Deloitte.

Deloitte Touche Tohmatsu Limited
1 New Street Square
London, EC4A 3HQ
United Kingdom

Phone: +44 (0)20 7936 3000
Fax: +44 (0)20 7583 1198
www.deloitte.com/about

Direct phone: +44 (0)20 7007 0884
vepoole@deloitte.co.uk

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Andreas Barckow
Chair
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London, E14 4HD
United Kingdom

Dear Dr Barckow

Request for Information – Post-implementation Review IFRS 9 *Financial Instruments* Impairment

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ("the IASB") *Request for Information – Post-implementation Review IFRS 9 Financial Instruments Impairment* ("the PIR").

We believe that the impairment requirements of IFRS 9 have generally worked well and overall have met the IASB's objective of more timely recognition of credit losses, resulting in users of financial statements being provided with useful information.

Our observations on the PIR are limited to topics related to the application of the impairment requirements where we believe improvements could be made to achieve greater comparability and to strengthen the Standard, for example by incorporating guidance from the *IFRS Transition Resource Group for Impairment of Financial Instruments*. These topics include the impact from guarantee contracts on the measurement of expected credit loss ("ECL"), certain aspects related to the presentation of ECL, and the interaction between ECL and modification accounting.

Our detailed responses to the questions in the PIR are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS and Corporate Reporting Leader

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Appendix

Question 1—Impairment
Do the impairment requirements in IFRS 9 result in: (a) more timely recognition of credit losses compared to IAS 39 and address the complexity caused by having multiple impairment models for financial instruments? Why or why not? (b) an entity providing useful information to users of financial statements about the effect of credit risk on the amount, timing and uncertainty of future cash flows? Why or why not?

The impairment requirements in IFRS 9 are providing more timely recognition of credit losses compared to IAS 39 and have resolved the complexity from the multiple impairment models that coexisted in IAS 39. Broadly, we believe the IFRS 9 impairment requirements have addressed the concerns regarding the timeliness of recognition of credit losses and responded to the information needs of users.

Question 2—The general approach to recognising expected credit losses
(a) Are there fundamental questions (fatal flaws) about the general approach? If yes, what are those fundamental questions? (b) Are the costs of applying the general approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

We do not believe there are fundamental questions (fatal flaws) about the general approach to impairment. We have provided in our response to other questions suggested improvements that we believe would reduce some divergence in practice arising from the application of the impairment requirements. We believe that these improvements could be integrated in IFRS 9 without introducing undue complexity and their implementation should not be onerous for preparers.

Question 3—Determining significant increases in credit risk
(a) Are there fundamental questions (fatal flaws) about the assessment of significant increases in credit risk? If yes, what are those fundamental questions? (b) Can the assessment of significant increases in credit risk be applied consistently? Why or why not?

We do not believe there are fundamental questions (fatal flaws) about the assessment of significant increases in credit risk ("SICR"). We acknowledge that different entities (with different exposures) weigh differently the various criteria in forming their judgement of what is a SICR. We believe that this is a reasonable consequence of the Standard, if accompanied with appropriate disclosure. We note that this diversity is less prevalent in the banking sector as the credit risk indicators used for prudential regulation are often used for IFRS 9 purposes, resulting in greater consistency of application.

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Question 4—Measuring expected credit losses (a) Are there fundamental questions (fatal flaws) about requirements for measuring expected credit losses? If yes, what are those fundamental questions? (b) Can the measurement requirements be applied consistently? Why or why not?

Integral credit enhancements

The definition of credit loss in IFRS 9: Appendix A indicates that cash flows "shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms." IFRS 9:B5.5.55 states that "the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms." The *IFRS Transition Resource Group for Impairment of Financial Instruments* ("Impairment TRG") in December 2015 stated that "credit enhancements included in the measurement of expected credit losses should not be limited to those that are explicitly part of the contractual terms."

These various statements have led to divergent practices on which credit enhancements, often purchased financial guarantee contracts or credit insurance, can be deemed integral and therefore included as part of the ECL measurement rather than being recognised separately. We note that the IFRS Interpretations Committee ("IFRC IC") concluded in March 2019 that the requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine whether to include the cash flows expected from a credit enhancement in the measurement of expected credit losses. However, the underlying assumption in the fact pattern presented in the submission to the IFRS IC was that the credit enhancement was recognised separately from the loan. We observe that there may be divergent views on whether and how a credit enhancement is recognised separately from the perspective of the holder as IFRS 9 contains only limited authoritative guidance in that respect. We also observe that securities market regulators have taken positions on this as part of their enforcement activities, including the public ESMA Decision ref EECS/0122-01[1].

We acknowledge that the Impairment ITG stated that judgement is needed to determine whether a credit enhancement is integral. However, we have observed that entities have developed significantly different practices and policies in exercising this judgement. Given the divergent approaches and the securities market regulators' responses in this area, we believe that it would be beneficial if IFRS 9 could address more clearly the types of credit enhancements that are not part of the contractual terms of the loan but can nevertheless reasonably be considered integral. This improvement to the existing requirements of IFRS 9 could be achieved by providing factors to consider in forming that judgement.

Non-linearity

At its December 2015 meeting, the Impairment TRG very helpfully observed that there may be a non-linear relationship between the different forward-looking scenarios and their associated credit losses and consequently using a single forward-looking economic scenario is not appropriate. Given the non-normal distribution of credit losses, this concept is important to ensure meaningful scenarios are selected that reflect the underlying distribution of these losses. Given this approach is often cited in practice when

[1] ESMA 26th Extract from the EECS's Database of Enforcement.

measuring ECL, we believe that it would be beneficial to integrate this concept directly in IFRS 9, as opposed to it being available as a reference only in the ITG summary.

Interest revenue recognition

IFRS 9:5.4.1 requires that in the case of exposures that become credit-impaired (i.e. moved to stage 3) the interest revenue is measured on the basis of the net carrying amount (gross carrying amount less expected credit loss) for 'subsequent reporting periods' (i.e. from the start of the period after they became credit-impaired). We support this approach. However, we observe different views on whether applying a change in the method used to calculate interest revenue from the beginning of the subsequent reporting period represents a requirement or simply a practical expedient. Some of those who view this as a practical expedient consider that the application from earlier dates/periods is acceptable if practicable. We consider the consistency of interpretation of timing of interest revenue measurement for credit-impaired financial assets is important, particularly given interest revenue is an important KPI for lenders, and therefore encourage the IASB to consider a clarification in this area.

Question 5—Simplified approach for trade receivables, contract assets and lease receivables

(a) Are there fundamental questions (fatal flaws) about the simplified approach? If yes, what are those fundamental questions?

(b) Are the costs of applying the simplified approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

We do not believe there are fundamental questions (fatal flaws) about the simplified approach to impairment.

We acknowledge that non-financial entities can find it challenging to determine expected credit losses given that often there is limited availability of quality forward-looking counterparty credit risk data including key inputs such as probability of default. This can be particularly challenging when these non-financial entities have large single asset exposures and do not have the benefit of deep historical and forward-looking credit risk data over assets with similar risk characteristics, as is generally the case for financial institutions determining ECL for portfolios of financial assets.

In particular, non-financial entities face challenge when measuring ECL for contract assets and intercompany loans. Consequently, we believe preparers may benefit from educational guidance published by the IASB on the simplified credit risk measurement techniques that may be used in such cases. Such educational guidance could take the same form as the educational guidance the IASB produced to assist preparers in estimating fair values of unquoted equity securities under IFRS 9.

Question 6—Purchased or originated credit-impaired financial assets

Can the requirements in IFRS 9 for purchased or originated credit-impaired financial assets be applied consistently? Why or why not?

We believe the distinction between purchased or originated credit-impaired ("POCI") financial assets and non-POCI assets is important and that different ECL measurement models should apply. In practice, determining whether a financial asset meets the definition of POCI or instead is subject to the general measurement approach can be challenging. We acknowledge that this determination requires judgement

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and that IFRS 9 provides a reasonable basis for forming that judgement. Therefore, we do not propose changes in this area.

However, we believe that the presentation of POCI financial assets in the statement of financial position and in the notes to the financial statements could be clarified. In particular, we believe that it would useful to address how to account for POCI financial assets when the expected credit losses at the reporting date are lower than they were expected to be at that date based on the ECL forecast when the asset was first recognised. Specifically, there is divergence on whether the improvement in credit risk that is recognised in profit or loss as an impairment gain by applying IFRS 9:5.5.14 (and IAS 1:82(ba)) is reflected in the statement of financial position as a negative ECL provision, or as an increase to the gross carrying amount through application of the effective interest rate method following IFRS 9:B5.4.6 (and IAS 1:82(a)(i) accordingly). In practice we have observed these two presentations being applied. We therefore believe IFRS 9 would benefit from being clearer as to which presentation should be applied, as this would eliminate existing diversity in practices.

Question 7—Application of the impairment requirements in IFRS 9 with other requirements

Is it clear how to apply the impairment requirements in IFRS 9 with other requirements in IFRS 9 or with the requirements in other IFRS Accounting Standards? If not, why not?

Interaction within IFRS 9

We believe that the impairment requirements in IFRS 9 have generally worked well with the other requirements in IFRS 9. However, one area that could be improved is the interaction between ECL and modification accounting for financial assets.

We note that IFRS 9 does not have a concept of credit-impaired versus non-credit-impaired debt restructuring and therefore the accounting entries for both are the same. Specifically, in accordance with IFRS 9:5.4.3, when a loan asset is modified (but not derecognised) the gross carrying amount is adjusted to reflect the modified cash flows and those cash flows are discounted using the original effective interest rate. This leads to a modification gain/loss recognised in profit or loss. Whilst this is intuitive for a non-credit-impaired restructuring, this presentation in profit or loss is not intuitive for credit-impaired debt restructuring as the recognition of a modification gain/loss (a loss if a concession is given because the borrower is in financial difficultly) results in the ECL being reversed and therefore a credit being recognised in the ECL line in profit or loss. We do not consider this presentation meaningful given the ECL has effectively been crystalised by the lender agreeing to forgive the borrower from paying the impaired cash flows. We believe in such instance the cash flows that are forgiven and have previously been provided for should not result in the reversal of the ECL provision (i.e. the recognition of an ECL gain in profit or loss) nor should a modification loss in profit or loss arise for the same amount. This is illustrated as follows:

- Gross carrying amount (GCA) immediately prior to modification is CU100. Immediately prior to the modification, the expected credit loss allowance increases to CU25 reflecting a significant change in credit risk and the expected cash shortfalls arising from a concession to be given to the borrower.

- Lender agrees to forgive the borrower cash flows with a present value, discounted at the original EIR, of CU20. The forgiveness is less than the ECL as there remains ECL related to the post-modification cash flows.

- The presentation required by IFRS 9 is as follows:
  - Dr Modification loss (P&L) 20
  - Cr GCA (SCFP) 20
  - Dr ECL provision (SCFP) 20
  - Cr ECL (P&L) 20

We propose that in such a scenario, the accounting entries should be limited to reflect the derecognition of the GCA and the ECL provision as follows:

- Dr ECL provision (SCFP) 20
- Cr GCA (SCFP) 20

Indeed, in this scenario, the modification to the GCA should not result in the recognition of a gain/loss in profit or loss as the loss arising from the modification has already been reflected in the ECL previously recognised in profit of loss. We believe our proposed approach is consistent with the statement in IFRS 9:5.4.4 that a write-off is a derecognition event (i.e. the write-off removes the ECL provision and GCA and does not result in gain/loss recognition). We believe this accounting treatment should be restricted to credit-impaired debt restructuring. This can be achieved by defining a credit-impaired debt restructuring as a modification that meets the credit-impaired definition already provided in IFRS 9 (i.e. an asset that is in stage 3 of the general impairment model). We believe that ensuring that modification gains or losses arising from a non-credit-impaired restructuring are presented outside impairment gains/losses as defined in IAS 1:82(ba) would increase the transparency of financial statements.

Interaction with other IFRSs

Similar to our observation on modification accounting, we note there remains some ambiguity as to the interaction between ECL and modifications of other arrangements that are outside the scope of IFRS 9, for example, IFRS 16 *Leases*. This was highlighted in feedback from constituents on the IFRS IC agenda decision of October 2022, *Lessor Forgiveness of Lease Payments (IFRS 9 Financial Instruments and IFRS 16 Leases)*. The Committee concluded that “all cash shortfalls” include all shortfalls irrespective of whether those cash shortfalls are credit related. We support the IFRS IC’s agenda decision as the amounts that were forgiven in the fact pattern addressed in the agenda decision were due but not yet been paid by the counterparty. However, we question the application of the approach taken in the agenda decision in other cases. For example, an entity may choose to modify a contract for which a financial asset is recognised, but the modification (which is beneficial to the counterparty) increases the value of what is to be delivered to the counterparty under the contract, which is accounted applying another IFRS Accounting Standard. We believe in order to reflect the economic substance of the transaction the entity must consider whether the loss relates to the recognised financial asset or relates to the other arrangement (whether recognised or not).

Additionally, the IFRS IC agenda decision states that the “measurement of expected credit losses includes the lessor considering its expectations of forgiving lease payments recognised as part of that receivable.” This has led to some questioning whether IFRS 9 requires an entity to forecast modifications that will result in losses to be captured as part of the ECL measurement, even if the modification is to assets that

are not-credit-impaired. Generally, most preparers would not reflect forecast non-credit-impaired debt restructurings in advance of them occurring since both parties need to agree to the modification (i.e. the change remains subject to negotiation). In respect of a credit-impaired debt restructuring (i.e. affecting a financial asset that is in stage 3), it appears more reasonable to reflect that forecast modification event since the forgiveness of cash flows will reflect the lender's forbearance strategy which the borrower is highly likely to accept (given the borrower benefits from having their obligation reduced). Consistent with our proposal on distinguishing between credit-impaired versus non-credit-impaired debt restructuring for the purposes of presentation described above, we believe that the IASB could address this issue by clarifying that forecast credit-impaired debt restructuring should be considered in assessing cash shortfalls, but forecast non-credit-impaired debt restructuring should not.

Question 8—Transition

Were the costs of applying the transition requirements and auditing and enforcing their application significantly greater than expected? Were the benefits to users significantly lower than expected?

We are unable to generalise as to the costs associated with transition given the vast array of types of entities that we audit that were subject to the new impairment requirements when IFRS 9 was introduced. In our experience, larger financial institutions, specifically banks, that were able to utilise existing high quality credit risk data and had deeper resources and expertise were, on a relative basis, better placed to implement the impairment requirements than less sophisticated entities, who faced some implementation challenges (see our response to Question 5). We also cannot comment on the costs associated with applying the impairment requirements for insurance companies given many chose to defer the application of IFRS 9 and are applying IFRS 9 in 2023 for the first time.

Question 9—Credit risk disclosures

(a) Are there fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk? If yes, what are those fundamental questions?

(b) Are the costs of applying these disclosure requirements and auditing and enforcing their application significantly greater than expected? Are the benefits to users significantly lower than expected?

We do not believe there are fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk. We do however observe differences in the granularity of disclosure across industry and geography, reflecting the relative significance of impairment of financial assets on the entity's financial performance and position. We note in some jurisdictions there have been bank-led disclosure initiatives supported by prudential and securities regulators as a way to raise the quality of the information and improve comparability of credit risk disclosures. We note that *The Taskforce on Disclosures about Expected Credit Losses* in the UK has proved successful. We would encourage the IASB to consider the work of such bodies in assessing whether improvements could be made to IFRS 7, or in developing educational material, that are proportional to entities that are not banks.

Question 10—Other matters (a) Are there any further matters that you think the IASB should examine as part of the post-implementation review of the impairment requirements in IFRS 9? If yes, what are those matters and why should they be examined? (b) Do you have any feedback on the understandability and accessibility of the impairment requirements in IFRS 9 that the IASB could consider in developing its future IFRS Accounting Standards?

We do not have further matters to raise.