Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Post-implementation review IFRS 9 - Impairment**	**Meeting:**	September 2023 (M198)
Topic:	**Staff analysis of the feedback received on ITC 52**	**Agenda Item:**	6.1
		Date:	28 August 2023
Contact(s):	Jia Wei jwei@aasb.gov.au Helena Simkova hsimkova@aasb.gov.au Fridrich Housa fhousa@aasb.gov.au	**Project Priority:** **Decision-Making:** **Project Status:**	Medium High Comment letter drafting

The objective of this paper

1 The objective of this staff paper is:

(a) to summarise the feedback received from Australian stakeholders on the IASB Request for Information on Post-implementation Review of IFRS 9 *Financial Instruments* — Impairment (the PIR); and

(b) for the Board to consider the staff analysis of the feedback and decide on the matters for inclusion in the AASB comment letter to the IASB.

Background

2 The International Accounting Standards Board (IASB) began the Post-implementation Review of the IFRS 9 *Financial Instruments* impairment requirements (the PIR) in the second half of 2022.

3 During Phase 1 in 2022, the AASB performed limited targeted outreach with some preparers, auditors and users, and reviewed some major banks' disclosures to identify matters the IASB should examine within the context of the objectives of the PIR.

4 In May 2023, the IASB published a Request for Information on its Post-implementation Review of the impairment requirements of IFRS 9 *Financial Instruments*. The due date for comments is 27 September 2023.

5 At its June 2023 meeting, the AASB agreed to submit a comment letter to the IASB on the PIR subject to the feedback received from the stakeholders.

6 In June 2023, the AASB issued an Invitation to Comment (ITC 52) that included the IASB Request for Information on IFRS 9 PIR. The ITC 52 comment period closed on 18 August 2023.

Attachments

7 The following documents are included for reference purposes:

(a) Financial Instruments Project Advisory Panel meeting minutes, 2 August 2023 (agenda item 6.3 in supplementary folder).

(b) Draft comment letter to the IASB (agenda item 6.2).

Outreach activities

8 Staff have received no written submissions on ITC 52. Staff conducted the following outreach activities to gather views from stakeholders:

(a) 29 September 2022 - AASB User Advisory Committee (UAC) meeting – members provided feedback to AASB staff on the first phase (identifying matters to be examined) of the PIR.

(b) other targeted consultations in 2022. Stakeholders provided feedback to AASB staff on the first phase (identifying matters to be examined) of the PIR.

(c) 9 June 2023 – AASB User Advisory Committee (UAC) meeting. Two UAC members provided feedback to AASB staff on the PIR.

(d) 27 July 2023 – AASB staff attended a joint meeting arranged by CAANZ and CPA Australia to obtain the views of their members. Four practitioners provided feedback on the PIR.

(e) 2 August 2023 – AASB Financial Instruments Project Advisory Panel (FIPAP) meeting. Five FIPAP members provided feedback to AASB staff on the PIR.

(f) Seven targeted consultations in July and August 2023. Stakeholders provided feedback to AASB staff on the PIR.

Summary of the feedback received from stakeholders, staff analysis and recommendations

9 There are ten sections in the PIR, each with explanatory material and corresponding numbered questions. Staff have considered all feedback received (Phase 1 and Phase 2) in providing their recommendations to the Board.

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?** Please provide information about the effects of the changes to the impairment requirements introduced by IFRS 9, including the ongoing costs and benefits of preparing, auditing, enforcing or using information about financial instruments. This question aims to help the IASB understand respondents' overall views and experiences relating to the IFRS 9 impairment requirements. Sections 2–9 seek more detailed information on specific requirements.

Summary of stakeholders' feedback and staff analysis

10 Most stakeholders who provided comments during the outreach agreed that the Standard overall achieved its objectives. Consistent with the findings of Oberson (2021)[1], which investigated a sample of 69 IFRS banks across 24 countries, Australian stakeholders concluded that IFRS 9 led to more timely recognition of credit losses compared to IAS 39. In addition, most stakeholders noted that the implementation costs were generally in line with expectations.

11 Some stakeholders noted that the Standard was thoroughly tested in the recent past with the effects of the pandemic and subsequently by increasing interest rates and economic uncertainty.

12 Stakeholders expressed mixed views regarding whether the expected credit losses (ECL) model increased volatility in credit provisions. Some stakeholders said that the practical effect of applying the ECL model increased volatility in credit provisions. They observed relatively large provisions being recognised at the start of the pandemic as the anticipation of its impact was higher and longer. Following the government stimulus and improved economic conditions, the excess of provisions was released. However, the reversals in 2021 and 2022 did not revert the provisions to the pre-pandemic level as the pandemic factors in the model's forward-looking assumptions were replaced by increased concerns about economic uncertainties, such as rapidly growing inflation and interest rates. Other stakeholders said that the ECL model worked as intended and did not result in unexpected spikes in volatility as pandemic drivers of increased credit risk were replaced by other drivers stemming from a high inflation environment. They explained that a significant part of the allowance for credit losses is created by an overlay, and even though forward-looking information changes over time, it did not result in a significant change unless the models were amended or the circumstances changed.

13 Preparers and auditors generally agree that IFRS 9 is an improvement over IAS 39 but commented that the degree of judgement required may have resulted in diversity in

1 Oberson, R., 2021. The credit-risk relevance of loan impairments under IFRS 9 for CDS pricing: early evidence. *European Accounting Review*, *30*(5), pp.959-987.

application. One preparer noted that IAS 39 enabled better comparability of the provisions, especially across the banking industry. This feedback was also echoed by the users of financial statements. More detailed feedback on impaired comparability is included in Question 4.

14 One stakeholder was unsure whether the standard achieved its intended objective in the non-banking sector, as based on their experience, the majority of the entities outside of the banking industry use historical loss models without embedding the forward-looking scenarios. However, another stakeholder considered the historical loss model to be better than the incurred loss model as the entities recognise expected losses (i.e., provision is recognised earlier as opposed to upon objective evidence of impairment under IAS 39).

15 One stakeholder noted the standard also worked well in the public sector. However, noting that it was the simplified approach applied to the balances like statutory receivables and the general approach would be too complex for such balances.

16 Stakeholders have identified several areas where there is potential scope for further improvements to IFRS 9 through additional standard-setting, application guidance, educational materials, or illustrative examples. These are further discussed in Questions 2 – 10.

17 Overall, stakeholder feedback in this staff paper is in line with the preliminary feedback noted in the IASB RFI, and the areas where further guidance is required are largely in line with the preliminary feedback received during the first phase of the PIR. Staff further note that the requests for additional guidance arise mainly from areas where a significant level of judgement is required in applying IFRS 9 Impairment requirements.

Staff recommendation on the AASB response to the IASB

18 Staff **recommend** the AASB should agree that IFRS 9 does, in most cases, 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,

(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.

Staff recommend addressing the concerns about impaired comparability in Question 4 as it is mainly a result of model overlays.

Question for Board members
Q1 Do the Board members agree with the staff's recommendation in paragraph 18? If not, how do the Board members want to respond to the questions?

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? Please explain whether requiring entities to recognise at least 12-month expected credit losses throughout the life of the instrument and lifetime expected credit losses if there has been a significant increase in credit risk achieves the IASB's objective of entities providing useful information about changes in credit risk and resulting economic losses. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the general approach. **(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?** If, in your view, the ongoing costs of applying the general approach to particular financial instruments are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those instruments.

Summary of stakeholders' feedback and staff analysis

19 Most of the stakeholders who provided comments during the outreach said that the general approach worked well most of the time, specifically in the case of banking institutions. However, stakeholders raised concerns in relation to the modelling aspect of the general approach.

20 Some stakeholders raised issues with the reconciliation required under IFRS 7 para. 35H[2] and 35I[3]. They noted the diversity in the note reconciling the opening and closing balance of the loss allowance with respect to the calculation and presentation of movements between the three stages. One stakeholder said this note was challenging for banks to prepare and might

---

2 IFRS 7 para. 35H:To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for: (a) the loss allowance measured at an amount equal to 12-month expected credit losses; (b) the loss allowance measured at an amount equal to lifetime expected credit losses for: (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit impaired financial assets; (ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and (iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with paragraph 5.5.15 of IFRS 9. (c) financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognised during the reporting period.

3 IFRS 7 para. 35I: To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 35H, an entity shall provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. The information shall be provided separately for financial instruments that represent the loss allowance as listed in paragraph 35H(a)–(c) and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include: (a) changes because of financial instruments originated or acquired during the reporting period; (b) the modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with IFRS 9; (c) changes because of financial instruments that were derecognised (including those that were written-off) during the reporting period; and (d) changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.

imply (for users) a level of precision between the stages (particularly stages 1 and 2) that does not exist.

21 Several stakeholders noted that sometimes the general approach seemed unnecessarily complex for corporate entities, and the degree of judgement required might result in diversity in application. Some stakeholders also observed that, as a result, corporate entities (especially smaller entities) often rely on historical information to trigger movement between the stages without incorporating other forward-looking factors. A stakeholder suggested that additional educational materials may improve understanding and compliance for smaller entities.

22 Two stakeholders indicated that the cost of compliance might be too high in situations where assets were not part of a portfolio.

23 Some stakeholders noted that the general model does not apply well to intercompany loans. Stakeholders explained that these loans are common in Australia, and lots of entities need to prepare separate financial statements. Several stakeholders said that many entities struggle to apply the general approach to intra-group lending as the credit loss may also depend on the parent entity's willingness to reimburse the lending entity, and the usefulness of resulting credit loss provisions may not be commensurate to the effort required for their calculation. In view of some, it would be beneficial to have a different approach to record intercompany loans. Some other stakeholders, however, commented that they would not see a difference between an intercompany loan in separate financial statements and other loans to the entities outside the group, whilst recognising relatively higher effort to arrive at the expected loan loss provision for these loans.

Staff recommendation on the AASB response to IASB

24 Staff noted that the relevant objective of the general approach was to distinguish between initial estimates of credit losses and subsequent changes and to provide users with useful information about changes in credit risk. However, whether such an objective was fully achieved is uncertain due to diversity in modelling and overlay adjustments, which decrease the transparency and comparability of the information disclosed. Staff analysed the feedback on modelling and overlays in Question 4.

25 Staff noted that applying the general approach in the case of intercompany loans may not result in providing useful information. Whilst the guidance can be applied to some intra-group receivables, there may be instances where the entities do not have access to required data, or other factors may affect whether the credit loss is incurred. Staff also understands that US GAAP ASC 326 *Financial Instruments—Credit Losses* does not include loans and receivables between the entities under common control. However, staff also notes that the IASB, in the context of financial guarantees, decided not to provide such scope exemption[4] and retained the scope largely unchanged from IAS 39 in the absence of any concerns raised by stakeholders, in particular noting (BC2.1 & BCZ2.14).

26 Staff considered the feedback on the complexity of the model for corporate entities. Staff noted that to assist entities with less sophisticated credit risk management systems, the simplified model for trade and lease receivables was developed, and rebuttable presumptions

---

4 The IASB noted that whilst some stakeholders commented that the requirement to recognise financial guarantee contracts in separate or individual financial statements would cause costs disproportionate to the likely benefits, given that intragroup transactions are eliminated on consolidation, to avoid the omission of material liabilities from separate or individual financial statements, the IASB did not create such an exemption.

and practical expedients were introduced. Staff considers that the existing simplification within the standard is sufficient, as developing a different impairment model for non-banking institutions would compromise the comparability of the information reported.

27 Staff recommend the Board submission should **confirm** that, in general, there are no fundamental questions (fatal flaws) about the general approach. However, staff recommend that the IASB reconsiders the appropriateness of the model used for intra-group balances and whether an alternative approach would be more proportionate whilst acknowledging such an approach would be an exception to the general approach to expected credit losses.

Question for Board members
Q2 Do the Board members agree with the staff analysis and recommendation in paragraph 27? If not, how do the Board members want to respond to the questions?

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? Please explain whether the principle-based approach of assessing significant increases in credit risk achieves the IASB's objective of recognising lifetime expected credit losses on all financial instruments for which there has been a significant increase in credit risk since initial recognition. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the assessment of significant increases in credit risk. **(b) Can the assessment of significant increases in credit risk be applied consistently? Why or why not?** Please explain whether the requirements provide an adequate basis for entities to apply the assessment 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, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. If you have identified diversity in application of the assessment, please provide your suggestions for resolving that diversity. In responding to (a) and (b), please include information about **applying judgement** in determining significant increases in credit risk (see Spotlight 3).

<u>Summary of stakeholders' feedback and staff analysis</u>

28 Stakeholders did not identify any fatal flaw. However, some stakeholders noted inconsistent application of requirements when assessing the significant increase in credit risk (SICR). A stakeholder suggested that the IASB should provide some additional application guidance.

29 One stakeholder noted that the additional guidance[5] issued by ASIC during the pandemic was helpful as the guidance in the standard was not applied consistently.

30 Another stakeholder expressed the view that SICR indicators should be indicators about the counterparty from the market.

31 One stakeholder noted that the ECL model is based on the entities' risk management model and internal policy. However, many entities, especially those in the non-financial services sector, do not have an explicit internal policy addressing the credit risk, or they do not clearly define the default event. Auditors may find it difficult to enforce the impairment when an entity's counterparty has the means to pay (i.e., no indication of SICR) but not the intention. More examples or indicators of default and subsequent measurement of expected credit losses, including a scenario when the counterparty has the ability but not the intention to pay, would be helpful. Staff considers that this comment appears to be of a similar nature to the matter considered in IFRS Interpretation Committee Agenda Decision *Lessor Forgiveness of Leases Payments* *(October 2022)*, which addressed a question of how the lessor applies the expected credit loss model in IFRS 9 to the operating lease receivable before the rent concession is granted if it expects to forgive payments due from the lessee under the lease contract. However, in the discussed scenario, the creditor did not forgive the payment; therefore, the creditor's expectation differs from the one in the IFRS IC Agenda Decision.

Staff recommendation on the AASB response to IASB

32 Staff noted that IFRS 9 BC5.156 states that respondents supported a principle-based approach to assessing SICR instead of prescriptive rules. BC5.171 further explains that during the exposure period, IASB was asked to specify the amount of change in the risk of a default that would require the recognition of lifetime ECL. However, IASB did not pursue that as it would:

(a) represent an increase in costs for entities with less sophisticated processes; and

(b) be arbitrary as it would be difficult to properly reflect the structure and pricing of credit that an entity should consider for different types of financial instruments, maturities and initial credit risk.

Consequently, the IASB confirmed its view that the requirements for when to recognise lifetime expected credit losses should be clear but also be broadly defined and objective-based (BC5.172).

33 Staff noted that para. B5.5.17 includes non-exhaustive guidance on possible indicators of increased credit risk. These indicators also include significant changes in external market indicators of credit risk or significant changes in external credit rating. Staff consider these examples to be sufficient indicators that originate in the market.

34 Staff also noted that during the pandemic, the IASB issued guidance to assist with SICR assessment[6], that addresses similar issues as the guidance issued by ASIC that was referred to by a stakeholder. Staff consider that as the respondents found the guidance helpful, it could be added into the Standard.

---

5 ASIC FAQ 9A: COVID-19 implications for financial reporting and audit: Frequently asked questions (FAQs) | ASIC

6 IASB, IFRS 9 and Covid-19 – Accounting for expected credit losses

35 Staff recommend that the Board submission should **confirm** that there are no fundamental questions (fatal flaws) about the assessment of significant increases in credit risk.

36 Staff suggest the Board should recommend the IASB to consider the need for further guidance to reduce the diversity in practice. Further targeted outreach may be required to identify the areas or scenarios that need additional guidance. The guidance should also address situations when the counterparty has the ability to repay the debt but not the intention.

37 In addition, staff suggest the IASB add the guidance issued during the pandemic into the Standard as an application guidance.

Question for Board members
Q3 Do the Board members agree with the staff analysis and recommendation in paragraphs 35-37? If not, how do the Board members want to respond to the questions?

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? Please explain whether the requirements for measuring expected credit losses 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. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the measurement requirements. **(b) Can the measurement requirements be applied consistently? Why or why not?** Please explain whether the requirements provide an adequate basis for entities to measure expected credit losses 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, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. If you have identified diversity in application of the requirements, please provide your suggestions for resolving that diversity. In responding to (a) and (b), please include information about **forward-looking scenarios** (see Spotlight 4.1), **post-model adjustments or management overlays** (see Spotlight 4.2) and **off-balance-sheet exposures** (see Spotlight 4.3), as relevant

Summary of stakeholders' feedback and staff analysis

38 Stakeholders noted a lack of consistency in the modelling, number of scenarios, and overlays (sometimes called post-model adjustments) used to estimate provisions and in the quality of information disclosed and its level of detail. This inconsistency makes it difficult to understand the drivers for the provision movements. One user also observed inconsistency in forward-looking adjustments across the three provisioning stages.

39 Another user expressed concern that the current model allows for reverse engineering, and entities may amend the assumptions and probabilities used in the model to achieve a desired

outcome. This stakeholder suggested that additional disclosures about model inputs, assumptions and management overlays are required. In particular, the current disclosures about overlays are inconsistent even within the banking industry. This results in the incomparability of provisions across otherwise similar bank institutions. This stakeholder also suggested disclosure requirements for assumptions for various scenarios, e.g., inputs in downside scenarios.

40 Two users explained that understanding the drivers of the movements in provision is currently difficult. They are interested in understanding:

(a) how the whole loan portfolio moves through the three stages rather than just the value allocated to each stage; and

(b) the extent of a change in ECL driven by changes in the underlying assets (e.g., the value of current period ECL if the model used prior period assumptions).

41 One preparer expressed the view that the comparability of the financial statements is compromised by the overlays. The current disclosure requirements constrain the information disclosed as they prescribe how to report movements in the provision. Therefore, investors' report needs to provide additional information about the overlays and needs to be read in conjunction with the financial report. This indicates that the existing disclosure requirements may not fully meet users' needs. According to his view, the current disclosure requirements would be sufficient if there was no significant impact of the overlay on ECL, which is not the current practice. This stakeholder pointed out that investors are interested in the quality of the portfolio, i.e., the movement between stage one and stage two, should other factors remain constant. However, as there is inconsistency among entities in the definition of SICR, comparing entities using this benchmark would be misleading.

42 To address the inconsistency,

(a) one stakeholder suggested that the IASB should mandate more specific disclosure requirements to increase the consistency of information disclosed, such as the details about model adjustments, what assumptions are included, and what thresholds are used in determining a significant increase in credit risks;

(b) one stakeholder proposed that there is an opportunity for convergence in the standard with respect to guidance for scenarios. The standard could provide more specific guidance on the number of scenarios and weights the entities use (e.g., if an entity is using scenarios, the standard could specify the type of scenarios, number of scenarios and probability weighting). It would increase the comparability of data;

(c) two stakeholders proposed a requirement for disclosing the sensitivity analyses to enable a better understanding of management overlays; however, the practicality of such disclosures and the cost-to-effort analysis would need to be considered. One user suggested that the sensitivity analysis should use standard amounts for the usual economic inputs such as unemployment rate, house prices, and GDP. In addition, the drivers of the change in individual scenarios should be clearly explained.

43 However, another stakeholder expressed a view that post-model adjustments are necessary to achieve the objective of the standard. The stakeholder noted that the adjustments are subject to thorough internal governance. Whilst the overlays are subject to analysts' focus, the stakeholder mentioned that the current level of disclosures is sufficient. They noted that in

the past, granular information was provided in investor presentations, but this practice has been discontinued as the overlays became a significant part of the provisions. Sensitivity analyses have been provided by major banks to enhance the transparency of the model. The stakeholder did not advocate for less flexibility in these types of adjustments and thought that Australian banks were providing sufficient disclosures.

44 Two other stakeholders added that given the inconsistencies in the expected credit loss models among entities, more disclosures about overlays may not help with increasing the comparability of the reports unless the consistency of information around models is addressed at the same time (i.e., some factors may be incorporated in the model by one entity whilst another entity may include them in overlay). The challenge is exacerbated by the fact that assumptions and inputs to the models and overlays change over time, or some inputs initially included in the overlay may later be incorporated into the model as the entity collects sufficient information.

45 One stakeholder noted that credit conversion factors for some retail credit card portfolios could be challenging as their models did not always allow for the requirements of IFRS 9, including the exception to measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period noted in IFRS 9 para. 5.5.20, so they used workarounds. The stakeholder requested additional educational material on modelling ECL for loan commitments such as retail credit cards. Similarly, one stakeholder noted that there were some implementation questions on financial guarantees. Though it is not a fundamental flaw, more educational material would be helpful.

Staff recommendation on the AASB response to IASB

46 The general feedback from the outreach indicated a need for enhanced consistency in ECL modelling and management overlays, including related disclosures.

47 Staff considered the proposal on mandating the number of scenarios used. IFRS 9 para. 5.5.18 specifies that the entity does not need to identify every possible scenario but needs to consider the probability that a credit loss occurs and the possibility that no credit loss occurs. B5.5.42 further explains that in some cases, a simple model without the need for a large number of detailed scenarios might be sufficient, while in other situations, identification of scenarios specifying details for particular outcomes might be needed. Whilst this guidance is not specific as requested by the stakeholder, staff consider that it would be difficult to mandate an exact number of scenarios or more precise guidance that could be applied by entities of all sizes in various jurisdictions.

48 BC5.265 explains that the IASB acknowledged that an entity may use various techniques to measure expected credit losses. The requirements in Section 5.5 of IFRS 9 do not list acceptable techniques or methods for measuring the loss allowance. The IASB was concerned that listing acceptable methods might rule out other appropriate methods for measuring expected credit losses or be interpreted as providing unconditional acceptance of a particular method even when such a measurement would result in an amount that is not consistent with the required attributes of an expected credit loss measurement. Instead, Section 5.5 of IFRS 9 sets out the objectives for the measurement of expected credit losses, allowing entities to decide the most appropriate techniques to satisfy those objectives. Staff consider that recommending the number of scenarios to be used would give rise to similar concerns.

49 Staff also noted that this topic was discussed by the Transition Resource Group for Impairment of Financial Instruments (ITG) in December 2015, which observed that whilst entities are not expected to consider every possible scenario, the scenarios considered should reflect a representative sample of possible outcomes.

50 However, staff observed that while illustrative examples are not mandatory, they are often followed by the preparers and may result in increased consistency. Therefore, IASB could prepare an illustrative example that could provide more application guidance and help the entities with an assessment of what reasonable number of scenarios constitutes.

51 Staff further considered the proposals on additional disclosure requirements relating to model assumptions and adjustments. IFRS 7 para. 35G[7] requires an entity to explain the inputs, assumptions and estimation techniques used and how forward-looking information has been incorporated into the model. However, these disclosures are qualitative and do not enable the users to quantify the impact of management assumptions.

52 Staff also noted that the intention of IFRS 7 para. 35H is to explain quantitative changes in the loss allowance and the reasons for those changes. However, based on the feedback received, staff understands that these disclosures do not provide information about the extent of movement in loss allowance driven by changes in economic outlooks, changes in thresholds determining the increase in significant credit risk, management assumptions or some other changes in management overlays.

53 Staff recommend requesting the IASB to consider the need for additional disclosures to enable users of financial reports to understand the quantitative impact of assumptions and other model adjustments on the loss provision. The required disclosure could be a sensitivity analysis or a value of the prior year ECL calculated using current period inputs (or vice versa). The practicality of such disclosures should be considered, and the costs of the disclosure should be assessed relative to the expected benefits to financial statement users.

54 Staff recommend the Board submission should **confirm** that there are no fundamental questions (fatal flaws) about requirements for measuring ECL.

55 Considering the feedback received, staff recommend the Board to include in the comment letter the following suggestions:

(a) Adding an illustrative example providing more guidance on the application of the requirements to help entities arrive at a reasonable number of scenarios that need to be considered;

(b) Additional disclosure requirements that would help users understand the quality of the portfolio and allow them to quantify the movement in the allowance driven by changes in management assumptions and overlays. The IASB should conduct further

---

7 IFRS 7 para. 35G: An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of IFRS 9. For this purpose an entity shall disclose: (a) the basis of inputs and assumptions and the estimation techniques used to: (i) measure the 12-month and lifetime expected credit losses; (ii) determine whether the credit risk of financial instruments has increased significantly since initial recognition; and (iii) determine whether a financial asset is a credit-impaired financial asset. (b) how forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information; and (c) changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

research to determine the best disclosures to increase the comparability. This could be for example:

(i) a sensitivity analysis; or

(ii) a value of the prior period ECL calculated using the current period inputs.

Question for Board members
Q4 Do the Board members agree with the staff analysis and proposed responses in paragraphs 54 to 55? If not, how do the Board members want to respond to the questions?

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? Does applying the simplified approach achieve the IASB's objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables? If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the simplified approach. **(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?** If, in your view, the ongoing costs of applying the simplified approach are significantly greater than expected, or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment.

Summary of stakeholders' feedback and staff analysis

56 Some stakeholders noted that there was no unreasonable increase in costs when entities implemented the simplified approach. However, several stakeholders thought that the requirement to incorporate forward-looking information is too complex for some smaller corporate entities, even when using the simplified approach. Those stakeholders noted a need for additional educational material to enhance understanding and compliance. One stakeholder noted that corporate entities preferred the incurred loss model.

57 On the other hand, one stakeholder from the insurance industry noted a gap between the general and the simplified approaches. The stakeholder thought that insurers do not have as large portfolios as banks, but their portfolios might be larger than other corporate entities. Developing a middle approach would be helpful.

58 One stakeholder noted that there was a challenge when estimating the credit risk of new customers/markets and standalone assets. Without sufficient historical information, a significant amount of judgement was involved. Guidance or educational material would be helpful.

59 One stakeholder expressed a view that entities do not clearly define the default event, and auditors find it difficult to enforce consistent application of the standard requirements given

the reliance of the standard on the credit risk management of the entity, even though the existence of the rebuttable presumption helps. Smaller entities often do not have an internal policy addressing credit risk management and, therefore, do not disclose information about credit risk management when the receivables are not material.

Staff recommendation on the AASB response to IASB

60 Staff agree that assessing the ECL for new customers or markets may be challenging. Nevertheless, the standard provides principles for the calculation of credit losses and explains the objectives. It would be challenging for a standard setter trying to provide a list of factors that need to be considered that could apply to various industries, markets or jurisdictions or for a specific type of asset without creating an exception, which would not be desirable as the stakeholders considered there are no fatal-flaws the ECL approach. For that reason, staff consider that management judgement needs to be applied when assessing the ECLs for new customers or markets.

61 With respect to the lack of definition of a default event, staff noted that IFRS 7 para. 35F(d) requires an entity to disclose definitions of a default, including reasons for selecting those definitions. In addition, IAS 1 para. 117 requires an entity to disclose its significant accounting policies comprising the measurement basis used in preparing the financial statements and other relevant accounting policies. Para. 119 further explains that in assessing which policy should be disclosed, the management considers whether disclosure would assist users in understanding how the events are reflected in the reported financial position. Staff considers that the standards already contain sufficient disclosure requirements; therefore, any noncompliance would be a result of insufficient understanding.

62 Staff recommend that the Board submission should **confirm** that there are no fundamental questions (fatal flaws) about the simplified approach.

63 Staff note that para. B5.5.51 notes that an entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses, and para. B5.5.52 provides further guidance on the use of historical information for the measurement of expected credit losses. Staff noted further explanation currently in BCE.164 that says that in some cases, entities with little historical information would draw their estimates from internal reports and statistics (which may, for example, have been generated when deciding whether to launch a new product), information that they have about similar products or from peer group experience for comparable financial instruments. It would be helpful to include this explanation in the guidance or an example within the standard. Staff suggest the Board include in the comment letter a suggestion that the IASB considers the need for educational material on the application of the standard (including incorporation of forward-looking factors) by smaller corporate entities, including an explanation of the relevance of the requirements in IAS 1 para. 117.

Question for Board members

Q5 Do the Board members agree with the staff analysis and suggestion in paragraphs 62 to 63? If not, how do the Board members want to respond to the questions?

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? Please explain whether the requirements can be applied consistently to these types of financial assets and lead to accounting outcomes that faithfully reflect the underlying economic substance of these transactions. If there are specific application questions about these requirements, please describe the fact pattern and: (a) explain how the IFRS 9 requirements are applied; (b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect); (c) explain how pervasive the fact pattern is; and (d) support your feedback with evidence.

Summary of stakeholder feedback and staff analysis

64 Some stakeholders said they found the interaction between ECL, restructuring, and modifications challenging, especially for purchased or originated credit-impaired (POCI). For example, if a loan is restructured and derecognised, which involves determining whether changes to the contractual cash flows are substantial or otherwise, the entity must determine whether the new loan is credit impaired at the point of re-origination. If yes, the new loan is considered POCI and must follow the POCI accounting requirements (IFRS 9 5.4.1(a) and 5.5.13). Making these determinations is often quite judgemental. Furthermore, the POCI accounting requirements themselves are difficult to apply operationally.

Staff recommendation on the AASB response to IASB

65 Staff recommend the Board submission to support additional guidance and illustrative examples in respect of the treatment of POCI, noting that the IASB has added a project on the amortised cost measurement to its research pipeline following the post-implementation review of IFRS 9 classification and measurement requirements and this project will consider findings from the post-implementation review of IFRS 9 impairment requirements.

Question for Board members
Q6 Do the Board members agree with the staff analysis and suggestion in paragraph 65? If not, how do the Board members want to respond to the questions?

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? If there are specific questions about how to apply the impairment requirements alongside other requirements, please 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. Please describe the fact pattern and: (a) indicate the requirements in IFRS 9 or in other IFRS Accounting Standards to which your comments relate; (b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect); (c) explain how pervasive the fact pattern is; and (d) support your feedback with evidence. In responding to this question, please include information about matters described in this section of the document.

Summary of stakeholder feedback and staff analysis

66 Some stakeholders said they found the interaction between IFRS 9 and IFRS 3 problematic. In the case of a bank acquisition, the value of loans after deducting ECL could be a proxy of their fair value. It is counterintuitive that the carrying value of loans immediately after the acquisition should differ from their fair values as the ECL needs to be recognised following the acquisition.

67 One stakeholder from the insurance industry noted that in some cases, applying all relevant standards to a simple transaction might be time-consuming. This stakeholder provided an example of a situation where the insurer takes ownership of the damaged vehicle under an insurance contract and receives cash flow from the sale of the vehicle. At the reporting date, this transaction should be accounted for by applying relevant aspects of IFRS 17, IFRS 15 and IFRS 9. In practice, similar transactions are accounted for by applying IFRS 17, as deconstructing the cash flow would be time-consuming.

68 Similar to comments raised regarding POCI in Q6 above, one stakeholder raised an issue relating to the modification of contractual cash flows in response to the interaction of ECL requirements with other IFRS 9 requirements or other standards. Assessing whether the modification is substantial or not is often challenging and has an impact on the ECL calculation. It would be helpful if the Standard could provide any indicators of what is considered to be a substantial modification. In addition, the accounting complexity is accompanied by operational challenges as the asset terms (e.g., interest rate) are often changed in the system by the front office team (bankers). The accounting systems are not sophisticated enough to even record such changes.

Staff recommendation on the AASB response to IASB

69 Staff acknowledge the stakeholders' comments on the interaction of IFRS 3 and IFRS 9. However, as IFRS 3 requires recognition of the acquired assets and liabilities at fair value,

similar issues are arising from interactions with other standards. Therefore, any suggested change would result in amendments to IFRS 3 that would likely have further consequences.

70 With respect to the interaction of IFRS 9 and IFRS 17, staff consider that any suggested practical expedient should be included in IFRS 17 rather than in other interacting standards. This comment can be considered as part of the IFRS 17 post-implementation review.

71 Modifications are specifically addressed in IFRS 9 para. B5.5.25-27. When contracts are renegotiated or modified, IFRS 9 requires an assessment as to whether the change to contractual cashflows is "substantial". If yes, such "substantial" changes result in the derecognition of the asset. When the modification results in the derecognition of the existing financial asset and the subsequent recognition of the new (modified) asset, the loss allowance for that asset is usually measured as a 12-month ECL. When the asset is not derecognised, it keeps its existing credit risk assessment, which may require the recognition of lifetime expected losses. Staff acknowledge that the standard is unclear regarding guidance on substantial as well as determination whether the asset is credit-impaired given the judgement involved when assessing the reasons for modification. Whilst staff acknowledge that management judgement will always be required, it would be helpful to include a non-exhaustive list of indicators of substantial modification.

72 Staff recommend the IASB consider developing guidance including indicators of substantial modification of contractual cash flow and interaction of the modification requirements with ECL requirements.

Question for Board members
Q7 Do the Board members agree with the staff analysis and recommendation in paragraph 72? If not, how do the Board members want to respond to the questions?

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? Please 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. Please explain any unexpected effects or challenges preparers of financial statements faced applying the impairment requirements retrospectively. How were those challenges overcome?

Summary of stakeholder feedback and staff analysis

73 The AASB did not receive any feedback on the transition.

Staff recommendation on the AASB response to IASB

74 Staff recommend the Board submission to note that the transition requirements worked as intended.

Question for Board members
Q8 Do the Board members agree with the staff recommendation in paragraph 74? If not, how do the Board members want to respond to the questions?

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? Please explain whether the combination of disclosure objectives and minimum disclosure requirements for credit risk achieves an appropriate balance between users of financial statements receiving: (i) 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; and (ii) 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, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the disclosure requirements. **(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?** If, in your 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, please explain your cost–benefit assessment for those disclosures. Please provide your suggestions for resolving the matter you have identified. If, in your view, the IASB should add specific disclosure requirements for credit risk, please describe those requirements and explain how they will provide useful information to users of financial statements. Please also 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.

Summary of stakeholder feedback and staff analysis

75 In addition to the comments mentioned under previous questions, some stakeholders questioned whether it is appropriate to require corporate entities and banks to apply the same disclosure requirements. They suggested that the IASB should avoid requiring boilerplate disclosures for non-material risks.

<u>Staff recommendation on the AASB response to IASB</u>

76 Staff consider that materiality judgement should be applied by each entity to avoid disclosing boilerplate information. Applying the materiality judgement is an overarching principle that applies to all disclosures.

77 Staff recommend that the Board submission should **confirm** that there are no fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk.

Question for Board members
Q9 Do the Board members agree with the staff analysis and staff suggestion in paragraph 77? If not, how do the Board members want to respond to the questions?

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? Please explain why those matters should be considered in the context of this post-implementation review and the pervasiveness of any matter raised. Please provide examples and supporting evidence. **(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?**

78 No additional issue was raised. Staff suggest not to raise any matter in response to Question 10.

Question for Board members
Q10 Do the Board members agree with the staff's proposed responses to Question 10 of the IASB PIR? If not, how do the Board members want to respond to the questions? Q11 Are there any other matters that the Board members want to raise in relation to the PIR?

Next steps

79 The comment period to the IASB PIR closes on 27 September 2023. As there is no further AASB meeting before the comment period close date, staff suggest a comment letter reflecting the Board's decisions from this meeting be finalised out-of-session by the Chair.

The proposed timing is as follows:

During week beginning	Deliverable
18 September 2023	Staff circulate a draft comment letter to the Chair for review.
21 September 2023	The Chair reviews the comment letter.
24 September 2023	Staff address any comments from the Chair.
27 September 2023	The comment letter is signed by AASB Chair and submitted to the IASB by 27 September 2023.

Questions for Board members

Q12 Do Board members agree with the staff recommendation that the AASB submission letter is finalised out-of-session by the Chair?

Q13 Do Board members have any comments or concerns about the proposed timing of the finalisation of the AASB comment letter?