Need to know

IASB seeks views on the post-implementation review of the IFRS 9 impairment requirements

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This *Need to know* outlines the Request for Information (RFI) *Post-implementation Review of IFRS 9—Impairment*, published by the International Accounting Standards Board (IASB) in May 2023.

- The IASB launched a call for stakeholders' feedback on its post-implementation review of the impairment requirements in IFRS 9 *Financial Instruments*
- In particular, the IASB is asking questions on the following areas of the impairment requirements in IFRS 9:
  - Impairment
  - The general approach to recognising expected credit losses
  - Determining significant increases in credit risk
  - Measuring expected credit losses
  - Simplified approach for trade receivables, contract assets and lease receivables
  - Purchased or originated credit-impaired financial assets
  - Application of the impairment requirements in IFRS 9 with other requirements
  - Transition
  - Credit risk disclosures
  - Other matters
- The RFI is open for comments until 27 September 2023

For more information please see the following websites:

www.ukaccountingplus.co.uk
www.deloitte.co.uk

Background

IFRS 9 *Financial Instruments* became effective for annual periods beginning on or after 1 January 2018 and replaced IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 brought the following main improvements to financial instruments accounting:

- Classification and measurement requirements for financial assets that reflect the entity's business model and the asset's cash flow characteristics
- An expected credit loss model that results in more timely recognition of loan losses
- A hedge accounting model with a better link between the economics of risk management and its accounting treatment

In September 2021, the IASB started its post-implementation review (PIR) of IFRS 9, beginning with the classification and measurement requirements. In the second stage of the PIR, the IASB is now seeking feedback on the impairment requirements in IFRS 9. The PIR on the hedge accounting requirements will take place at a later time when more information is available about the effects of the application of the hedge accounting requirements in IFRS 9.

Questions for respondents

Impairment

When developing IFRS 9, the IASB introduced a forward-looking impairment model that reflects expected credit losses—the 'expected credit loss' (ECL) model. The ECL model is a principle-based model, designed to require entities to recognise credit losses on a more timely basis than required in IAS 39. The model eliminated the threshold for recognising credit losses so that it is no longer necessary for a credit event to have occurred before credit losses are recognised. Accordingly, expected and updated credit losses are recognised throughout the life of financial instruments, and the same impairment model is applied to all financial instruments within the scope of IFRS 9 that are subject to impairment accounting.

Observation

While stakeholders largely agree with the introduction of the ECL model, they observe diversity in application of the impairment requirements, including disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* for credit risk, and identified application matters for specific requirements.

The RFI asks respondents whether the impairment requirements in IFRS 9 result in more timely recognition of credit losses compared to IAS 39 and whether they address the complexity caused by having multiple impairment models for financial instruments. The IASB is also seeking views as to whether the impairment requirements in IFRS 9 result in 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.

The general approach to recognising ECL

The ECL model distinguishes between the effect of initial estimates of ECL and subsequent changes in those loss expectations. It makes that distinction based on increases in credit risk since initial recognition by requiring entities to recognise:

- A loss allowance at an amount equal to at least 12-month ECL throughout the life of the instrument
- Lifetime ECL if there has been a significant increase in credit risk since initial recognition

The RFI asks whether there are fundamental questions (fatal flaws) about the general approach to recognising ECL. The RFI asks respondents to explain whether this general approach achieves the IASB's objective of entities providing useful information about changes in credit risk and resulting economic losses.

The IASB is also seeking views on the costs of applying the general approach and auditing and enforcing its application. In particular, the IASB would like to know whether these costs are significantly greater than expected or whether the benefits to users are significantly lower than expected. If that is the case for particular instruments, respondents are asked to explain their cost-benefit assessment for those instruments.

Determining significant increases in credit risk

IFRS 9 requires recognising lifetime ECL on all financial instruments for which there has been a significant increase in credit risk since initial recognition. IFRS 9 uses a principle-based approach to assessing significant increases in credit risk instead of prescriptive rules that might create 'bright lines'. It does not prescribe a specific or mechanistic approach to assess changes in credit risk.

Observation

Stakeholders have told the IASB that they observe a lack of consistency in:

- What entities deem to be a significant increase in credit risk
- The use of collective versus individual assessment for changes in credit risk
- How entities define 'default'

The RFI asks whether there are fundamental questions about the assessment of significant increases in credit risk. In particular, the RFI asks respondents to explain whether the principle-based approach of assessing significant increases in credit risk achieves the IASB's objective of recognising lifetime ECL on all financial instruments for which there has been a significant increase in credit risk since initial recognition.

The IASB is also seeking views on whether the assessment of significant increases in credit risk can be applied consistently to all financial instruments within the scope of impairment requirements in IFRS 9. If diversity in application exists for particular financial instruments or fact patterns, the RFI asks respondents to explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Respondents should also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. If respondents have identified diversity in application of the assessment, they are asked to provide their suggestions for resolving that diversity.

In responding to these questions, respondents are asked to include information about applying judgement in determining significant increases in credit risk.

Measuring ECL

IFRS 9 requires the measurement of ECL to reflect:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes
- The time value of money
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions

Observation

Stakeholders have highlighted the following areas with regard to measuring ECL:

- **Forward-looking scenarios**—when measuring ECL, an entity is not required to identify every possible scenario. However, it reflects the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility is very low. Stakeholders told the IASB that they observe diversity in the number of scenarios entities identify, the variables considered, and the weightings attached to particular scenarios
- **Post-model adjustments or management overlays**—stakeholders have told the IASB that the increased economic uncertainty in recent years, particularly economic conditions for which historical information is not necessarily representative of the future economic outlook, have given rise to an increase in the use of post-model adjustments or management overlays
- **Off-balance sheet exposures**—applying IFRS 9, in general, the maximum period over which ECL is measured is the maximum contractual period (including extension options) that the entity is exposed to credit risk and not a longer period. An exception applies to certain financial instruments that include both a drawn and undrawn component. Nevertheless, stakeholders reported difficulties in determining the maximum period to consider on financial instruments such as revolving credit facilities and in assessing whether particular financial instruments qualify for the exception

The RFI asks whether there are fundamental questions about the requirements for measuring ECL. In particular, the RFI asks respondents to explain whether the measurement requirements for ECL achieve the IASB's objective of providing users of financial statements with useful information about the amount, timing and uncertainty of an entity's future cash flows.

The IASB is also seeking views on whether the measurement requirements can be applied consistently for all financial instruments within the scope of impairment requirements in IFRS 9. If diversity in application exists for particular financial instruments or fact patterns, the RFI asks respondents to explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Respondents should also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. If respondents have identified diversity in application of the requirements, they are asked to provide their suggestions for resolving that diversity.

In responding to these questions, respondents are asked to include information about forward-looking scenarios, post-model adjustments or management overlays, and off-balance sheet exposures, as relevant.

Simplified approach for trade receivables, contract assets and lease receivables

The simplified approach applies to trade receivables and contract assets that result from transactions within the scope of IFRS 15 *Revenue from Contracts with Customers*, and lease receivables that result from transactions within the scope of IFRS 16 *Leases*. The simplified approach removes the need to calculate 12-month ECL and track the increase in credit risk for these assets.

For trade receivables and contract assets that do not contain a financing component, the simplified approach requires an entity to recognise a lifetime expected loss allowance. For other trade receivables, other contract assets, operating lease receivables and finance lease receivables it is an accounting policy choice that can be separately applied for each type of asset (but applies to all of that type of asset). The RFI asks whether there are fundamental questions about the simplified approach. In particular, the RFI asks whether the simplified approach achieves the IASB's objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables.

The IASB is also seeking views on whether the costs of applying the simplified approach, and auditing and enforcing its application, are significantly greater than expected or whether the benefits to users are significantly lower than expected. If that is the case, respondents are asked to explain their cost-benefit assessment.

Purchased or originated credit-impaired financial assets

IFRS 9 includes a specific approach to recognising and measuring ECL and interest revenue for purchased or originated credit-impaired financial assets, which was substantially carried forward from IAS 39. For purchased or originated credit-impaired financial assets, an entity is required to:

- Apply the credit-adjusted effective interest rate, calculated by considering the initial ECL in the estimated cash flows, to the amortised cost of those assets from initial recognition

- Recognise the cumulative changes in lifetime ECL since initial recognition as a loss allowance

- Recognise the amount of the change in lifetime ECL as an impairment gain or loss in the statement of profit or loss

The RFI asks whether the requirements in IFRS 9 for purchased or originated credit-impaired financial assets can be applied consistently and whether they lead to accounting outcomes that faithfully reflect the underlying economic substance of these transactions.

If there are specific application questions about these requirements, respondents are asked to describe the fact pattern and explain how the IFRS 9 requirements are applied, the effects of applying the requirements, and how pervasive the fact pattern is.

Application of the impairment requirements in IFRS 9 with other requirements

The impairment requirements in IFRS 9 intersect with many other requirements both within IFRS 9 and in other IFRS Accounting Standards.

Observation

Stakeholders told the IASB that sometimes the requirements are not sufficiently clear when applying the impairment requirements alongside other requirements, for example:

- **The modification of financial assets**—an entity is required to adjust the gross carrying amount of a financial asset when a modification does not result in derecognition and recognise a modification gain or loss in the statement of profit or loss. The IASB was previously made aware of application questions about the boundaries between the requirements on modification of financial assets and ECL, including questions about the order in which these requirements are applied to a financial asset

- **The write-off of financial assets**—IFRS 9 requires an entity to directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering that financial asset or a portion thereof. Such a write-off constitutes a derecognition event, thus an entity is required to recognise a write-off loss. However, stakeholders said IFRS 9 does not provide requirements about the presentation of write-off losses, which leads to diversity in how entities present these losses in the statement of profit or loss

- **The recognition of ECL for trade receivables, contract assets and lease receivables**—stakeholders have informed the IASB that there are specific questions about how to apply the impairment requirements to these transactions, including whether:

  - An entity that accepts lower consideration from a customer whose financial position has deteriorated should account for the reduction in consideration as a contract modification applying IFRS 15, or as ECL applying IFRS 9

  - A lessor should exclude the unguaranteed residual value of the asset underlying a finance lease applying IFRS 16 for the purpose of measuring ECL in accordance with IFRS 9

The RFI asks whether it is 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 there are specific questions about how to apply the impairment requirements alongside other requirements, respondents are asked to explain what causes the ambiguity and how that ambiguity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. Respondents are asked to describe the fact pattern and to indicate the requirements in IFRS 9 or in other IFRS Accounting Standards to which the comments relate. Respondents should also explain the effects of applying the requirements and how pervasive the fact pattern is.

Transition

Upon initial application of IFRS 9, entities were required to apply the impairment requirements retrospectively. However, transition reliefs were available to mitigate potential challenges that might have arisen from retrospective application, such as a lack of initial credit risk data and the risk of using hindsight. For example, entities were allowed to:

- Apply practical expedients and rebuttable presumptions to determine whether there has been a significant increase in credit risk since initial recognition

- Recognise lifetime ECL at each reporting date until derecognition, if determining whether there has been a significant increase in credit risk since initial recognition would have required undue cost or effort

IFRS 9 did not require the presentation of restated comparative information. Instead, entities were required to disclose the effect on impairment of financial instruments of the transition to IFRS 9.

The RFI asks whether the costs of applying the transition requirements, and auditing and enforcing their application, was significantly greater than expected or whether the benefits to users were significantly lower than expected. Respondents are asked to explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements. The IASB also asks respondents to explain any unexpected effects or challenges preparers of financial statements faced applying the impairment requirements retrospectively, including how those challenges were overcome.

Credit risk disclosures

IFRS 7 provides objective-based disclosure requirements for credit risk and identifies three disclosure objectives to assist users of financial statements to understand:

- An entity's credit risk management practices and how they relate to the recognition and measurement of ECL, including the methods, assumptions and information the entity uses
- The amounts in the financial statements arising from ECL, including changes in the amount of ECL and the reasons for those changes
- An entity's credit risk exposure (that is, the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant credit risk concentrations

Observation

Stakeholders told the IASB that there is a lack of consistency in the type and granularity of information disclosed by different entities for credit risk, in particular in the disclosures about:

- Determining significant increases in credit risk
- Post-model adjustments or management overlays
- Reconciliation from the opening balance to the closing balance of ECL
- Sensitivity analysis

Users of financial statements said that this lack of consistency significantly impairs comparability between different entities and affects the quality of their credit risk analysis.

The RFI asks whether there are fundamental questions about the disclosure requirements in IFRS 7 for credit risk. In particular, respondents are asked to explain whether the combination of disclosure objectives and minimum disclosure requirements for credit risk achieves an appropriate balance between users of financial statements receiving:

- Comparable information—that is, the same requirements apply to all entities so that users receive comparable information about the risks to which entities are exposed
- Relevant information—that is, the disclosures provided depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks

If an appropriate balance is not achieved, respondents are asked to explain what they think are the fatal flaws about the clarity and suitability of the core objectives or principles of the disclosure requirements.

The RFI also asks whether the costs of applying these disclosure requirements, and auditing and enforcing their application, are significantly greater than expected or whether the benefits to users are significantly lower than expected.

If, in respondents' view, the ongoing costs of providing specific credit risk disclosures are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, they are asked to explain their cost-benefit assessment for those disclosures and to provide their suggestions for resolving the matter they have identified.

If, in respondents' view, the IASB should add specific disclosure requirements for credit risk, they are asked to describe those requirements and explain how they will provide useful information to users of the financial statements.

Respondents are also asked to explain whether entities' credit risk disclosures are compatible with digital reporting, specifically whether users of financial statements can effectively extract, compare and analyse credit risk information digitally.

Other matters
The RFI asks whether there are any further matters respondents think the IASB should examine as part of the PIR of the impairment requirements in IFRS 9. If yes, respondents are asked what those matters are and why they should be examined.

The RFI also asks whether respondents 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.

Comment period and next steps
The RFI is open for comments until 27 September 2023.

After the comment period ends, the IASB will consider comments from the public consultation along with information gathered from any additional analysis and other consultative activities. The IASB will then publish a report and feedback statement summarising its findings and, if any, next steps. The next steps may include providing educational materials or considering possible standard-setting.

Further information
If you have any questions about the RFI, please speak to your usual Deloitte contact.

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