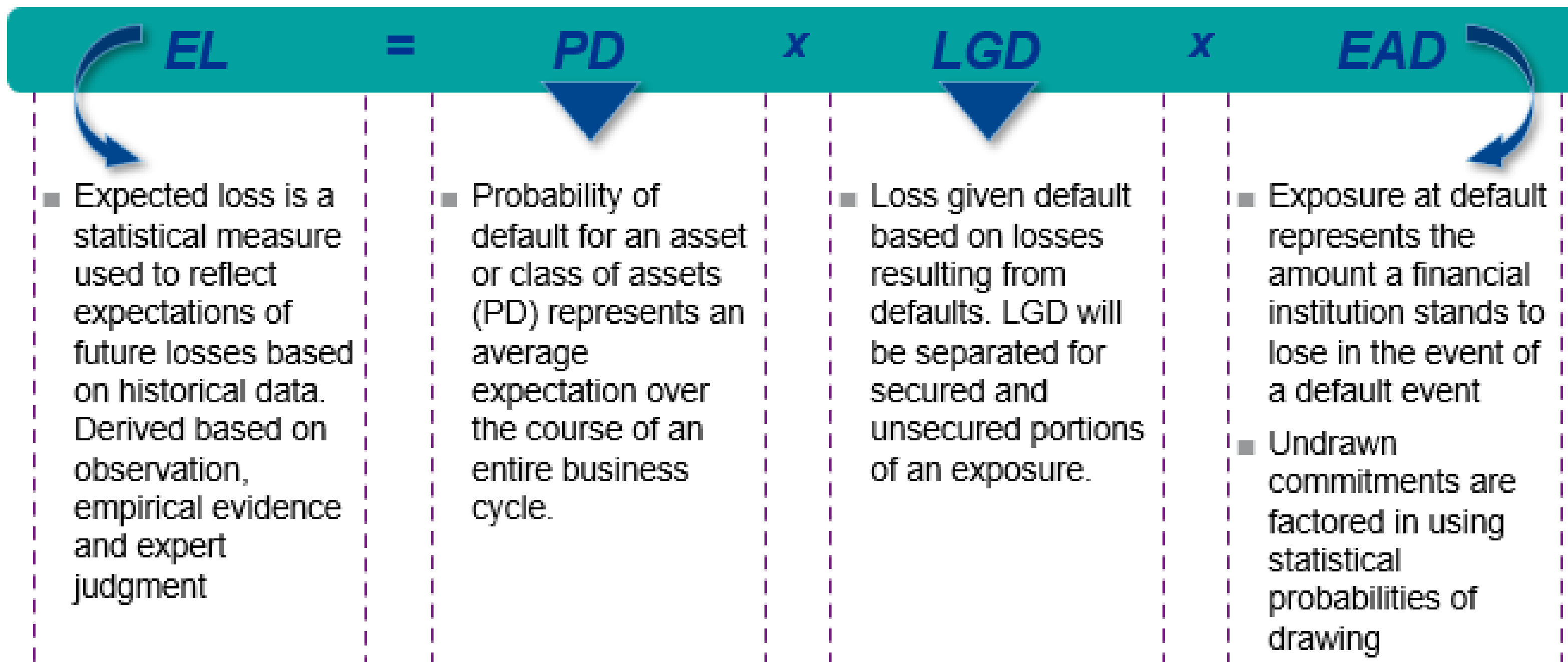
Impairment - ECL

Stage	Performance	Loss Allowance	Interest Revenue
1	Initial recognition, no significant increase in credit risk	12-month expected credit loss	Effective interest on gross carrying amount
2	Significant increase in credit risk since initial recognition	Lifetime expected credit loss	Effective interest on gross carrying amount
3	Credit impaired assets	Lifetime expected credit loss	Effective interest on net carrying amount

New ECL Model



Impairment – high level overview



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

Simplified Model – Trade receivables

IPSAS 41 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

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

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%

ECL Computation

Calculation of ECL

Calculate the ECL at 31 December 2017 assuming the aging below and the impact of forward looking information is 1.05% reduction to historical PDs.

Bucket	Amount	Historical PD	FLI	Adjusted PD	ECL
0 – 30 days	2,000,000	6%	-1.1%	5.20%	103,983
31 – 60 days	1,000,000	14%	-1.1%	12.84%	128,363
61 – 90 day	300,000	32%	-1.1%	31.17%	93,509
91+ days	900,000	100%	0.0%	100.00%	900,000

Disclosures

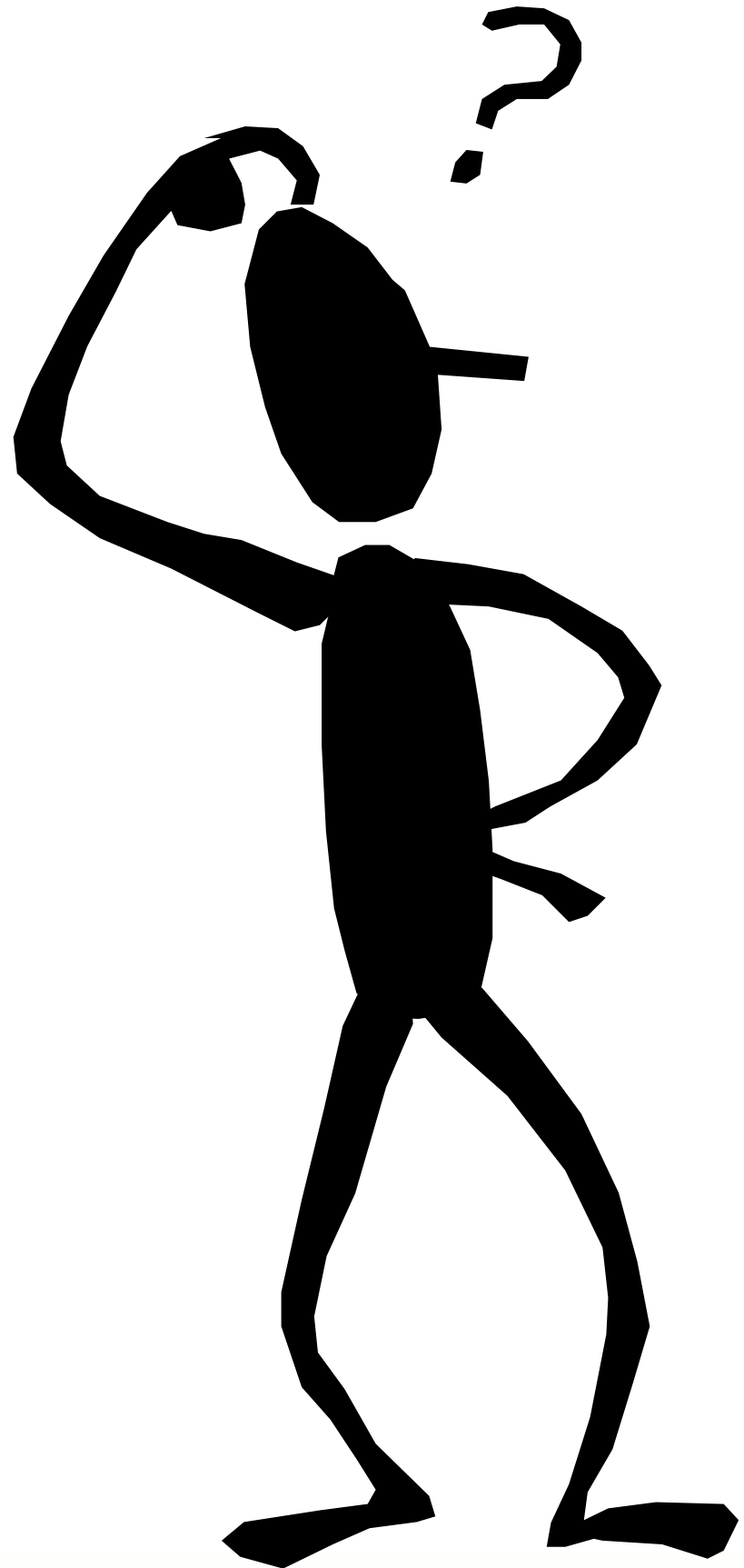
Disclosure Objective

Enable users to evaluate:

- The significance of financial instruments for the entity's financial position and performance; and
- The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

Disclosure requirements

- Categories of financial assets and financial liabilities
- Items of revenue, expense, gains or losses
- Accounting policies
- Hedge accounting
- Fair values of financial instruments
- Concessionary loans
- Nature and extent of risks arising from financial instruments



Questions and discussions