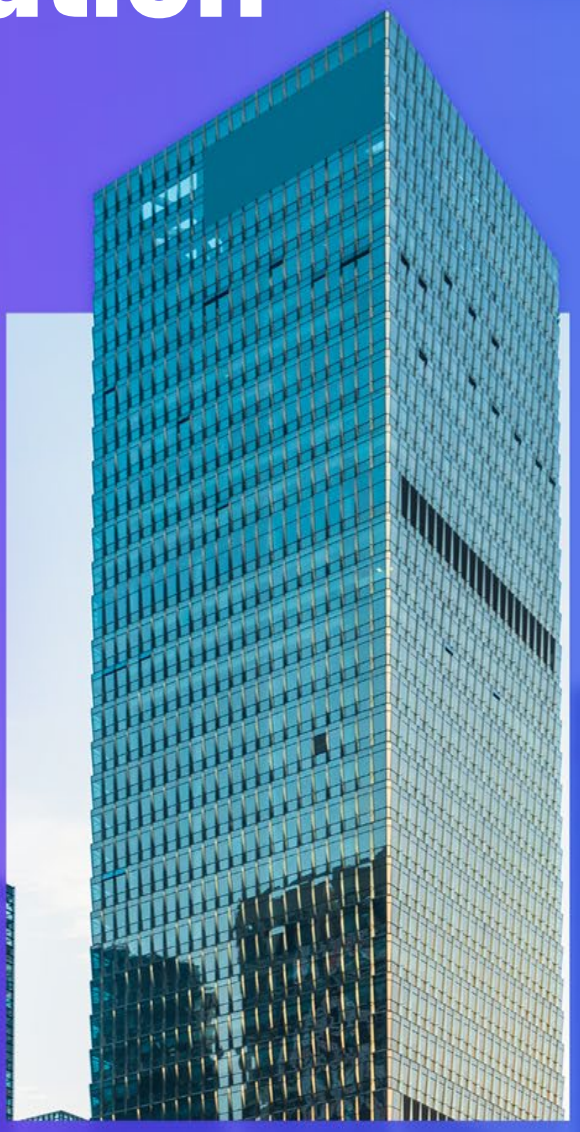
KPMG

Effective Interest Rate (EIR) Implementation



KPMG in Cambodia

Risk Consulting

Why EIR Methodology?

- Interest recognition using EIR is required by the accounting standard.
- EIR is used to calculate amortised cost of a financial asset or financial liability, and to allocate interest income or interest expense over a relevant period.
- EIR discounts estimated future cash flows, without taking into account of future credit losses, to the gross carrying amount of asset or the amortised cost of liability.
- EIR depends on:
  - Expected Life (behavioral life)
  - Prepayment behavior
  - Interest rate structure
  - Fee and cost at origination that are integral to the origination of financial assets etc.

Current Bank Practices

Based on KPMG's observed EIR practice, **interest income** in Cambodia is often based on **contractual rate and straight-lining of processing fee under Cambodian Accounting Standard ("CAS")**

Under Cambodian International Financial Reporting Standard ("CIFRS"), this practice creates a **potential risk of material misstatement** on the "unearned processing fee" line item, as **banks relies on straight-line instead of EIR-adjusted amortisation.**

Over time, banks have had **to justify the impact on an on-going basis with external auditor.**

With **EIR properly calculated using EIR principle,** unearned fee can be amortised according to international acceptable accounting standards.

Other downstream impact includes the use of **EIR instead of contractual for Expected Credit Losses ("ECL") discounting.**

KPMG Approach:

Our Experience

We operate a dedicated Financial Risk Management practice in Cambodia and our CIFRS 9 professionals have assisted majority of the top Banks and Microfinance Institutions in the credit risk model related space.

Our committed and experienced teams of local and expatriate professionals are ready to support you in tailor-made CIFRS 9 implementation projects, particularly in carrying out the EIR Methodology in your institution.

Our Expertise

As one of the largest professional firms in Cambodia, we bring together diverse perspectives and skills from experts in CIFRS 9 ECL and EIR methodologies, regulatory compliance and CIFRS audits to develop innovative approaches and deep expertise to deliver real results.

Our Tailored Solutions

Our services range from assisting clients to develop an EIR implementation plan through developing an EIR calculation tool, CIFRS 9 compliant and customised EIR policy and conduct gap analysis reports on products in-scope of EIR calculation. We also conduct hands-on training on EIR calculation and related topics.

Our Outputs

Case Study 1

This case study illustrates how a new commercial bank started right by using EIR methodology in calculating interest revenue and loan fees amortisation

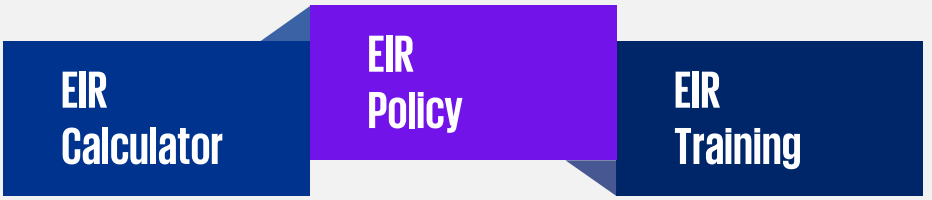
In-state analysis:

- The Bank was a start-up founded in 2022 with an objective to ensure that all their banking practices are in line with regulatory guidelines (i.e. Prakas) and acceptable CIFRS requirements.
- The Bank aimed to establish EIR policy in connection to their credit risk and accounting policies to comply with CIFRS 9 requirements.

KPMG Insights and Solutions

KPMG was able to conduct a walkthrough of the Bank's current practice to be able to design an EIR policy and tool that is in line with the requirements of CIFRS 9.

Outcomes



Case Study 2

This case study illustrates how a large commercial bank implemented EIR methodology as part of the Bank's credit risk management enhancement initiative.

In-state analysis:

- The Bank being one of the largest banks in Cambodia aims to implement EIR Methodology in their amortisation of loan fees to be in line with Prakas and CIFRS requirements.

Impact/Issues noted:

- Loan schedule was not properly maintained to ensure that loan value zeroes out at the end of the term affecting amortisation schedule of loan fee after calculating effective interest rate at day-one.

KPMG Insights and Solutions

- KPMG conducted a thorough gap analysis review on the treatment of loan fees that are part of CIFRS 9;
- KPMG also provided calculation tools to cater the product needs such as single rate and multiple rate fixed loans including modification assessment guidance for EIR calculation when there is subsequent loan modification;
- KPMG developed a customised EIR policy to address issues and impacts noted to serve as a guidance to the Bank moving forward.

Outcomes

Output customised to cater client banking needs

Contact us

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