



FINANCIAL SERVICES

Bank of Thailand Seminar: IAS 32, IAS 39, IFRS 7

Impairment of loans

13 June 2008

AUDIT

Agenda

- ◆ **Impairment under IFRS**
- ◆ **Impairment under BOT regulations**
- ◆ **Impairment of consumer loans using collective approach**
- ◆ **Debt restructuring under IFRS and TAS**



Impairment Under IFRS

Impairment requirements

- ◆ **A financial asset or a group of financial assets is impaired if, and only if,**
 - there is objective evidence of impairment as a result of one or more events that occurred after initial recognition; and
 - the loss event has an impact on estimated future cash flows

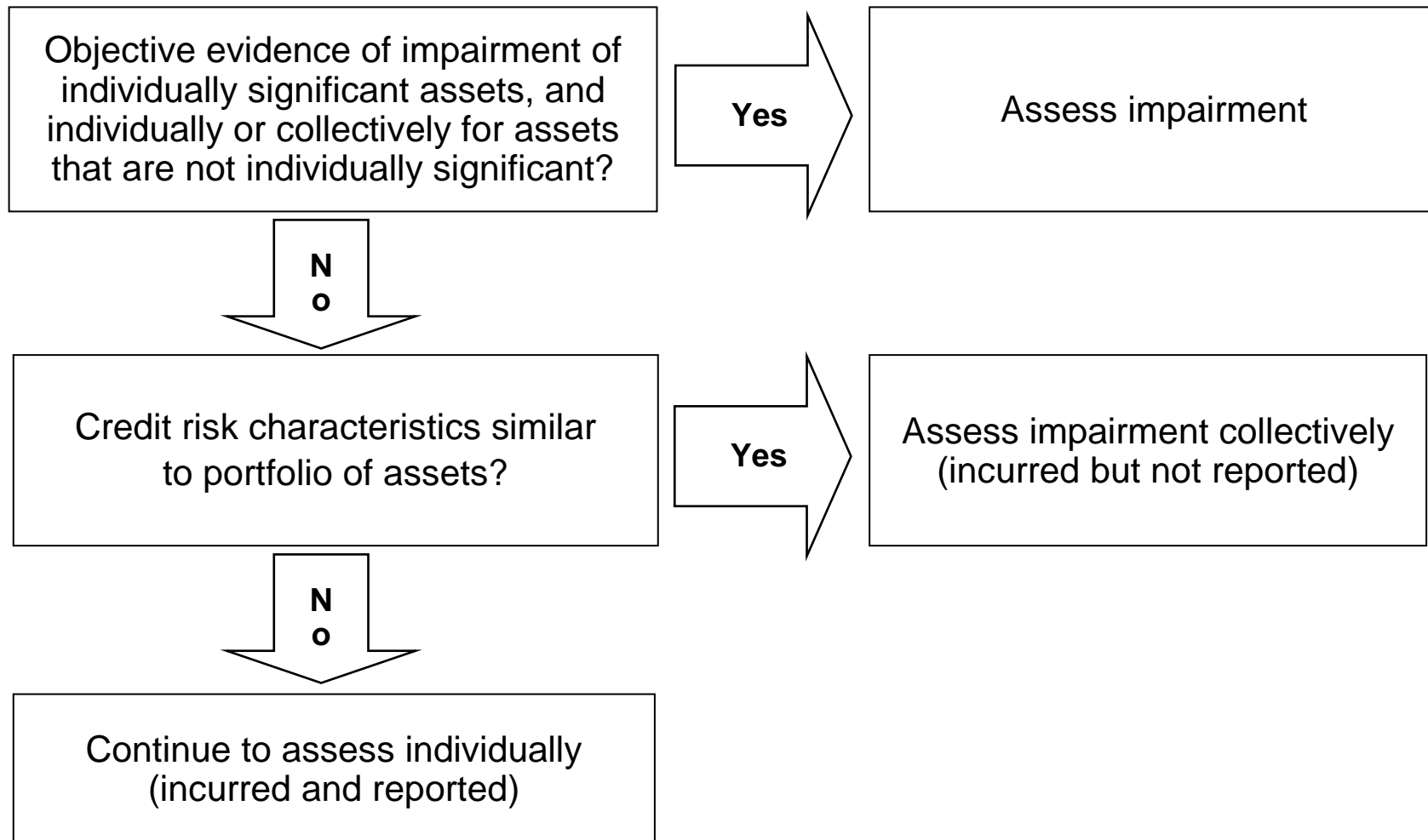
- ◆ **An impairment loss is measured as the difference between:**
 - the asset's carrying amount and the present value of estimated future cash flows - for loans and receivables or held-to-maturity investments; and
 - the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment losses previously recognised— for available-for-sale financial assets

Loans and receivables: objective evidence of impairment

At each balance sheet date, the entity should assess whether there is objective evidence of impairment for an asset or group of financial assets

- ◆ Significant financial difficulty of the issuer/obligor
- ◆ Default or breach of contract
- ◆ Granting of a concession by the lender
- ◆ Bankruptcy or financial reorganisation of the borrower
- ◆ Disappearance of an active market for the assets concerned
- ◆ Measurable decrease in the estimated future cash flows

Loans and receivables: impairment assessment



Loans and receivables: evaluation of impairment on a portfolio basis

◆ Future cash flows

- Estimated cash flows
- Historic loss experience
- Changes in related observable data

◆ Discount rate

- Original effective interest rate

◆ Losses incurred but not reported

- At each year end the present value of the estimated cash flows is re-calculated and impairment loss recognised for the difference between this amount and the carrying value of the portfolio. The estimated cash flows take into account incurred losses, not expected future losses
- When loans are identified as individually impaired they are removed from the portfolio

Impairment of available-for-sale equity securities

◆ Additional indicators of impairment for equity securities

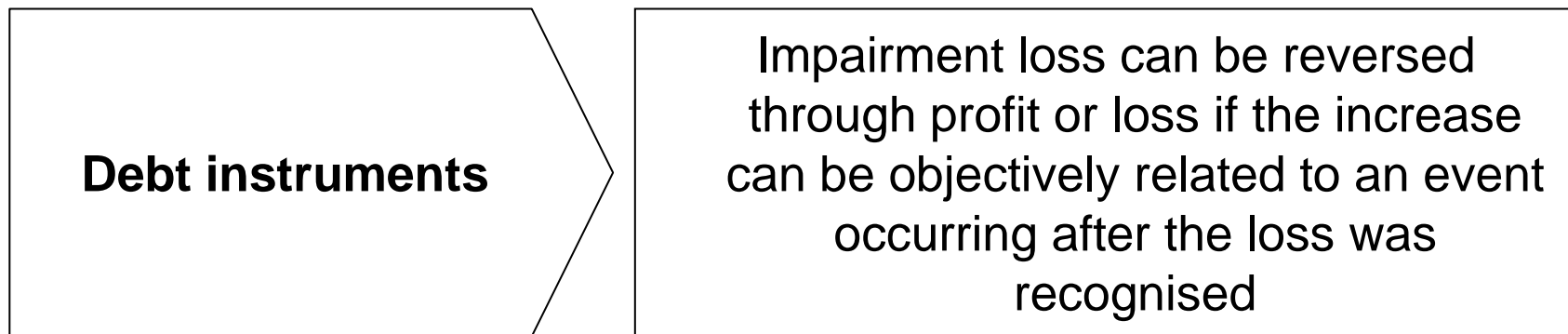
- Adverse effects of changes in technological, market, economic or legal environment, in which the entity operates
- Significant or prolonged decline in the fair value of an investment in the equity instrument



Impairment of available-for-sale debt securities

◆ Indicators of impairment for debt securities (similar to those for loans and receivables)

- Significant financial difficulty of the issuer
- Bankruptcy or financial reorganisation of the issuer
- Disappearance of an active market for the bonds concerned
- Measurable decrease in the estimated future cash flows





Impairment Under Bank of Thailand Regulations

Bank of Thailand regulations for estimating loan losses

- ◆ Allowance for doubtful accounts is determined through methods based on the Bank of Thailand regulations and on individual banks' estimated loan losses
- ◆ Banks determine provisions for corporate loans on an individual case by case basis while the allowance for retail loans is determined on a portfolio basis with similar risk characteristics (see later – collective approach)
- ◆ The collective approach is a prudent approach for the consumer banking portfolios of banks where the provision is set from historical loss experience of each customer group adjusted by the information on trend, economic conditions, current situations, and relevant factors.
- ◆ The overall provision (specific and portfolio) determined by a bank must meet at least the minimum requirements established by the Bank of Thailand. If the bank determines provisions which are lower than the regulatory minimum additional provisions are required. If higher no adjustment is required, as they are in accordance with bank policy and meet regulatory minimum requirements.

Bank of Thailand Regulations for estimating loan losses – minimum requirements

- ◆ **Bank of Thailand Regulations, with amended criteria in accordance with IAS 39 dated 7 December 2006, banks classify their loan portfolios into six categories primarily based on the non-accrual period.**
- ◆ **For loans classified as pass and special mention, the calculation of allowances for doubtful accounts is based on the regulatory minimum percentage requirement (1% and 2% respectively), taking into account the collateral value, where the collateral type and date of the latest appraisal are qualifying factors**
- ◆ **For loans classified as sub-standard, doubtful and doubtful of loss the allowances on these accounts are set at 100 percent of the difference between the outstanding book value of the debt and the present value of future cash flows expected to be received or the expected proceeds from the disposal of collateral, or the amount set up using the collective approach, as applicable.**



Impairment of consumer loans using collective approach

Consumer Loans Portfolio Impairment (PI) – Background

Background

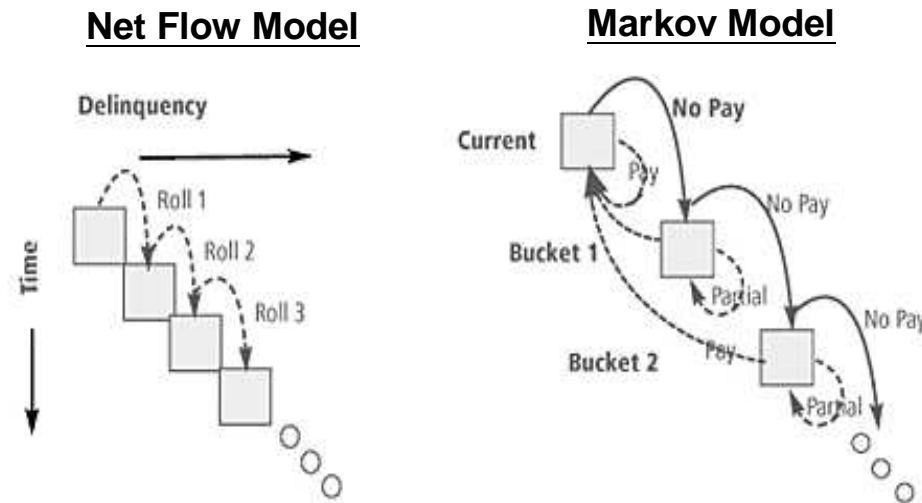
- ◆ Under International Financial Reporting Standards, the PI is a provision, held on Balance Sheet, created at the portfolio level against losses expected that are to be incurred within the next six to twelve months, but which have not yet been specifically identified at the account level.
- ◆ The establishment of such a provision is seen as an interim step pending the identification of impairment losses on an individual basis.
- ◆ A PI covers in-built losses within the portfolio that are yet to manifest themselves but which can be substantiated based on historical patterns of a group of similar customer receivables. Each portfolio pool is based on loans with similar credit risk characteristics.
- ◆ PIs are reassessed at each reporting period with the movement being charged or released to the income statement.

Consumer Bank Portfolio Impairment – Calculation Process

Calculation Process

- ◆ Companies use a combination of “net flow to write-off” and “Markov Chain” methodologies which may be usefully terms the collective approach. Both methodologies rely principally on historical data to establish a percentage of loans that are current (or in any state of delinquency) today that are expected to result in charge off at a future point in time. Flow rates may then be adjusted to reflect current market conditions. This “flow to write-off” or “gross” provision is then reduced by expected recoveries to arrive at the required “net” provision.
- ◆ The key differentiating factor of the Markov Chain approach is the consideration of reverse, as well as forward, flows along delinquency buckets. The net flow to write-off approach takes into consideration that a percentage of loans that are current, or in any state of delinquency, today will end up being charged off. This approach uses a product of asset balance projections and compound flows to loss (assuming straight line ageing) from each delinquency state prior to the point of impairment recognition to calculate PI. The six most recent months of actual portfolio flow rates are typically used in the PI calculation.

Net Flow Models versus Markov Chains



- ◆ **Net flow models are a simplified version of the broader class of Markov Models – a linear model of delinquency**
- ◆ **A Markov approach provides a more conservative estimate of the portfolio provision, taking into account the multiple permutations that may exist between an account experiencing impairment and that impairment becoming reported in the individual asset**

	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	BOT Minimums	BOT Minimums Total required	Using flow rates (annualised rates to Sep 07)	Amount Using flow rates (annualised rates to Sep 07)
Period End Outstanding	5,953	6,505	7,552	8,169	8,976	9,671	10,357	10,579	10,753				
Overdue \$													
Current	5,953	5,953	6,999	7,250	8,101	8,820	9,421	9,584	9,511	1%	95	0.42%	40
1 - 29 dpd		553	459	721	665	579	601	627	839	1%	8	5.13%	43
30 - 59 dpd			94	136	98	123	132	121	150	2%	3	24.69%	37
60 - 89 dpd				62	64	59	72	87	78	2%	2	40.93%	32
90 - 119 dpd					47	51	48	59	72	100%	72	50.99%	37
120 - 149 dpd						40	45	36	57	100%	57	59.16%	34
150 - 179 dpd							38	34	24	100%	24	75.27%	18
180 dpd+								32	22	100%	22	100.00%	22
										Total	283		263
										% port	2.63%		2.44%
Flow Rate %													
Current		9.28%	7.71%	10.31%	9.18%	7.14%	6.82%	6.66%	8.75%				8.23%
1 - 29 dpd			16.96%	29.59%	13.62%	18.51%	22.85%	20.13%	23.90%				20.79%
30 - 59 dpd				66.32%	47.33%	60.13%	58.21%	65.46%	64.57%				60.34%
60 - 89 dpd					75.67%	79.16%	81.16%	82.11%	83.22%				80.26%
90 - 119 dpd						84.71%	88.39%	75.09%	96.55%				86.18%
120 - 149 dpd							94.47%	74.65%	66.67%				78.60%
150 dpd - Write Off								85.03%	65.52%				75.27%
									100.00%				100.00%



Debt Restructuring under IFRS and TAS

IFRS and TAS – Troubled Debt Restructuring

- ◆ **No specific IFRS deals with troubled debt restructuring.**
- ◆ **TAS 34 – Accounting for Troubled Debt Restructuring – is based on US GAAP – SFAS 15: Accounting by debtors and creditors for troubled debt restructuring and SFAS 114: Accounting by creditors for impairment of a loan**

TAS 34 – Accounting for troubled debt restructuring

- ◆ **The fair value of collateral (assets, equity) can be used as the recoverable amount of the restructured debt if it is probable that the borrower could be defaulted and the foreclosure of collateral is expected**

- ◆ **Where re-structuring a loan involves a modification of its terms the present value of its future cash flows is calculated by using discount rates at the time of re-structuring as follows:**

- ◆ **TAS 34 allows for the choice of the discount rate used by creditors in calculating the recoverable amount of an impaired loan as follows:**
 - market rate
 - the higher of the cost of funds rate and the new contract rate; or
 - the effective historical contract rate

- ◆ **For impaired loans, IAS39 provides that the original effective interest rate of the loan should be used to calculate the present value of the expected future cash flows of the troubled debt.**



Presenter's contact details

Supot Singhasaneh

KPMG Phoomchai Audit Ltd.

+66 2 677 2000

www.kpmg.co.th

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.