ZICA PRE-AGM CONFERENCE

IFRS 9,15, 16 & 17 OVERVIEW

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Zambia Institute of Chartered Accountants

WHAT SHALL BE COVERED IN THIS SESSION

- IFRS 16 - LEASES - ZICA GUIDANCE OVERVIEW LAND ISSUE
- IFRS 9 - FINANCIAL INSTRUMENTS - LESSONS LEARNT
- IFRS 15 - REVENUE - LESSONS LEARNT
- IFRS 17 - INSURANCE CONTRACTS

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IFRS 16 *Leases*

ZICA - ACCOUNTING FOR LAND BASED ON INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) 16 LEASES GUIDANCE NOTE #01/22

ISSUED ON 17 MAY 2022

IFRS 16 *Leases*
Objective of the ZICA Guidance

The objective of the paper issued by ZICA is to provide guidance on the accounting treatment for Leasehold Land in Zambia in accordance with the requirement of the International Financial Reporting Standards (IFRS).

- IFRS 16 Leases (IFRS 16) specifies the recognition, measurement, presentation and disclosure of leasehold land as there is no conceptual basis for differentiating long-term leases of land from other leases.
- The IASB considered but decided against a scope exclusions for long-term leases of land.

IFRS 16 *Leases*
Background of the land issue

- In Zambia, ownership of land is vested in the Zambian people, but administered by the Republican President.
- Therefore, land in Zambia is held on leasehold basis.
- Accordingly, on acquisition of land from the Government, one is given either a 99 years or 14 years period as tenant or lessee from the Ministry of Lands.
- There is no freehold land ownership in Zambia.
- Extensive stakeholder consultation was done on the land issue in Zambia by ZICA.

IFRS 16 *Leases*
IASB Staff Interpretation paper Sept 2012

Staff Interpretation paper of September 2012:

Two positions were presented.

- An entity or individual purchases the right over the land from the individual owner of the land in a sale and purchase agreement.
- The land reverts to the government (not to the individual owner), if an entity decides not to extend or renew the right to use the land, as opposed to the transaction under 'entities' right over the owners' where the land reverts to the individual owner.

IFRS 16 *Leases*
FACT PATTERNS ON THE LAND ISSUE

- The fact patterns in Zambia are similar to those articulated in the IFRS Committee's interpretation of September 2012 in that payment is made directly to the individual owner to purchase the right to use land generally based on the fair value of the land.
- Once an individual or entity purchases the right, any rights over the land transfers to the new entity, with only the government having the right to revoke the entity's right, but only on the ground of public interest or if the entity fails to meet the administrative requirements which includes the payment of annual land rates.

IFRS 16 *Leases*
FACT PATTERNS ON THE LAND ISSUE

- Further, the right to use land can be extended and renewed indefinitely at only an insignificant cost (administrative fees and related taxes) to be paid to the government and the entity has a legally protected right to obtain the extension/renewal, provided that all the legal and administrative requirements are met and that the land is not claimed by the government to be used for public interest purposes.
- No compensation is provided for the land if the government revokes the entity's right when the period of the right has ended/expired or if the application to extend or renew the right is declined by the government.

IFRS 16 *Leases*
FACT PATTERNS ON THE LAND ISSUE

- Hence entities do not substantially own the land because the government has a right to reject the renewal.
- In addition, compensation for land would not be provided if the government revokes the entity’s right when the period of the right has ended.

IFRS 16 *Leases*
FACT PATTERNS ON THE LAND ISSUE

- The IASB IFRS Interpretation Committee used the same fact pattern to determine that there was a lease. These characteristics included:
  - Right to use an asset: a right to use land is a right to use an asset.
  - Existence of lessor and lessee: the government is identified as a lessor, and the entity/individual is a lessee.
  - A payment or series of payments: payment to purchase the right is made directly from the entity to the individual owner who surrenders the land to the government, and the annual land rates paid to government
  - Agreed period of time: there is an agreed period of time between the government and the entity including renewal options.

IFRS 16 *Leases*
FACT PATTERNS ON THE LAND ISSUE

- Further in the basis of conclusion, 'IFRS 16 BC78A' the IASB guided that the "*long term lease of land*" is sometimes regarded as being economically similar to the purchase of land, which prompted some stakeholders to suggest that long term leases of land should be excluded from the scope of IFRS 16.

IFRS 16 *Leases*
FACT PATTERNS ON THE LAND ISSUE

- The IASB however decided not to specifically exclude such leases from the scope of IFRS 16 because:
- There is no conceptual basis for differentiating long term leases of land from other leases, because if the contract does not transfer control of the land to the lessee, but gives the lessee the right to control the use of the land throughout the lease term, the contract is a lease and should be accounted for as such.

IFRS 16 *Leases*

ZICA CONCLUSION AND POSITION

Based on the authoritative guidance above; the following is the conclusion:

- There is no conceptual basis for differentiating long term leases of land from other leases, as such if the contract does not transfer control of the land to the lessee but gives the lessee the right to control the use of the land throughout the lease term it meets the lease definition of the IFRS 16.
- In Zambia, the current subsisting laws only provide for leasehold land and does not provide for freehold land tenures and vests all statutory land in the President of Zambia. Accordingly, all land in Zambia must be treated under the provisions of IFRS 16, as it meets the definition of a lease.

IFRS 16 *Leases*
ZICA CONCLUSION AND POSITION (CONT'D)

- Land must be separated from the building components in accordance with IFRS 16, subject to the practical expedients.
- All land in Zambia is treated as a lease and must be accounted for as a right of use asset in accordance with IFRS 16.
- The ROU must be depreciated in accordance with IFRS 16.
- The payments (annual land rates) made to Government must be computed as fixed lease payments and added to the ROU asset and lease liability in accordance with IFRS 16, representing the obligation to pay annual land rates to government for the duration of the lease on the balance sheet.

IFRS 16 *Leases*
ZICA CONCLUSION AND POSITION (CONT'D)

- The transaction cost for the purchase of the land will continue to be capitalized and depreciated in line with the tenure of the land as the first part,
- Present assets held under a finance lease as property at an amount equal to the net investment in the lease.

IFRS 16 *Leases*

IMPACT ON THE ANNUAL FINANCIAL STATEMENTS

Retrospective restatement will be required, either by applying the full retrospective approach (third balance sheet) or the modified retrospective approach (opening retained earning adjustment) to the financial statements.

IFRS 9 FINANCIAL INSTRUMENTS OVERVIEW AUGUST 2022

LESSONS LEARNT

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IFRS 9 OVERVIEW

Key objectives of the session

During this session we will cover IFRS 9 – Financial Instruments;

- ✓ IFRS 9 – Exemptions in respect to the introduction of IFRS 17.
- ✓ IFRS 9 – Overlay approach and the transition to IFRS 17.
- ✓ IFRS 9 – Lessons learnt since January 2018.

IFRS 9 Impairment Model

Temporary exemption from IFRS 9 – COMES TO AN END

- Only some issuers of insurance contracts were permitted to apply the temporary exemption from IFRS 9.
- The temporary exemption was only available to companies that, considering their activities as a whole (at the reporting entity level), meet the following qualifying criteria:
    - they had not previously applied IFRS 9; and
    - they have activities that were predominantly connected with insurance.
- Each reporting entity was required to assess whether it was eligible for the temporary exemption.

IFRS 9 Impairment Model

Overlay approach - COMES TO AN END

- IFRS 9 was to applied in full, so information provided about financial instruments by issuers of insurance contracts is comparable with the information provided by other companies; and
- Affected entities had the option to apply IAS 39 to eligible financial assets to calculate a single line item adjustment to profit or loss so that the total effect on profit or loss for the eligible financial assets is the same as if IAS 39 still applied to those assets.
- Amendments to IFRS 4 required that companies disclose the effect of the overlay approach to users of financial statements.

IFRS 9 Impairment Model

Lessons learnt and challenges

- Obtaining reliable industry specific data for various sectors.
- Determining appropriate PD curves.
- Absence of studies on corelation of macro-economic parameters in determining PD's.
- These parameters include the impacts of exchange rates, interest rates, and GDPs.
- Previous studies have failed to establish such correlation between NPL, similar trends have been in Zambia during the COVID pandemic.
- Assessing the correlation of LGD's and the PDs.
- Conversion of TTCs rating systems to PIT rating systems.
- Relationship between regulatory provisions and ECLs.

IFRS 15 – REVENUE CONTRACTS WITH CUSTOMERS

AUGUST 2022

LESSONS LEARNT

Discussion topics

Revenue recognition

- Overview of IFRS 15
- Overview of the five-step model
- Lessons learnt

Overview of IFRS 15

Different sectors or industries were affected in many different ways along the 5-step model. The ***industries*** that faced the biggest challenges included:

- **Telecommunications** (with link to example: Identifying individual performance obligations and allocating transaction price)
- **Manufacturers** (example included below: Contract modifications)
- **Real estate and property development** (example included below: Revenue over time/at the point of time)
- **Software development and technology** (example included below: Splitting the contract into 2 separate obligations)

IFRS 15 Revenue from contracts with customers

Overview of the model

Core principle: Recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity ***expects to be entitled*** in exchange for those goods or services

1	Identify the contract(s) with the customer	Contract	
2	Identify the performance obligations in the contract	Performance obligation (PO #1)	Performance obligation (PO #2)
3	Determine the transaction price	Transaction price	
4	Allocate the transaction price to performance obligations	Amount of the transaction price for PO #1	Amount of the transaction price for PO #2
5	Recognise revenue as (or when) a performance obligation is satisfied	Recognition PO #1	Recognition PO #2

Change from "transfer of risks and rewards" to "satisfaction of performance obligations", when the customer has **control** of the asset or the service is consumed

IFRS 15 Model

Lessons learnt and challenges

Over time recognition

- Understanding why over time recognition is appropriate (step 5)
  - Detail is important
- Linking to performance obligation (step 2)
- When to use ‘input’ and ‘output’ methods (linking step 5 and step 2)

  Is not a choice –

  - When entity selects a method to use to recognise revenue over time, the method selected should faithfully depict the entity’s performance towards satisfaction of a performance obligation (IFRS 15.B15).
- Disaggregation of data.
- Fulfilment of a performance obligation.

IFRS 17 – INSURANCE CONTRACTS

AUGUST 2022

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IFRS 17 OVERVIEW

Key objectives of the session

During this session we will cover IFRS 17 – Insurance Contracts;

- ✓ IFRS 17 – Key definitions
- ✓ Key difference between IFRS 4 and IFRS 17
- ✓ IFRS 17 – Measurement models
- ✓ IFRS 17 readiness assessments
- ✓ IFRS 17 – Transition approaches

IFRS 17 - Insurance Contracts

- The aim of IFRS 17 is to standardise insurance accounting globally to improve comparability and increase transparency, and to provide users of accounts with the information they need to meaningfully understand the insurer's financial position, performance and risk exposure.
- On 25 June 2020, the IASB issued Amendments to IFRS 17 to address concerns and implementation challenges that were identified after IFRS 17 Insurance Contracts was published in 2017.
- The amendments are effective for annual periods beginning on or after **1 January 2023.**

IFRS 17 - Insurance Contracts
ZICA Guidance on its way

- ZICA currently drafting and finalising the IFRS 17 Guidance and roadmap.
- ZICA has done extensive consultations with,
    - Pensions and Insurance Authority (PIA), road map issued by PIA on 27 July 2022 to all Insurance entities, deadlines must be adhered to.
    - Insurance Association of Zambia (IAZ),
    - Working Group has been set up by ZICA to draft the implementation guidance for Insurance entities.
- Webinars and trainings are ongoing from various consulting firms.

IFRS 17 - Insurance Contracts

Changes brought by IFRS 17.

- IFRS 17 brings a change in the presentation of financial statements
- A comparison of the statement of comprehensive income under the current IFRS 4 and after the adoption of IFRS 17:

IFRS 4 and IFRS 17 comparison - Financial Statements	
IFRS 4	IFRS 17
Premiums	Insurance revenue
Investment income	Incurred claims and expenses
Gross claims and benefits	Insurance service result
Changes in insurance contract liabilities	Investment income
Profit or loss	Insurance finance expense
	Net financial loss
	Profit or loss

IFRS 17 - Insurance Contracts

IFRS 4	IFRS 17
Permits application of different accounting policies per insurance contract.	It only permits a single accounting policy for insurance contracts
Lack the ability to compare insurance companies in different jurisdictions or countries.	Improves comparability between insurance companies in different jurisdictions and countries.
Lack the ability to compare insurance companies against non-insurance companies.	Provides for similar accounting methodologies for insurance companies and non-insurance companies.
Accounting estimates were not required to be updated.	Requires all accounting estimates to be updated at each financial reporting period.
Did not provide clarity on the profit key drivers.	Profit key drivers (underwriting versus investment) are more transparent under this standard.
The discount rate was based on investment.	The discount rate is required to be based on cash flows of the insurance contract.

IFRS 17 - Insurance Contracts

Overview of the ‘IFRS 17 Insurance Contracts (IFRS 17)’ Measurement Approaches

There are three possible measurement models within IFRS 17:

a) the General Model (GM),

b) the Premium Allocation Approach (PAA) and

c) the Variable Fee Approach (VFA).

IFRS 17 - Insurance Contracts

In order to explain the measurement models it is important to first highlight the main definitions.

- Expected cash flows: the expected cash flows the insurance company expects to get and pay. The expected cash flows are calculated among different unbiased scenarios, taking into account different cash flows like expenses, claims, premiums etc.
- Discount rate; the expected cash flows are discounted with the discount rate which reflect the time period and the financial risk of the contract.
- Risk Adjustment: the money the insurer wants to get on top of the cash flows in order to take the uncertainty of the insurance contract. So this is for the insurance risk, the non-financial risk.

IFRS 17 - Insurance Contracts

- CSM: contribution service margin. The expected unearned profit of a contract. So more or less the profit we expect to make if our assumptions hold. This is the money which is left if we take the expected cash flow in – expected cash flow out – risk adjustment. If this total is negative then we have a loss component instead of the CSM, this holds for <u>**onerous**</u> contracts.

- As a general rule, the CSM should never be negative.

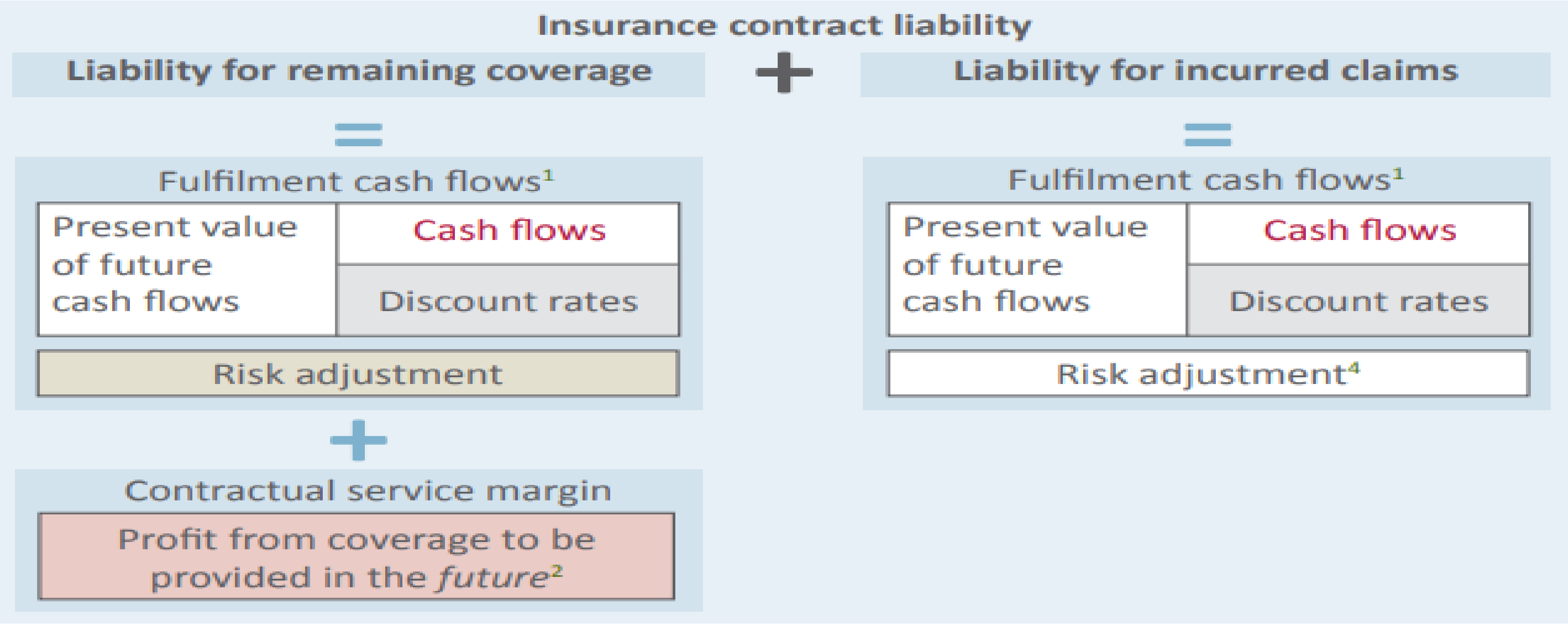
- However for reinsurance entities the CSM can be both negative or positive, i.e. losses / costs are not automatically taken to the P&L.

IFRS 17 - Insurance Contracts

The General measurement model (GMM) or Building Block approach (BBA)

- The default or the standard approach.
- You calculate the expected discounted cash flows, risk adjustment and the remaining CSM or loss component and you put this on the balance.
- Expected loss onerous contracts need to go directly through P&L.
- Every year you update your assumptions and the amounts for the expected cash flows, risk adjustment, CSM and loss component. Positive or negative changes can go through CSM, P&L or can hit the own funds directly.
- Once we delivered the insurance service then part of the CSM will go through the P&L resulting in a profit. At inception no profit can be made!

IFRS 17 – Insurance Contracts
GMM or BBA model



IFRS 17 - Insurance Contracts

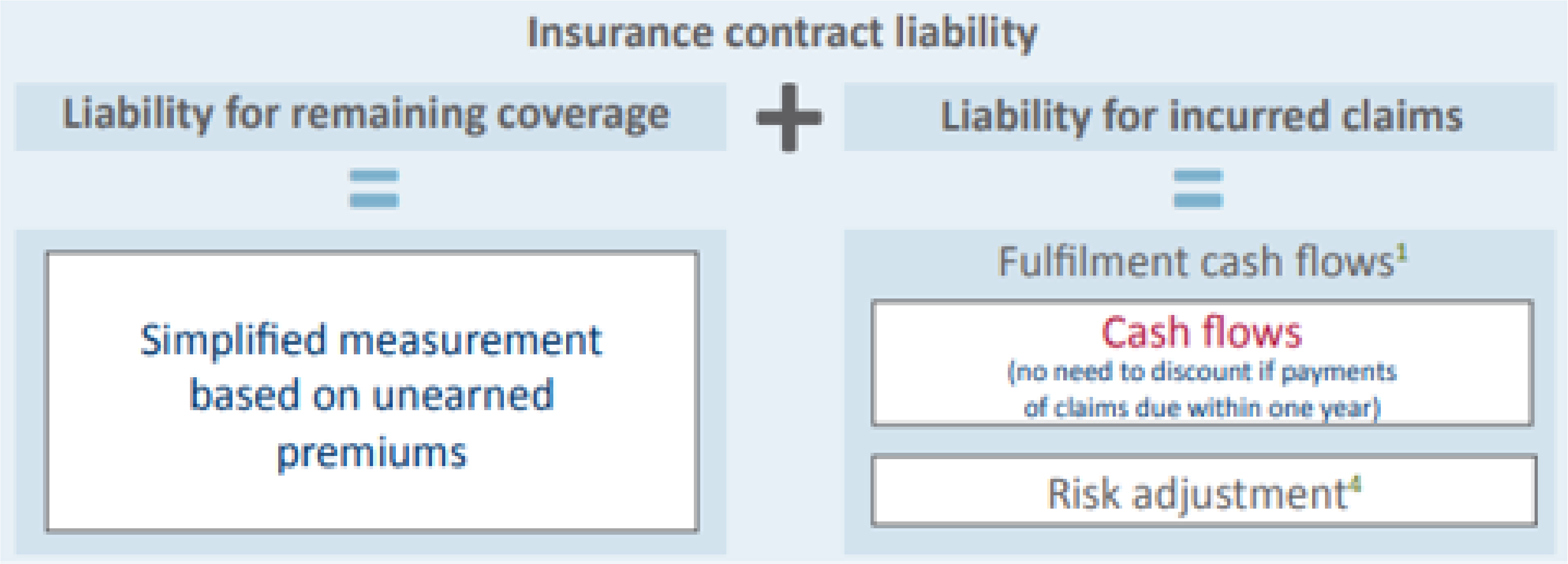
The Premium allocation approach (PAA)

- Simplified approach which you may only use when contracts are at inception onerous, or when the coverage period is smaller than one year or when the insurer can show that the **result of the PAA is no different than the GMM**.

- The way of calculating the insurance liability once a policy holder has indicated a claim is not different, the only difference is for the coverage period.

- With PAA there is a simplified method, comparable with how insurers currently do, while with GMM are the cash flows, discounting, risk adjustment and CSM calculated.

IFRS 17 - Insurance Contracts
PAA model



IFRS 17 - Insurance Contracts

The Variable fee approach (VFA)

- Comparable to GMM, only difference is that this group of insurance contract have policy holders who participate in share of clearly identified pool of underlying items.

- The insurer expects that part of the profit of the underlying items needs to be paid to the policy holder, while the amount paid to the policy holder depends on the underlying item.

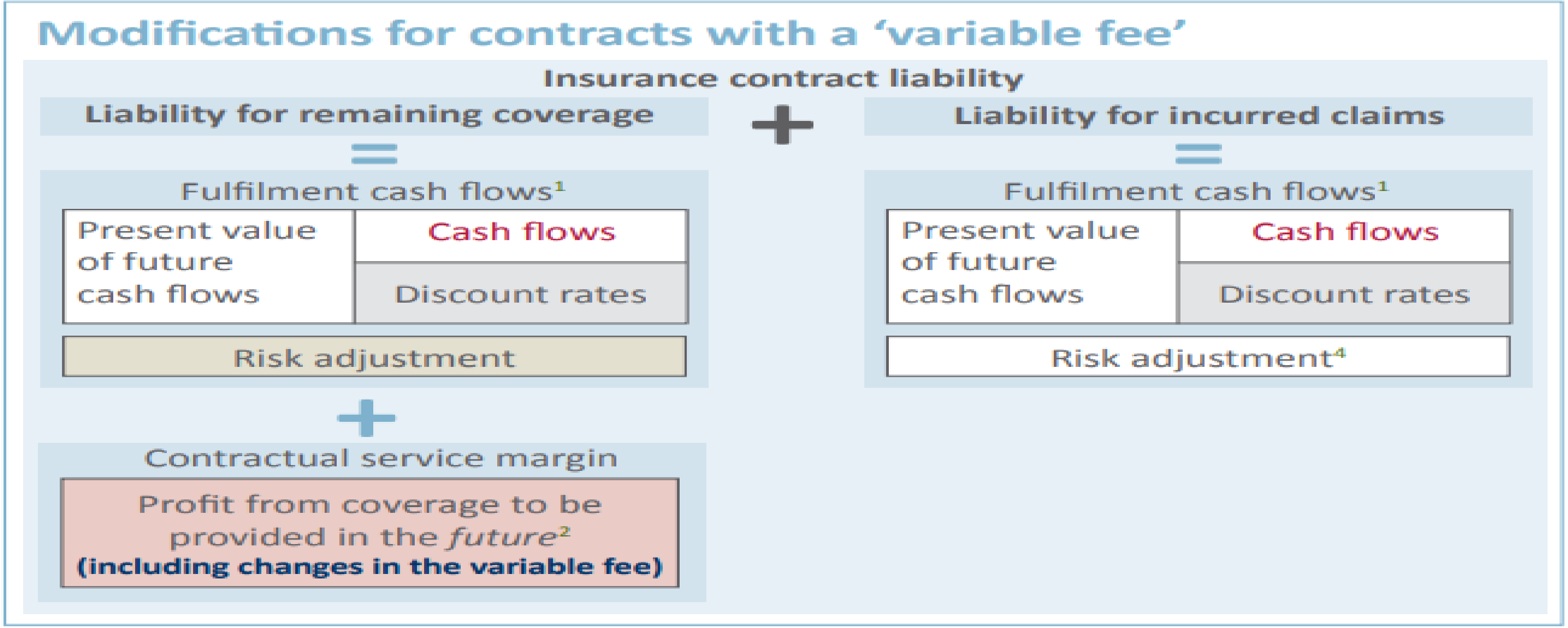
- The result is that VFA looks like GMM, not different at the start of the contract.

IFRS 17 - Insurance Contracts

The Variable fee approach (VFA)

- Only the subsequent years there are differences in the cash flows (as part goes to policy holder) and the CSM does not reflect the unearned profit for the insurer, as part of it also belongs to the policy holder.

IFRS 17 – Insurance Contracts
VFA Model



IFRS 17 - Insurance Contracts

- When a group becomes onerous the IFRS 17 standard requires that the loss is fully recognised in the P&L immediately and no CSM is held on the balance sheet.
- The Fulfilment Cash Flows are maintained and released to revenue as coverage is provided.
- The loss is unwound over time from expenses to revenue so that by the end of the contract revenue and expenses fully reflect the actual loss incurred.

IFRS 17 - Insurance Contracts

The next steps to a successful implementation

- IFRS 17 is a journey that may be starting now, but it will continue on for many years to come.
- There are likely to be a number of ttransitional false starts and hence rethinking of previously decided issues are inevitable to some extent.
- There is need for cross-departmental input on the impact of IFRS 17, including finance, treasury, risk management, information technology and actuarial services.
- IFRS 17 is an accounting standard and must be driven by the accountants, however, no finance department can work through the change is isolation.

IFRS 17 - Insurance Contracts

IFRS 17 and Solvency II

Insurers need to think of IFRS 17 as an evolution of Solvency II it is better at an early stage to think of IFRS 17 as something new.

- That way you will get to better solutions quicker through a proper appreciation of the challenge.
- There is need for Insurers to utilise the capabilities in personnel, some systems and data developed during the Solvency II project, to make IFRS 17 implementation more efficient.

IFRS 17 - Insurance Contracts

IFRS 17 and Solvency II

How long will it take to implement IFRS 17

- Our estimations for the time taken to set up, configure and test our part of the solution is between 9 months to 1 year.
- Additional time may be required for system integration and initial data load.
- Implementation will need to be done in phases in a phased approach.
- Need to engage your consultants immediately and commence the process.
- It is never too late if you plan carefully the approach with the consultants.

IFRS 17 - Insurance Contracts

The IFRS 17 Transitional arrangements

In other IFRS change programs entities have been required to load all historic data for active contracts. IFRS 17 provides insurers 3 transitional options.

- Option 1 – Assuming insurance contract data is available, then a full data load is required under the **Full Retrospective** approach. This will be similar to simulating historic month ends.
- Option 2 - **Modified Retrospective** which allows the insurer the ability to make some assumptions. The exact assumptions that are allowed are prescribed which limits the flexibility of this.
- Option 3 - **Fair Value approach** which allows insurers to effectively value the contracts as if they were purchased.

Thank you!