

# GRAP 104 Reference Group

## Loan commitments

### 19 July 2023





# Disclaimer

***The views and opinions expressed in this presentation are those of the individual. Official positions of the ASB on accounting matters are determined only after extensive due process and deliberation.***



# Acronyms and abbreviations

Acronyms and abbreviations	Description
CAEIR	Credit adjusted effective interest rate
ECL	Expected credit loss
EIR	Effective interest rate
FL	Financial liability
FVTSD	Fair value through surplus or deficit
PV	Present value
SFPER	Statement of financial performance
SFPOS	Statement of financial position
SPPI	Solely payments of principal and interest



# Overview of today's session

- Loan commitments
- Loan commitments granted on normal market terms
- Concessionary loans (issuer) – summary of the September discussion
- Loan commitments on concessionary loans granted
- Disclosures relevant to loan commitments





# Loan commitments





# Definitions (par.2.1)

**Loan commitment** is a firm commitment to provide credit under pre-specified terms and conditions.

**Firm commitment** is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.



# Scope (par.1.3 and 1.7)

## **Includes loan commitments relating to the following:**

- Those designated as FL at FVTSD
- Derivatives – loan commitments to be settled net in cash or issue/deliver another financial instrument
- Commitments to provide a loan at a below-market interest rate, including concessionary loans



# Scope (par.1.3 and 1.7)

## Exclude from the scope:

- All other loan commitments

## Exception to scope exclusion:

- Issuer of a loan commitment outside the scope of GRAP 104: Apply impairment requirements of GRAP 104.
- For all loan commitments, apply:
  - derecognition requirements in GRAP 104.
  - disclosure requirements in GRAP 104.



# Scope summary (Appendix C)

Loan commitment transactions:	Recognition	Measurement		Impairment	Derecognition	Presentation	Disclosure
		Initial	Subsequent				
Below market interest rate	x	x	x	x	x	x	x
Settled net in cash or another financial instrument	x	x	x	n/a	x	x	x
Designated at fair value on initial recognition	x	x	x	n/a	x	x	x
Others granted on normal market terms (and the resulting loan is measured at amortised cost)	n/a	n/a	n/a	x	x	x	x

# **Loan commitments granted on normal market terms (resulting loan measured at amortised cost)**



# Initial measurement

(par.1.3(e))

- Initial recognition and initial measurement is out of scope of GRAP 104
- Revenue recognition – consider GRAP 9 Revenue from exchange transactions



# Subsequent measurement

(par.1.3(e), 5.17, AG8.12)

- Recognise loss allowance on loan commitments
- Loss allowance on loan commitment is recognised as a provision
- Separate the loss allowance for the loan commitment and financial asset
- Cannot separate the loss allowance – combine with financial asset
- If financial asset is negative – recognise as a provision



# Loss allowance

(par.5.17, AG5.67, AG5.89)

- **Loss allowance** is the allowance for expected credit losses on loan commitments
- **Expected credit losses** are the weighted average of credit losses with the respective risks of a default occurring as the weights
- **Risk of a default** occurring on the loan to which a loan commitment relates
- **Credit loss** is the present value of the difference between:
  - Contractual cash flows if the holder draws down the loan; and
  - Expected cash flows if the loan is drawn down

# Loss allowance

(par.5.17 to par.5.35)

Financial performance	Financial position					
<p><u>Gain or loss equal</u></p> <ul style="list-style-type: none"> <li>Loss allowance (if higher than fair value)</li> <li>Less</li> <li>Carrying amount of loan commitment on the reporting date</li> </ul> <p><u>Loss allowance:</u> The weighted average of credit losses with the respective risks of a default occurring as the weights.</p>	<b>Loss allowance</b>					
	<b>Step 1: 12 months or lifetime</b>	<table border="1"> <tr> <td data-bbox="643 504 1619 722"> <p><i>Significant change in credit risk</i></p> <ul style="list-style-type: none"> <li>- 12 month <u>or</u></li> <li>- Lifetime</li> </ul> <p>[Indicators]</p> </td> <td data-bbox="1622 504 1897 722"> <p>Loan commitment</p> </td> </tr> <tr> <td data-bbox="643 725 1619 1340"> <ul style="list-style-type: none"> <li>Significant change in credit risk = risk of default occurring.</li> <li>Risk of a default occurring on the loan to which a loan commitment relates</li> <li>Assess the change in default between reporting date and initial recognition.</li> <li>Default not later than 90 days past due.</li> <li>Significant change in credit risk if 30 days past due.</li> <li>Individual or collective basis.</li> <li>Use reasonable and supportable information without undue cost and effort.</li> </ul> </td> <td data-bbox="1622 725 1897 1340"> <p>No significant change for instruments with low credit risk.</p> </td> </tr> </table>	<p><i>Significant change in credit risk</i></p> <ul style="list-style-type: none"> <li>- 12 month <u>or</u></li> <li>- Lifetime</li> </ul> <p>[Indicators]</p>	<p>Loan commitment</p>	<ul style="list-style-type: none"> <li>Significant change in credit risk = risk of default occurring.</li> <li>Risk of a default occurring on the loan to which a loan commitment relates</li> <li>Assess the change in default between reporting date and initial recognition.</li> <li>Default not later than 90 days past due.</li> <li>Significant change in credit risk if 30 days past due.</li> <li>Individual or collective basis.</li> <li>Use reasonable and supportable information without undue cost and effort.</li> </ul>	<p>No significant change for instruments with low credit risk.</p>
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# Loss allowance

(par.5.17 to par. 5.35, AG5.89)

Financial performance	Financial position	
<p><u>Gain or loss equal</u> Loss allowance less Carrying amount of loan commitment on the reporting date</p> <p><u>Loss allowance:</u> The weighted average of credit losses with the respective risks of a default occurring as the weights</p>	<p><b>Loss allowance</b></p>	
	<p><b>Step 2: Calculate expected credit losses</b></p>	<p>Credit loss is the present value of the difference between:</p> <ul style="list-style-type: none"> <li>• Contractual cash flows if the holder draws down the loan and</li> <li>• Expected cash flows if the loan is drawn down</li> </ul> <ul style="list-style-type: none"> <li>• <i>Probability weighted</i> estimate of credit losses over 12 months or lifetime.</li> <li>• Loan commitment that will be drawn down within 12 months of the reporting date for <b>estimating 12 month expected credit losses</b>; and</li> <li>• Loan commitment that will be drawn down over the expected life of the loan commitment when estimating <b>lifetime expected credit losses</b>.</li> <li>• Contractual period = maximum contractual period over which an entity has a present contractual obligation to extend credit</li> <li>• Consider <u>what</u> CF an entity expects to receive, and <u>when</u> they will be received.</li> <li>• Discounted using EIR or CAEIR.</li> </ul>

# Derecognition (par.6.16 to 6.19)

- A loan commitment is derecognised when the obligation is discharged, cancelled, expires or is waived.
- Modifications to the contract may result in the existing commitment derecognised and a new financial liability recognised – apply the 10% rule





# Concessionary loans (Issuer)



# Summary – concessionary loans (issuer)

- Definition: Loan granted to an entity on terms that are not market-related
- Analyse the loan into component parts
- Account for each part separately:

## Debit

**Social benefit**  
[Conceptual  
Framework]

**Loan granted**  
(financial asset)  
[GRAP 104]

## Credit

**Bank**  
[GRAP 104]

- Social benefit calculated and recognised when loan commitment is recognised (if applicable)

# Loan commitments on concessionary loans



# Initial recognition

(par.3.1, 5.1, 5.21 and AG5.33)

- Recognise at the date the loan commitment is issued, i.e. entity becomes a party to the contractual provisions of the instrument
- Date the entity becomes a party to the irrevocable commitment



# Initial measurement

(AG5. 22 - .23, AG5.33)

- Issuer measures **initially** at:
  - Fair value; or
  - If there is no reliable measure of fair value:
    - The loss allowance on the loan commitment; plus
    - Social benefit value
- Fair value is most likely the commitment fee charged
- The off-market portion is recognised as a social benefit [Conceptual framework]
- Determine the effective interest rate on initial recognition – this rate does not change each time there is draw down



# Subsequent measurement

(AG5. 22 and par.4.7(d))

- Issuer measures subsequently at the **higher of**:
  - Initial recognition amount less amortised revenue (where applicable); or
  - Loss allowance plus the social benefit provided
- All gains and losses are recognised in surplus or deficit

# Example

## Initial measurement

- Department of Agriculture provides a low-interest loan to a qualifying farmer at the beginning of the wheat season.
- The loan amount is R10 000 000 and bears no interest.
- The R10 000 000 is made available as a facility and can be drawn as needed. No commitment fee is payable for the facility.
- The principal debt must be repaid before the next harvest season.
- A market-related interest rate is 7%.
- The Department estimates the loss allowance as R100 000.
- There is no reliable estimate for the fair value of the loan facility.

# Example

## Initial measurement

- The concessionary loan part (social benefit) is calculated as follows:

Loan	R10 000 000	A
Period	1 year	
Market related interest	7%	
Present value of the loan	R9 345 794	B
Social benefit	<b>R654 206</b>	A - B



# Example

## Initial measurement

- The journal entries are as follows:

	Debit	Credit
Social benefit	R654 206	
ECL in SFPER	R100 000	
Loan commitment liability		R754 206
<i>Recognition of the loan commitment</i>		

# Example

## Subsequent measurement

- Continuing with the example of the Department of Agriculture providing a farmer with a R10 000 000 low-interest loan facility.
- At the reporting date:
  - The farmer has not drawn any funds from the facility.
  - The Department expects that the farmer will draw the full R10 000 000 on the facility within 30 days after the reporting date.
  - The loan must be repaid before the next harvest season, which is 8 months after the expected draw down.
  - The Department expects that the farmer will repay R9 000 000 on the due date.
  - There has been a significant increase in credit risk.

# Example

## Subsequent measurement

- Calculate the ECL at the reporting date

	Contractually	Expectation	ECL
Amount to repay	R10 000 000	R9 000 000	
Period	8 months	8 months	
EIR	7% per year	7% per year	
<b>Present value of the cash flows</b>	<b>R9 558 964</b>	<b>R8 603 067</b>	<b>R955 896</b>
Social benefit from initial recognition			R654 206
Value at the reporting date			<b>R1 610 102</b>

# Example

## Subsequent measurement

- The journal entry is as follows:

	<b>Credit</b>
Loan commitment liability at initial recognition	R754 206
Loan commitment at reporting date	R1 610 102
<b>Movement</b>	<b>R855 896</b>

	<b>Debit</b>	<b>Credit</b>
ECL in SFPER	R855 896	
Loan commitment liability		R855 896
<i>Recognition of the reporting date adjustment to the loan commitment</i>		

# Example

## Subsequent measurement

- The farmer drew the full R10m 30days after the reporting date
- The journal entry is as follows:

	Debit	Credit
Loan commitment liability (social benefit)	R654 206	
Concessionary loan asset	R9 558 964	
Surplus or deficit		R213 170
Bank		R10 000 000
<i>Recognition of the draw down of the loan facility.</i>		

# Example Subsequent measurement

- The journal entry to loss allowance is as follows:

	Debit	Credit
Loan commitment liability (loss allowance)	R955 896	
Provision for ECL		R955 896
<i>Clear the loan commitment liability to the loss allowance for the concessionary loan asset.</i>		



# Disclosures on loan commitments and concessionary loans





# Disclosure (par.8.2 to 8.60)

## Loan commitments

- All loan commitments are subject to GRAP 104 disclosure (par.8.2)
- Gains or losses in surplus or deficit (par.5.46)
- Loss allowances recognised as provisions and information on changes in the loss allowance for financial assets separately from those for loan commitments (par.AG8.12)
- Maximum credit risk exposure (par.8.52 and AG8.19):
  - Full amount of the commitment if issuer cannot settle the loan commitment net in cash or another financial instrument
    - Irrevocable over the life of the facility or
    - Revocable only in response to a material adverse change





# Disclosure (par.8.2 to 8.60)

## Loan commitments

- By risk rating the exposure to credit risk (par.8.54):
  - Credit risk exposure for 12-month expected credit losses
  - Credit risk exposure for lifetime expected credit losses:
    - Significant increase in credit risk since initial recognition
    - Credit-impaired at reporting date
- Maturity analysis for FL, gross loan commitments (par.8.58, AG8.23 and AG8.24)
  - Commitment to make amounts available in instalments, i.e undrawn loan commitment, is included in the time band containing the earliest date it can be drawn down



# Disclosure (par.8.2 to 8.60)

## Loan commitments

- Market risk exposure and sensitivity analysis for each significant type of market risk (par.8.59)
  - Interest rate risk on loan commitments not recognised in the statement of financial position (AG8.32)

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