IFRS® Accounting

Staff paper

Agenda reference: 4

Accounting Standards Advisory Forum meeting

Date	**March 2024**
Project	**IASB's PIR of IFRS 9 *Financial Instruments*—Impairment**
Topic	**Application matters in determining ECL**
Contacts	**Iliriana Feka (ifeka@ifrs.org)** **Riana Wiesner (rwiesner@ifrs.org)**

Purpose of this session

- To provide a brief overview of feedback received on the post-implementation review (PIR) of impairment requirements in IFRS 9
- To update ASAF members with the progress of the IASB's feedback deliberations to date
- To discuss the prominence of other matters raised during the PIR in various jurisdictions

Questions for ASAF members

- Slide 8 and slide 10 set out questions for this session

Project overview

The **objective** is to **assess** whether the **effects** of applying the requirements on users of financial statements, preparers, auditors and regulators are those the IASB **intended** when it developed the requirements

PIR of **impairment requirements** in IFRS 9 and **credit risk disclosure requirements** in IFRS 7 *Financial Instruments: Disclosures*

Phase 1 of PIR
Q4 2022
Outreach and identify matters to examine

The RFI
May 2023
Comment period ended in Sep 2023

Phase 2 of PIR
Nov 2023 – Q2 2024
Feedback analysis

Project Summary
Q3 2024

A reminder of the PIR process—how does the IASB respond to findings?

1 Consider whether to take action, based on the extent to which:

objectives have **fundamental questions** (ie 'fatal flaws')

benefits to users are significantly lower than expected

costs of applications are significantly higher than expected

2 Determine the prioritisation of the findings based on the extent to which:

finding has **substantial consequences**

finding is **pervasive**

finding arises from an issue that **can be addressed** by the IASB or the IFRS Interpretations Committee (IC)

the benefits of any action would be expected to **outweigh** the costs

3 Determining the timing of taking action

High priority	to be addressed as soon as possible
Medium priority	to be added to the IASB or the IC research pipeline
Low priority	to be considered in the next agenda consultation
No action	require no further action

Overview of PIR feedback

Overall positive feedback

Almost all stakeholders said that the impairment requirements in IFRS 9:

- result in more timely recognition of credit losses compared to IAS 39; and
- work as intended with no fundamental questions ('fatal flaws').

Hot topics:

- application challenges arising from the interaction between the impairment requirements and other IFRS 9 requirements on modification, derecognition and write; and
- diversity in the quality and granularity of credit risk disclosures.

Other application matters, including**:**

- Expected credit losses (ECL) for intragroup financial instruments and initial ECL for purchased financial assets; and
- ECL for loan commitments, reflecting the effect of some financial guarantees in the measurement of ECL and application questions on purchased or originated credit-impaired (POCI) financial assets.

IFRS Accounting

Project plan

Topics for IASB discussion

General Approach

Feedback: Application challenges for some financial instruments such as intragroup or purchased assets

Discussion: February 2024
Outcome: No standard-setting

Significant Increase in Credit Risk (SICR)

Feedback: Requests for further application guidance and illustrative examples on determining SICR

Discussion: February 2024
Outcome: No standard-setting

Measurement

Feedback: Diversity in practice and requests to add application guidance, including for the effect of credit enhancements in ECL

Discussion: March 2024
Outcome: TBD

ECL and other requirements

Feedback: Challenges in accounting for changes in expected credit losses vs modifications or derecognitions

Discussion: April 2024
Outcome: TBD

Credit risk disclosures

Feedback: Significant diversity in the quality and granularity of credit risk disclosures provided by entities

Discussion: Q2 2024
Outcome: TBD

POCI & other matters

Feedback: Application questions on POCI assets and on other matters, eg simplified approach

Discussion: Q2 2024
Outcome: TBD

IFRS Accounting

IASB discussions to date—The general approach and SICR

Topics	PIR feedback	IASB response
		No standard-setting action
General approach to ECL • The general approach is applied to intragroup and some non-commercial financial instruments • The approach is also applied to purchased assets that are not credit-impaired	**Approach works well for most financial instruments, however:** • Applying the approach to some intragroup and non-commercial financial instruments results in undue costs • Applying the approach to some purchased assets results in ‘double-counting’ of ECL	• The principles-based and ‘methods agnostic’ general approach in IFRS 9 provides an adequate basis for recognising ECL for these instruments • Addressing the ‘double-counting’ issue would require an overhaul to the ECL model—not justified by the overall positive PIR feedback
Determining SICR • Principle-based requirements for determining SICR	**It is imperative to keep the SICR approach principles-based, but:** • More explicit application guidance and illustrative examples may be helpful	• More explicit guidance would result in little incremental benefits which are unlikely to outweigh the operational costs from a change • Application of judgement will still be required

Questions for ASAF members on IASB discussions to date

- Do you have any questions or comments regarding the IASB’s discussions to date?
- In the light of the IASB’s tentative decision to take **no standard-setting action** in response to the PIR feedback on these matters, do you have any comments about other actions the IASB could take that might reduce the common application challenges for intragroup financial instruments?

Other matters

Questions for ASAF members on other matters

- The IASB is evaluating matters identified in the PIR feedback against the criteria set out in the PIR framework (see slide 4), to assess what, if any actions should be taken in response to the feedback. In this context, do you think any of the application matters identified in slides 11–15:

  1. are pervasive and have substantial consequences; and
  2. if yes, what is the root cause for the matter.

- Do you think the benefits of any standard-setting action would be expected to outweigh the costs, considering the extent of disruption and operational costs from change and the importance of the matter to users of financial statements.

1. *Lack of definition for loan commitments*

PIR feedback

- Suggest that the IASB defines what is a ‘loan commitment’.
- Entities refer to the definition of a financial instrument in IAS 32 *Financial Instruments: Presentation* and the description of a loan commitment in paragraph BCZ2.2 of the Basis for Conclusions on IFRS 9 which explains that ‘loan commitments are firm commitments to provide credit under pre-specified terms and conditions’.
- Lack of a definition gives rise to application questions eg whether a commitment to enter into a convertible bond is a loan commitment subject to ECL or is it a derivative.

Staff note

- Acknowledge that there is no specific definition for a loan commitment, but the PIR feedback does not provide evidence that substantial consequences arise in practice.
- In addition to the requirements and the basis mentioned in the PIR feedback, we also note that paragraph 2.3 of IFRS 9 requires loan commitments that can be settled by delivering or issuing another financial instrument to be accounted as derivatives.

2. Period over which to estimate ECL for individually managed instruments

PIR feedback

- Suggest that the IASB clarifies the scope of the exception in paragraph 5.5.20 of IFRS 9—specifically, whether facilities, such as corporate overdrafts, that are managed on an individual basis are outside the scope of this exception and, thus, their ECL is required to be measured over the maximum contractual period.
- In paragraph B5.5.39(c) of IFRS 9, 'managed on a collective basis' is described as one of the characteristics of the financial instruments that generally fall in the scope of the exception.

Staff note

- As noted in paragraph BC5.255 of the Basis for Conclusions on IFRS 9, the exception was designed to address specific concerns—that, for loan commitments managed on a collective basis, an entity usually has no practical ability to withdraw the commitment before a loss event occurs and <u>to limit the exposure to credit losses to the contractual period over which it is committed to extend the credit.</u>
- PIR feedback did not indicate whether stakeholders are unclear about the accounting outcome in accordance with IFRS 9 or whether they consider that outcome to be inadequate.

3. Credit enhancement in the measurement of ECL

PIR feedback

- Suggested the IASB add application guidance for determining the credit enhancements that are considered 'part of' / 'integral to' the contractual terms for the purposes of measuring ECL applying paragraph B5.5.55 of IFRS 9.
- Accounting firms have developed broadly consistent guidance which has been helpful in applying judgement required for this assessment.

Staff note

- Potential application guidance (eg non-exhaustive list of factors to consider) might support application, but it will not eliminate the need to apply judgement relevant to specific facts and circumstances.
- Adding application guidance is a standard-setting activity, follows the same due process to an Accounting Standard and thus, results in disruption and operational costs from a change.
- The IASB will need evidence that the incremental benefits of any action would outweigh those costs, also considering the relevant scope. Credit enhancements, other than financial guarantees, might also require consideration.

4. *Accounting for premiums received over time for financial guarantees issued*

PIR feedback

- Paragraph 4.2.1(c) of IFRS 9 or the related requirements are not sufficiently clear for entities to determine the accounting outcome for financial guarantee contracts for which the premiums are received over time, rather than upfront.
- Lack of specific requirements results in diversity in practice (some recognise a separate receivable for future premiums not yet due and a corresponding liability for the financial guarantee, others do not).
- Although the accounting firms have developed guidance on this matter, that guidance varies among firms and therefore, it does not lead to consistent accounting outcomes.

Staff note

- PIR feedback indicates that there is diversity in practice. However, the IASB will need to consider evidence whether such diversity results in substantial consequences and, if yes, why?

5. *Accounting for subsequent improvements in credit risk of POCI assets*

PIR feedback

- Diversity in practice was reported on the accounting for decreases in credit risk since initial recognition—specifically, some entities adjust the gross carrying amount of a POCI financial asset, others recognise it as a negative entry to the ECL allowance.
- Paragraph 5.5.14 of IFRS 9 provides requirements for recognition in the statement of profit or loss—it requires an entity to recognise favourable changes in lifetime ECL as an impairment gain, even if the lifetime ECL are less than the amount of ECL that were included in the estimated cash flows on initial recognition.
- Primarily a matter of presentation in the statement of financial position but it affects information such as coverage ratios, hence some stakeholders asked the IASB to do standard-setting to clarify the requirements.

Staff note

- PIR feedback indicates that there is diversity in practice, but it does not necessarily suggest that such diversity results in substantial consequences in practice.

IFRS Accounting

Follow us online

ifrs.org

@IFRSFoundation

IFRS Foundation

International Accounting Standards Board

The views expressed In this presentation are those of the presenter, not necessarily those of the IFRS Foundation, International Accounting Standards Board or the International Sustainability Standards Board.