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Bad Debt Provisioning Policy for Trade Receivables

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PURPOSE

The purpose of the document is to establish policy for recognizing/recording an amount for Expected Credit Loss (ECL) in line with the requirements of IFRS-9 on trade receivables.

OVERVIEW

IFRS-9 is applicable for accounting periods beginning on or after January 01, 2018, however earlier adoption is permitted. IMS adopted IFRS-9 to account for its trade receivable provision from July 01, 2017.

There are two approaches for recognizing/recording ECL.

1. General Approach
2. Simplified Approach

Under general approach a company is required to record impairment of its financial assets in three stages.

Stage	1	2	3
Impairment	12 month expected credit loss	Lifetime expected credit loss	

Stage-1 When no significant increase in credit risk.

Stage-2 In case of significant increase in credit risk.

Stage-3 In case of credit impairment.

In simplified approach a company is required to record impairment of its financial assets on Lifetime expected credit loss basis. This approach is allowed for:

a) Trade receivable WITHOUT significant financing component
b) Contract assets under IFRS-15 WITHOUT significant financing component

METHODOLOGY

As IMS receivables consist of balances without any significant financing component, therefore it has adopted to record its ECL based on simplified approach using a provision matrix. The matrix is prepared on the basis of type of customer and their probability of default.

Type of customer	**Probability of default**			
	30 Days	**30-180 Days**	**180-365 Days**	**Above 365 Days**
Sponsor/Director Accounts	0%	0%	0%	0%
Corporate Accounts	0%	0%	0%	0%
Individual Accounts with Security Balance	0%	0%	0%	0%
Individual Accounts having Active Trading Record	0%	0%	0%	0%
Individual Accounts with Recovery Record	0%	0%	0%	0%
Individual Accounts without Security Balance and Active Trading Record	0%	5%	10%	15%

In case of Individual accounts without security balance and any active trading record, 100% of the amount is written off where the balance has been outstanding for more than 3 year.

Amount of ECL for each individual customer is calculated using the following formula:

Expected credit losses = Exposure at default * probability of default

(ECL = EAD * PD)

PROCEDURE

To calculate ECL for a period following steps are followed:

1. Aging data for the period is extracted from Back Office System with 30, 180, 365 and 1,095 days parameter along with CDC/Security balances.
2. Customers are classified into categories i.e. Individual, Corporate and Director.
3. Subsequent recovery of outstanding balances is incorporated into the calculation.
4. Exposure at default (EAD) is calculated by taking balances from aging and adjusting any subsequent clearances as per step 3 from it.
5. Probability of default (PD) is applied to each individual balance using provision matrix.
6. Loss given default before considering available collateral is calculated by multiplying exposure at default calculated in step 4 with probability of default as per step 5 (EAD*PD).
7. VAR (Value at Risk) adjusted collateral balances available against each individual balance is extract from Back Office System.
8. Amount calculated in step 6 is compared with balances in step 7 and any amount in excess of it is recorded as ECL.
9. ECL calculated in step 8 is compared with previously recorded ECL to arrive at charge/reversal for the period.

Line Manager reviews the calculation for any correction and forwards it to CFO for approval. Once approved the amount is incorporated in the Financial Statements through following journal entry:

Account Code	Head of account	Debit	Credit
1401001	Bad & Doubtful Debt Expense	XXX	
0901003	Provision for bad debts		XXX