AASB Exposure Draft

Tier 2 Supplement to ED 237
July 2013

Financial Instruments: Expected Credit Losses

Comments to AASB by 16 September 2013

Australian Government

Australian Accounting Standards Board

Invitation to Comment

Comments on this Tier 2 Supplement to AASB Exposure Draft ED 237 are requested by 16 September 2013.

Comments should be addressed to:

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All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to those submissions being treated as confidential. The latter will only occur if the public interest warrants such treatment.

Obtaining a Copy of this Tier 2 Supplement to AASB Exposure Draft

This Tier 2 Supplement to ED 237 is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this Exposure Draft are available by contacting:

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Background

In March 2013, the IASB published ED/2013/3 *Financial Instruments: Expected Credit Losses* for comment by 5 July 2013. ED/2013/3 contains proposals that would require (i) earlier recognition of impairment of financial assets than current requirements; and (ii) impairment to be measured based on expected credit losses. The proposals in ED/2013/3 are intended to replace the current incurred loss impairment requirements in IAS 39 *Financial Instruments: Recognition and Measurement*.

Consistent with its policy of adopting International Financial Reporting Standards (IFRSs), in March 2013 the AASB published ED 237 *Financial Instruments: Expected Credit Losses* (for which the comment period to the AASB closed on 10 May 2013), which incorporated IASB ED/2013/3. The AASB's response to IASB ED/2013/3 is available on the AASB website under Work in Progress/Submissions from AASB.

This Exposure Draft sets out the disclosures proposed in ED 237 from which it is proposed entities applying Tier 2 reporting requirements should be exempt. The proposals in this Exposure Draft should not be seen as any indication of AASB support or otherwise for the IASB's proposals in IASB ED/2013/3. That will be determined through the ED 237 due process.

Analysis of Proposed Disclosures

The AASB's conclusions in relation to proposed Tier 2 disclosure requirements in this Exposure Draft have been reached after applying its usual approach to the analysis of the disclosures proposed in ED 237 compared with disclosures set out in the IASB's *IFRS for SMEs* and application of the AASB's 'Tier 2 Disclosure Principles'. Those principles and that analysis are available on the AASB website under Work in Progress/Reduced Disclosure Requirements.

A summary of the comparison between ED 237 and *IFRS for SMEs* Section 11 *Basic Financial Instruments* in terms of the recognition and measurement accounting policies for the purpose of applying Tier 2 Disclosure Principles are outlined in the Appendix to this Exposure Draft.

AASB Specific Matters for Comment

The purpose of this Tier 2 Supplement to AASB ED 237 is to seek comment on the disclosure requirements that should apply to Tier 2 entities.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

The AASB would particularly value comments on the following:

1. whether you agree with the AASB disclosure proposals regarding paragraphs 28-45, IE72 and IE73 of ED 237 in relation to Tier 2 entities as set out in the Proposed Reduced Disclosure Requirements section below;

2. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of these proposals, particularly any issues relating to:

   (a) not-for-profit entities; and

   (b) public sector entities;

3. whether, overall, these proposals would result in financial statements that would be useful to users;
4. whether these proposals are in the best interests of the Australian economy; and
5. unless already provided in response to specific matters for comment 1-4 above, the costs and benefits of the proposals, whether quantitative (financial or non-financial) or qualitative.

Proposed Reduced Disclosure Requirements

The disclosures proposed in ED 237 are provided below. Entities applying Tier 2 requirements are proposed to be exempted from applying disclosure requirements shown as shaded text.

PROPOSED REDUCED DISCLOSURE REQUIREMENTS: AASB ED 237

28 **An entity shall disclose information that identifies and explains:**

(a) **the amounts in its financial statements that arise from expected credit losses that are measured in accordance with this [draft] IFRS; and**

(b) **the effect of deterioration and improvement in the credit risk of financial instruments that are within the scope of this [draft] IFRS.**

29 To meet the requirements of paragraph 28, an entity shall consider:

(a) the level of detail that is necessary to satisfy the disclosure requirements;

(b) how much emphasis to place on each of the disclosure requirements;

(c) how much aggregation or disaggregation is appropriate; and

(d) whether users of financial statements need additional information to evaluate the quantitative information that has been disclosed.

RDR29.1 Entities applying Tier 2 disclosure requirements shall consider the following when applying the Tier 2 disclosure requirements of this Standard:

(a) the level of detail that is necessary to satisfy the disclosure requirements;

(b) how much emphasis to place on each of the disclosure requirements; and

(c) how much aggregation or disaggregation is appropriate.

30 If the disclosures provided in accordance with the requirements in this [draft] IFRS and other relevant Standards are insufficient to meet the objectives in paragraph 28, an entity shall disclose additional information to meet those objectives.

31 Other Standards (eg IFRS 7) may require disclosures that may satisfy the disclosure requirements in accordance with this [draft] IFRS. Entities need not duplicate the information and are permitted to cross-refer to these disclosures.

32 The disclosure requirements in this [draft] IFRS shall either be given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a risk report and disclosures, that is available to users of financial statements on the same terms as the financial statements at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

33 The disclosure requirements in this [draft] IFRS apply to all financial instruments that are in the scope of this [draft] IFRS. However, an entity that measures the loss allowance at an amount equal to lifetime expected credit losses either for trade receivables or for lease receivables in accordance with paragraph 12-13 need not apply the disclosure requirements in paragraphs 35(a), 38(a), 42-43 and 45 to those financial assets. In addition, paragraph 40(a) does not apply to lease receivables.

34 For the purpose of the disclosures provided in accordance with this [draft] IFRS, an entity shall group financial assets, loan commitments and financial guarantee contracts into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments (including their grouping into portfolios). An entity shall provide

sufficient information to permit reconciliation to the line items that are presented in the statement of financial position.

35 An entity shall provide a reconciliation from the opening balance to the closing balance of the gross carrying amount and the associate loss allowance for:

(a) financial assets with a loss allowance measured at an amount equal to 12-month expected credit losses;

(b) financial assets with a loss allowance measured at an amount equal to lifetime expected credit losses;

(c) financial assets that have objective evidence of impairment at the reporting date but that are not purchased or originated credit-impaired financial assets; and

(d) purchased or originated credit-impaired financial assets. In addition to the reconciliation for these assets, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition.

36 An entity shall provide a reconciliation from the opening balance to the closing balance of the provision for loan commitments and financial guarantee contracts consistent with paragraph 35.

37 An entity shall disclose its write-off policy (for example, the entity's indicators for write-off), including whether there are assets that have been written off that are still subject to enforcement activity. In addition to including any write-offs and recoveries in the reconciliation in accordance with paragraph 35, an entity shall disclose the nominal amount of financial assets written off that are still subject to enforcement activity.

38 An entity shall disclose at the end of the reporting period during which the contractual cash flows on a financial asset have been modified the amortised cost and the modification gain or loss for financial assets that have been modified while they had a loss allowance at an amount equal to lifetime expected credit losses. The entity shall also disclose at each reporting date subsequent to such modification throughout the remaining life of the financial asset:

(a) the gross carrying amount of financial assets that have been modified during their life and for which the measurement of the loss allowance has changed from an amount equal to lifetime expected credit losses to an amount equal to 12-month expected credit losses; and

(b) the re-default rate on such financial assets that have been modified while in default (ie the percentage of financial assets that defaulted again subsequent to modification).

The disclosure requirements in this paragraph, other than paragraph 38(a), also apply to trade receivables or lease receivables on which lifetime expected credit losses are always recognised in accordance with paragraph 12 but only if modified while more than 30 days past due.

39 An entity shall explain the inputs, assumptions and estimation techniques that it used when estimating the 12-month and lifetime expected credit losses. For this purpose an entity shall disclose:

(a) the basis of inputs (for example, internal historical information or rating reports, including how default is defined and why that definition was selected, assumptions made about the remaining life of the financial instrument and the timing of the sale of collateral) and the estimation technique, including how the assets were grouped if they are measured on a collective basis in accordance with paragraph B25;

(b) an explanation of the changes in estimates of expected credit losses and the cause of those changes (for example, severity of loss, change in portfolio composition or changes in volume of financial instruments purchased or originated);

(c) any change in the estimation technique and the reason for that change; and

(d) information about the discount rate that the entity has selected in accordance with paragraph B29(a), including:

  (i) what discount rate an entity has elected to use (ie risk-free rate, effective interest rate, or something in between) and the reasons for that election;

  (ii) the discount rate (percentage) used; and

  (iii) any significant assumptions made to determine the discount rate.

40 If an entity has financial assets, loan commitments or financial guarantee contracts secured by collateral or other credit enhancements, it shall disclose:

(a) a description of the collateral held as security and other credit enhancements, including a discussion on the quality of the collateral held (for example, the stability of the asset value and liquidity) and an explanation of any changes in the quality as a result of deterioration or changes in the collateral policies of the entity;

(b) the gross carrying amount of financial assets that have an expected credit loss of zero because of the collateral; and

(c) for financial instruments that have objective evidence of impairment at the reporting date, quantitative information about the extent to which collateral and other credit enhancements reduce the severity of expected credit loss.

41 An entity shall disclose quantitative and qualitative analyses of significant positive or negative effects on the loss allowance that are caused by a particular portfolio or geographical area.

42 An entity shall explain the inputs, assumptions and estimation techniques used when determining whether the credit risk of the financial instruments has increased significantly since initial recognition and when determining if it has objective evidence of impairment (see paragraphs 5, 14-15 and 25(b)). For this purpose an entity shall disclose:

(a) the basis of inputs (for example, internal historical information or rating reports, including how significant deterioration in credit risk is met, how default is defined and why that definition was selected) and the estimation technique (including how financial instruments were grouped if the criterion in paragraph 5 is assessed on a collective basis, in accordance with paragraphs B17-B18);

(b) an explanation of the changes in the estimates of the credit risk and the cause of those changes; and

(c) any change in the estimation technique and the reason for that change.

43 If an entity has rebutted the presumption that financial assets more than 30 days past due have a significant increase in credit risk, the entity shall disclose how it has rebutted that presumption (see paragraph 9).

44 An entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the amount recognised as a provision for loan commitments and financial guarantee contracts in a grade. An entity shall disclose this analysis separately for financial assets, loan commitments and financial guarantee contracts for which the loss allowance or provision is measured with accordance with paragraphs 4, 5, 12 and 14-15. The number of credit risk rating grades used for this disclosure shall be sufficient to enable users of the entity's financial statements to assess the entity's exposure to credit risk. The number of grades shall not exceed the number that the entity uses for internal credit risk management purposes except that an entity shall always disaggregate its portfolio across at last three grades, even if that entity uses fewer credit risk rating grades internally. For trade receivables and lease receivables to which an entity applies paragraph 12, this disclosure may be based on a provision matrix (see paragraphs B34-B35).

45 An entity shall disclose the gross carrying amount of financial assets and the amount recognised as a provision for loan commitments and financial guarantee contracts that are assessed on an individual basis and whose credit risk has increased significantly since initial recognition.

IE72 The following example illustrates one way of applying the disclosure requirements as set out in paragraph 35. The below reconciliation does not illustrate the requirements for financial assets for which there is objective evidence of impairment on initial recognition, and does not disaggregate the disclosures by class.

Reconciliation of the gross carrying amount of those assets with the loss allowance measured at an amount equal to 12-month expected credit losses	**20XX ‘000**
	CU
Gross carrying amount at 1 January	112,500
Financial assets changed to have a loss allowance at an amount equal to 12-month expected credit losses	3,200
Financial assets changed to have a loss allowance at an amount equal to lifetime expected credit losses	(8,500)
Interest revenue using the effective interest method	5,650
Repayments of principal and interest	(29,500)
New financial assets originated or purchased	20,600
Recoveries of amounts previously written off	650
Foreign exchange and other movements	(1,400)
At 31 December	103,200

Loss allowance measured at 12-month expected credit losses	**20XX ‘000**
	CU
Loss allowance at 1 January	5,400
Amount charged to profit or loss	800
Other movements	(400)
At 31 December	5,800

Reconciliation of the gross carrying amount of those assets with the loss allowance measured at an amount equal to lifetime expected credit losses	**20XX ‘000**
	CU
Gross carrying amount at 1 January	45,000
Financial assets changed to have a loss allowance at an amount equal to lifetime expected credit losses	8,500
Financial assets changed to have a loss allowance at an amount equal to 12-month expected credit losses	(3,200)
Interest revenue using the effective interest method	4,250
Repayments of principal and interest	(3,400)
Amounts written off	(2,000)
Modification of cash flows	(600)
Recoveries of amounts previously written off	450
Other movements	(750)
At 31 December	48,250

Loss allowance measured at an amount equal to lifetime expected credit losses	**20XX ‘000**
	CU
Loss allowance at 1 January	13,500
Amounts written off	(2,000)
Amounts charged to profit or loss	3,900
Other movements	100
At 31 December	15,500

IE73 The following example illustrates the forms of application of the disclosure requirements in paragraph 44.

Gross carrying amount for consumer loan credit risk profile by internal rating grades and by the associated loss allowance

20XX	**Consumer—Credit Card**		**Consumer—Automotive**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
Internal Grade 1	CUxx,xxx	xx,xxx	CUxx,xxx	xx,xxx
Internal Grade 2	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Internal Grade 3	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Internal Grade 4	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Internal Grade 5	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Internal Grade 6	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Internal Grade 7	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Internal Grade 8	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Total	xx,xxx	xx,xxx	xx,xxx	xx,xxx

Gross carrying amount for corporate loan credit risk profile by external rating grades and by the associated loss allowance

20XX	**Corporate—Equipment**		**Corporate—Construction**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
AAA	CUxx,xxx	xx,xxx	CUxx,xxx	xx,xxx
AA	xx,xxx	xx,xxx	xx,xxx	xx,xxx
A	xx,xxx	xx,xxx	xx,xxx	xx,xxx
BBB	xx,xxx	xx,xxx	xx,xxx	xx,xxx
BB	xx,xxx	xx,xxx	xx,xxx	xx,xxx
B	xx,xxx	xx,xxx	xx,xxx	xx,xxx
CCC	xx,xxx	xx,xxx	xx,xxx	xx,xxx
CC	xx,xxx	xx,xxx	xx,xxx	xx,xxx
C	xx,xxx	xx,xxx	xx,xxx	xx,xxx
D	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Total	xx,xxx	xx,xxx	xx,xxx	xx,xxx

Gross carrying amount for corporate loan risk profile by probability of default and by the associated loss allowance				
	Corporate—Unsecured		**Corporate—Secured**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
0.00 – 0.10	CUxx,xxx	xx,xxx	CUxx,xxx	xx,xxx
0.11 – 0.40	xx,xxx	xx,xxx	xx,xxx	xx,xxx
0.41 – 1.00	xx,xxx	xx,xxx	xx,xxx	xx,xxx
1.01 – 3.00	xx,xxx	xx,xxx	xx,xxx	xx,xxx
3.01 – 6.00	xx,xxx	xx,xxx	xx,xxx	xx,xxx
6.01 – 11.00	xx,xxx	xx,xxx	xx,xxx	xx,xxx
11.01 – 17.00	xx,xxx	xx,xxx	xx,xxx	xx,xxx
17.01 – 25.00	xx,xxx	xx,xxx	xx,xxx	xx,xxx
25.01 – 50.00	xx,xxx	xx,xxx	xx,xxx	xx,xxx
50.01+	xx,xxx	xx,xxx	xx,xxx	xx,xxx
Total	xx,xxx	xx,xxx	xx,xxx	xx,xxx

Appendix A – Differences between Recognition and Measurement Accounting Policies underlying ED 237 *Financial Instruments: Expected Credit Losses* and Section 11 *Basic Financial Instruments* of the *IFRS for SMEs*

AASB ED 237 deals with the expected loss impairment requirements of financial instruments. Section 11 of the *IFRS for SMEs* deals with the incurred loss impairment requirements for financial instruments.

The disclosures proposed in AASB ED 237 and the disclosure requirements in Section 11 of the *IFRS for SMEs* are compared in the Analysis to Tier 2 Supplement to AASB ED 237, which is available on the AASB website under Work in Progress/Reduced Disclosure Requirements.

Main Differences in Recognition, Measurement and Presentation Requirements

The proposals in AASB ED 237 differ from the incurred loss impairment requirements in Section 11 of the *IFRS for SMEs*, such that the proposals:

(a) would apply to financial instruments measured at amortised cost and at fair value through other comprehensive income (FVOCI). The *IFRS for SMEs* incurred loss model applies only to financial instruments measured at amortised cost;

(b) would require a 12-month expected credit loss to be recognised at initial recognition of a financial asset and subsequently a rolling 12-month expected credit loss unless the credit quality associated with the financial instrument deteriorates significantly, in which case the proposed model would require a lifetime expected credit loss.[1] This is in contrast to the incurred loss model under the *IFRS for SMEs*, which first requires the identification of a credit loss event in order for losses to be recognised; and

(c) would require impairments to be determined based on expected credit losses using past, present and forecast information. The *IFRS for SMEs* prohibits impairments based on forecast information.

1 Except that the proposals would provide an accounting policy election to apply the proposed model or to recognise lifetime expected credit loss at all times, including at initial recognition, for trade and lease receivables that constitute a financing transaction.