Section 11(*j*)(i)/IFRS 9 application

In order for SARS to review your request, you are required to consider, complete and provide documentation where required.

The application is made up of 2 documents:
Part 1 -   Request for Information (The RFI); and
Part 2 -   Loss allowance model template (The Loss Allowance Model).

A Glossary is provided on page 12.

Part 1: The RFI

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Part 2: The Loss Allowance Model

The Loss Allowance Model that must be completed is provided in excel format.
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IFRS 9 compliance

1. Please provide:
   - The approval and acknowledgement by your appropriate governing body of the financial impact resulting from adopting IFRS 9.

2. Please provide:
   - Financial statements for the last year of applying IAS39.
   - Financial statements for the first year of applying IFRS 9.

3. Please provide:
   - The name of your current external auditors, including date of appointment.

4. Should your latest financial results (prior financial year-end or current financial year-end interim results) contain a modified audit report, please indicate the level of audit qualification.

   A modified audit report could be expressed as one of –
   - an *'except for'* audit report*;*
   - an *'adverse'* audit report*;*
   - an *'inability to form an opinion'* audit report*.*

   In all cases where there is a modified audit report, please provide full details of the possible effect of the modification on the values and categorisation of your IFRS 9 impairment provisions.

5. Please provide:
   - Further details on any reference to 'emphasis of matter' in the audit report.
   - Although a reference to 'emphasis of matter' does not constitute a qualification, any mention of 'emphasis of matter' requires explanatory details.

Business overview; internal process, procedure and governance

6. Please provide:
   - An overview of your business activities, including the types of finance (instalment sale, lease etc.) that you provide as well as the underlying commodities that are being financed.

7. Please provide:
   - An overview of your group structure and all the governing bodies of your own legal entity as well as group imposed governance.

8. Please provide:
   - A list of other new accounting standards (other than IFRS 9) that were adopted since 1 January 2018, should the standard have any impact on impairment calculations.

9. Please provide:
   - A list of all the changes made by your organisation which was necessitated by or resulting from the adoption of IFRS 9, i.e. a change in the definition of default or credit provisioning methodology.

10. Please provide:
    - A copy of your accounting policies, only if the AFS for the first IFRS 9 year-end is not yet available.

11. Please provide copies of your risk management policies that relates to:
    - Credit Risk Management; and
    - Model Risk and Validation.

12. Please provide:
    - A copy of your credit provisioning methodology.

Questions

13. Although the documents above may include information that relates to this questionnaire section, you are required to capture your response to all questions afresh in the space provided. Should you attach supporting documentation, please clearly indicate the relevant pages and paragraphs applicable to each question.

Response to Question #
Taxpayer response: Capture answer here **or** make reference to a separate document, which is clearly marked as "*Response to Q #*".

Taxpayer response: *Documentation*	Where appropriate, the taxpayer can attach existing documentation which would validate the response and / or assist in answering the question. Should the supporting documentation cover a broad spectrum of principles, the taxpayer should refer to the specific pages contained in the documentation that relates to the answer of the question being addressed.

Section 11(*j*)(i) considerations

14. Section 11(*j*)(i) requires consideration, by the Commissioner, of the following factors in determining the percentage allowance which can be increased, to a percentage not exceeding 85%:
    A. The history of a debt owed to that taxpayer, including the number of repayments not met, and the duration of the debt;
    B. Steps taken to enforce repayment of the debt;
    C. The likelihood of the debt being recovered;
    D. Any security available in respect of that debt;
    E. The criteria applied by the taxpayer in classifying debt as bad; and
    F. Such other considerations as the Commissioner may deem relevant.

    The factors listed above are addressed through the provision of the detailed information requested hereunder.

Reclassification and measurement

15. Please provide your interpretation and application of IFRS 9, in relation to reclassification and measurement. Your response should include the classification and measurement of asset classes as was done under IAS39 and a description of the new classifications and measurements as is now being done under IFRS 9. Your business model assessment should make reference to terms such as amortized cost, SPPI, FVOCI or FVPL.

The model

16. Please provide a detailed description of your ECL model, including (at least) the following aspects:
    • Inputs;
    • Assumptions;
    • PD model;
    • LGD model;
    • EAD models; and
    • FLI.

    Should the terminology used in your ECL model be different to the terminology referred to above, please provide the necessary detail that describes your provisioning model.

17. Credit exposures are generally classified as in default if the exposure is overdue for more than 90 days. In order to understand the relationship between "days in arrear" and "contractual delinquency", the following example is provided:
    - Instalment 1 is due on t0.
    - Instalment 1 is missed.
    - For the period that the 1ˢᵗ instalment is overdue for a period of 1 to 29 days, it is referred to as "dirty".
    - On the day that the 2nd instalment is due and missed, the 1st instalment would be overdue for 30 days.
    - On the day that the 3rd instalment is due and missed, the 1st instalment would be overdue for 60 days.
    - On the day that the 4th instalment is due and missed, the 1st instalment would be overdue for 90 days.
    - Therefore, to be overdue for 90 days and more would be at the point where 4 full consecutive instalments were missed.

Instalment	P1				P2				P3				P4
Days	0	1	2	..	30	31	32	..	60	61	62	..	90

18. An entity should apply a definition of default that is consistent with the definition used for internal credit risk management purposes for the relevant financial instrument. Please provide the necessary details, including:
    - A detailed description of how a change in PD is used as a trigger for stage classification change;
    - An illustration of this application in your environment;
    - Do you allow the restructure of existing debt, distressed or otherwise? If so, your interpretation and application of IFRS 9 in relation to the definition of distressed restructure, including a list of your qualifying conditions is required;
    - Since not all loan restructures automatically qualify for a higher stage allocation, please provide detail on how different types of restructures are categorised.

19. Whilst a significant portion of the advances book may relate to secured retail exposures which require focus on determining the risk associated with the carrying value of the loan or instalment sale agreement (closed facility), it is recognised that many entities would hold exposures on undrawn facilities such as revolving loans and credit cards (open facility). Please provide a detailed description of how your entity calculates EAD values.

20. To the extent that the funding provided by your organisation was in respect of secured lending, please elaborate on how the recoverable value of securities was incorporated into your LGD models.

21. Please provide detail on how other cash flows (e.g. life insurance and post write-off recoveries) were incorporated into your LGD models.

22. When estimating ECLs, management should consider information that is reasonably available, including information about past events, current conditions and reasonable and

supportable forecasts of future events and economic conditions. IFRS 9 requires management to forecast the credit losses that the company is expected to incur as the result of defaults under different scenarios covering prescribed future periods. Forward-looking macro-economic information must be incorporated into expected loss estimates through the application of quantitative modelling and expert-judgement-based adjustments. ECLs should be calculated for the core (best estimate) scenario, an upside scenario and a downside scenario. The probability-weighted average of the ECL figures calculated under each of these scenarios should deliver unbiased ECL estimates.

- Please provide a detailed description of how FLI was obtained or calculated.
- Please provide a detailed description of how FLI was incorporated into your provision modelling application with specific reference to PD and ECL estimates.

Stage migration

23. The transition from recognising 12-month ECLs (i.e. Stage 1) to LECLs (i.e. Stage 2 or Stage 3) in IFRS 9 is based on the notion of a SICR over the remaining life of the debt in comparison with the credit risk on initial recognition. The focus is on the changes in the risk of a default, and not the changes in the amount of expected credit losses.

24. The concept of default is fundamental to the application of the model and the standard established two rebuttable presumptions. SICR for purposes of migrating from Stage 1 to Stage 2 does not occur later than when debt is more than 30 days past due. The standard also states that default (Stage 2 to Stage 3) does not occur later than when debt is more than 90 days past due. These presumptions may be rebutted only if an entity has reasonable and supportable information. Has your organisation rebutted any one or both of these presumptions, and if so, please provide details of the factors used to rebut these presumptions?

25. A simple or absolute comparison of PDs at initial recognition and at the reporting date is not appropriate. All else being equal, the PD of debt should reduce with the passage of time. Please provide a detailed description of how the initial PD as well as the PD-curve of a term loan is established at loan origination date.

26. Please provide a detailed description of how current PDs are obtained, other than through the observation of contractual delinquency.

27. The assessment of whether credit risk has significantly increased depends, critically, on the interpretation of the word 'significant'. Defining significance generically for purposes of assessing the amount of change in the risk of a default occurring would be arbitrary as this depends on the type of products, maturities and initial credit risk. Accordingly, in order for SARS to understand your interpretation and application of IFRS 9, in relation to the "definition of SICR", you are requested to provide the necessary detail required, including your definition of and measurement criteria for the word 'significant'.

28. A migration from Stage 1 to Stage 2 or to Stage 3 can also include debt that has shown a significant increase in credit risk but that do not have objective evidence of impairment, i.e. no contractual delinquency was observed. Please provide a detailed description of how the interpretation of 'significant' is applied at a practical level when considering the change in PD with reference to the PD comparison threshold for migration from 12-month ECL to LECL. The detail should include a detailed overview of all qualitative considerations when determining whether individual exposures have experienced a SICR.

29. Please provide an overview of cure definition, requirements and process of migration from Stage 3 to Stage 2 and finally back to Stage 1.

Extension of measurement period

30. IFRS 9 requires the entity to write off NPLs at the point where there is no reasonable expectation of further material recoveries. Please provide the necessary detail required including a methodology description of establishing the probability point of further recovery being improbable. Your description must at least include the following:
    - Please provide an overview of your debt collection process, including internal and external legal processes followed, with specific reference to stage classification and subsequent write-off and possible recoveries.
    - Please provide your definition of and measurement criteria for the phrase 'reasonable expectation'. This could be expressed as the period that a loan and its associated provision must be held on balance sheet before the entity believes that no further material recoveries would be collected.
    - Please provide your definition of and measurement criteria for the phrase 'material recoveries'. Material recoveries refer to any amounts received post write-off and should be limited to such recoveries not exceeding a specified percentage of prior write-offs.

31. Please provide a detailed description of how the extension of the measurement period has impacted the write-off point in your organisation. How does the current expected recovery % compare to what was recovered under IAS39?

32. Section 11(*j*)(i)*(aa)*(B) provides for an allowance in respect of the amounts of debts disclosed as bad debt written off for financial reporting purposes that have not been allowed as a deduction under section 11(*i*) for the current or any previous year of assessment and the debt is included in the income of the taxpayer in the current or any previous year of assessment. Please provide the value of such debts that have been previously written off for financial reporting purposes which have been disallowed for tax purposes and the reasons therefore.

Interest in suspense

33. For debt classified as Stages 1 and 2, interest revenue is calculated on the gross carrying amount whereas Stage 3 debt calculates interest revenue on the amortised cost (i.e. the

gross carrying amount less the loss allowance). Whilst the IAS 39 accounting for and disclosure of interest in suspense was not treated consistently by all, the change brought about by IFRS 9 eliminates this problem. With interest in suspense now being classified as impairment provisions, it is important to identify the different accounting treatments in order to ensure consistent tax treatment. Please provide a detailed description of your proposed accounting and tax treatment of interest in suspense. The description should include your accounting and tax treatment of the transition value of interest in suspense.

Model overview and instructions for completion

34. The objective of the model is to obtain the maximum amount of granular data regarding the loan book and the associated IFRS provisions. Data must be captured on the relevant tab, depending on the IFRS approach that was adopted (general / simplified / both).

Tab 1 – Application Summary

35. Tab 1 requires the following inputs:

TAYPAYER NAME:	ER
TAX REFERENCE NUMBER:	9999/888/77/6
FIRST DAY IFRS9 TRANSITIONED:	01 January 2018
FIRST YEAR END IFRS9:	31 December 2018
DATE OF DATA SUPPLIED:	1-Jan-18

36. All data captured onto tabs 2 (IFRS 9 Detail General) and 3 (IFRS 9 Detail Simplified) will automatically update the summary tab.

37. Two templates of the loss allowance model have been provided –
   * IAS39 converted to IFRS 9 – day of adoption;
   * First year end reported under IFRS 9.

38. Please check that tab 1 correctly reflects the output of your application.

Tab 2/3 – IFRS 9 Detail General / Simplified

39. There is no difference between tabs 2 and 3 other than the heading.

40. The body of the model consists of 3 main areas:
   * Drop-down selections;
   * Value capture;
   * Tax allowance rate application capture.

41. The drop-down selections can be found in lines/columns B129:H156.

DROP DOWN SELECTIONS						
Borrower's Sector	Homogeneous Group Identifier	Type of finance	Collateralised	Underlying Asset being funded	Stage Allocation	Delinquency events
Select	Select	Select	Select	Select	Select	Select
Individual	Spare	Term: to 6 m's	Unsecured	Clothing	Stage 1	Clean
SME	Spare	Term: to 12 m's	Secured: Asset	Communication	Stage 2	Instalment 1 - 29 days in arrear / Dirty
Corporate	Spare	Term: to 18 m's	Secured: Guarant	Electricity	Stage 3	Instalment 30 - 59 days in arrear / CD 1
Municipality	Spare	Term: to 24 m's	Spare	Furniture	n/a	Instalment 60 - 89 days in arrear / CD 2
Parastatal	Spare	Term: to 36 m's	Spare	General	n/a	Instalment 90 - 119 days in arrear / CD 3
SOE	Spare	Term: to 48 m's	Spare	House	n/a	Instalment 120 - 159 days in arrear / CD 4
Spare	Spare	Term: > 48 m's	Spare	Rates & Taxes	n/a	Event #7
Spare	Spare	Call loan	Spare	Services	n/a	Event #8
Spare	Spare	Credit Card	Spare	Vehicle	n/a	Event #9
Spare	Spare	Guarantee	Spare	Spare	n/a	Event #10
Spare	Spare	Lease	Spare	Spare	n/a	Event #11
Spare	Spare	Mortgage	Spare	Spare	n/a	Event #12
Spare	Spare	Revolving credit	Spare	Spare	n/a	Event #13
Spare	Spare	Spot Invoice	Spare	Spare	n/a	Event #14
Spare	Spare	Term: Annual	Spare	Spare	n/a	Event #15
Spare	Spare	Term: Bullet	Spare	Spare	n/a	Event #16
Spare	Spare	Term: Structured	Spare	Spare	n/a	Event #17
Spare	Spare	Spare	Spare	Spare	n/a	Event #18
Spare	Spare	Spare	Spare	Spare	n/a	Event #19
Spare	Spare	Spare	Spare	Spare	n/a	Event #20

42. Each drop-down box is pre-populated with a number of descriptions. Should the current descriptions not be adequate for your business, "spare" lines can be used.

43. A spare column "Homogeneous Group Identifier" was inserted. The "spare" can be populated and used accordingly. Should you make use of the "spare", please provide a description in the heading – cell C130.

44. Delinquency events need to be captured in line with your own business model and credit management process and at the lowest level of granularity. It MUST include at least the first 6 events as populated in the drop-down box.

45. Please provide data at the most granular level, with specific reference to "type of finance". Should you provide for example both 6 and 12 month loans, please capture separately.

46. Once the drop-down boxes are populated and representative of your credit management and loss provisioning processes, data can be captured.

47. Please note that the calculations (columns Q to AP) are dependent on the data in the drop-down selections as well as the tax allowance rate (column P) that is being requested.

48. Individual asset classes must be captured between lines:
   - Lines 13 – 87: Assets, Exposure at Default and Provisions – for those assets where no partial write-off was applied;
   - Lines 91 – 100: Assets, Exposure at Default and Provisions – for those assets where partial write-off was applied;
   - Lines 104 – 113: Provisions – where overlay provisions were recognised but were not allocated to specific groups of debtors;
   - Lines 117 – 122: Exposure at Default and Provisions – for undrawn facilities.

49. Each line item requires the selection of identifiers contained in the drop-down boxes.

50. A capture example is shown below:
    - In the example below, the spare "Homogeneous Group Identifier" was not required;
    - All other drop-down boxes were completed;
    - A "one missed payment" delinquency event was set up for this example;
    - Value of loan was captured as R100 000 000;
    - Exposure at default was captured as R80 000 000;
    - The asset was classified as "Secured: Asset" which should result in an exposure at default being lower than the gross loan – meaning that the asset would be repossessed and sold;
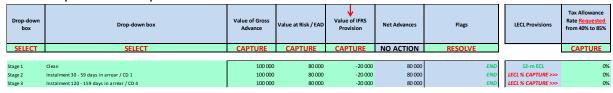   - IFRS 9 Provision was captured as (R20 000 000).

Borrower's Sector	Homogeneous Group Identifier	Type of finance	Collateralised	Underlying Asset being funded	Stage Allocation	Delinquency events	Carrying value of Gross Advances	Value at Risk / EAD	IFRS9 Provision	Net Advances	
Drop-down box	Drop-down box	Drop-down box	Drop-down box	Drop-down box	Drop-down box	Drop-down box	Value of Gross Advance	Value at Risk / EAD	Value of IFRS Provision	Net Advances	Flags
SELECT	SELECT	SELECT	SELECT	SELECT	SELECT	SELECT	CAPTURE	CAPTURE	CAPTURE	NO ACTION	RESOLVE
Individual	Select	Term: to 24 m's	Secured: Asset	Vehicle	Stage 2	One missed payment	100 000 000	80 000 000	-20 000 000	80 000 000	END

51. Any errors or omissions will result in a "flag". All "flags" must be resolved prior to submission.

52. An example of an omission:

Drop-down box	Drop-down box	Drop-down box	Drop-down box	Drop-down box	Drop-down box	Drop-down box	Value of Gross Advance	Value at Risk / EAD	Value of IFRS Provision	Net Advances	Flags
SELECT	SELECT	SELECT	SELECT	SELECT	SELECT	SELECT	CAPTURE	CAPTURE	CAPTURE	NO ACTION	RESOLVE
Individual	Select	Term: to 24 m's	Secured: Asset	Vehicle	Stage 2	One missed payment	100 000 000	-	-20 000 000	80 000 000	ADV + NO VAR?

General Approach:

53. All 12-month ECLs (Stage 1) will automatically generate the appropriate rate of 25%.

54. All LECLs (Stages 2 and 3) will automatically generate the appropriate rate of 40%.

55. Should a rate higher than 40% be required, such higher rate for LECLs must be captured in column P.

56. An example of rate capture:

Drop-down box	Drop-down box	Value of Gross Advance	Value at Risk / EAD	Value of IFRS Provision	Net Advances	Flags	LECL Provisions	Tax Allowance Rate Requested from 40% to 85%
SELECT	SELECT	CAPTURE	CAPTURE	CAPTURE	NO ACTION	RESOLVE		CAPTURE
Stage 1	Clean	100 000	80 000	-20 000	80 000	END	12-m ECL	0%
Stage 2	Instalment 30 - 59 days in arrear / CD 1	100 000	80 000	-20 000	80 000	END	LECL % CAPTURE >>>	0%
Stage 3	Instalment 120 - 159 days in arrear / CD 4	100 000	80 000	-20 000	80 000	END	LECL % CAPTURE >>>	0%

57. Should no rate be captured in column P, the minimum rate of 40% will be applied.

Simplified Approach:

58. All LECLs (Stages 1, 2 and 3) will automatically generate the appropriate rate of 40%.

59. Should a rate higher than 40% be required, such higher rate for LECLs must be captured in column P.

60. An example of rate capture:

Drop-down box	Drop-down box	Value of Gross Advance	Value at Risk / EAD	Value of IFRS Provision	Net Advances	Flags	LECL Provisions	Tax Allowance Rate Requested from 40% to 85%
SELECT	SELECT	CAPTURE	CAPTURE	CAPTURE	NO ACTION	RESOLVE		CAPTURE
Stage 1	Clean	100 000	80 000	-20 000	80 000	END	LECL % CAPTURE >>>	0%
Stage 2	Instalment 30 - 59 days in arrear / CD 1	100 000	80 000	-20 000	80 000	END	LECL % CAPTURE >>>	0%
Stage 3	Instalment 120 - 159 days in arrear / CD 4	100 000	80 000	-20 000	80 000	END	LECL % CAPTURE >>>	0%

61. Should no rate be captured in column P, the minimum rate of 40% will be applied.

Tab 4 – Recoveries

62. You are required to provide the values of write-offs and recoveries for the past ten years.

Summary

63. Capture taxpayer data in Summary.

64. Prepare drop-down selections in IFRS 9 Detail General & Simplified.

65. Capture individual line items in one of four sections:
   - Section A: Assets where partial write-off was not applied;
   - Section B: Assets where partial write-off was applied;
   - Section C: Provisions, where overlay provisions were recognised but were not allocated to specific groups of debtors;
   - Section D: Undrawn facilities exposure at default and associated provisions.

66. For each line entry, select the relevant identifier from each drop-down box.

67. For each line entry in sections A and B, capture the gross advance, exposure at default and IFRS provision.

68. For each line entry in section C, capture the IFRS provision.

69. For each line entry in section D, capture the exposure at default and the IFRS provision.

70. Please note that although provisions in respect of Undrawn Facilities will not qualify for a tax allowance, you are still required to provide the data in the Loss Allowance table.

71. A value capture error or omission will result in a "Resolve Flag" message.

72. For each line entry where LECL provisions were calculated and a rate higher than 40% is applied for, the relevant rate must be captured.

73. The omission of the rate capture will result in the minimum rate of 40% being applied.

74. Complete the Recoveries tab.

75. Check the output as calculated in the Summary tab.

<u>Glossary</u>

DIA	Date of initial application
IFRS 9	International Financial Reporting Standard
IAS39	International Accounting Standard
EAD	Exposure at default
ECL	Expected credit loss
FLI	Forward-looking information
IBNR	Incurred but not reported
ISP	Interest in suspense
LECL	Lifetime expected credit loss
LGD	Loss given default
NPLs	Non-performing loans
PD	Probability of default
PSI	Portfolio specific impairments
SICR	Significant increase in credit risk
SPPI	Solely to payments of principles and interest
VAF	Vehicle asset finance