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PIR IFRS 9 Impairment

Cover Note

Objective

1 The objective of this session is to provide EFRAG FR TEG-CFSS with:

(a) a brief overview of feedback received by the IASB on the post-implementation review (PIR) of impairment requirements in IFRS 9 *Financial Instruments*;

(b) an update of a status of the IASB redeliberations on the project; and

(c) to discuss the prominence of other matters raised during the PIR in various EU jurisdictions.

Background of the IASB project

RFI

2 The IASB published the RFI on PIR of IFRS 9 Financial Instruments - *Impairment* on 30 May 2023.

3 The RFI set out questions in ten sections:

(a) Section one sought general information on the effect the application of the impairment requirements in IFRS 9 has had on preparers of financial statements, users of financial statements, auditors, and regulators;

(b) Sections two to eight sought information on specific areas of the impairment requirements in IFRS 9, including information on the application of these requirements alongside other requirements in IFRS 9 or in other IFRS Accounting Standards;

(c) Section nine sought information on application of the disclosure requirements in IFRS 7 for credit risk; and

(d) Section ten sought other information relevant to the post-implementation review of the impairment requirements.

EFRAG comment letter

4 After extensive consultation with constituents, EFRAG published its final comment letter on 27 September 2023.

5 In its comment letter EFRAG considered that the impairment requirements in IFRS 9 generally work as intended and that the use of a forward-looking expected credit loss model results in more timely recognition of credit losses than applying IAS 39 *Financial Instruments: Recognition and Measurement*.

6 Nevertheless, EFRAG highlighted some issues of application or diversity in practice with different levels of priority that should be further considered by the IASB in the context of this PIR:

(a) **Cash shortfalls used to measure expected credit losses** - whether the expression "all cash shortfalls" used in Appendix A of IFRS 9 to define credit loss should be interpreted within the scope of concessions from the lender due to financial difficulties of the borrower.

(b) **Interaction between modification, impairment, and derecognition** requirements in IFRS 9.

(c) More guidance in the form of illustrative examples and/or educational material would enhance **the quality and comparability of credit risk disclosures**.

7 In addition, EFRAG recommended the IASB to consider other issues with medium priority, such as intra-group loans and guarantees, collective assessment of significant increases in credit risk, loan commitments, financial guarantees and other credit enhancements and purchased or originated credit impaired assets requirements.

Overview of the feedback received by the IASB

8 Overall feedback was positive. In particular it was noted that IFRS 9 impairment requirements result in more timely recognition of credit losses compared to IAS 39 *Financial Instruments: Recognition and Measurement,* work as intended and provide useful information about the effect of credit risk on the future cash flows.

9 Although the PIR feedback did not identify any fatal flaws, respondents identified specific **application challenges** and diversity in practice, mostly in areas that require use of judgement. They focused on:

(a) **application issues** arising from the **interaction between the impairment requirements and** the requirements in IFRS 9 for **modifications, derecognition and write-off** - identified in EFRAG comment letter as a **high priority issue**; and

(b) diversity in the quality and granularity of **credit risk disclosures** - identified in EFRAG comment letter as a **medium priority issue**.

10 In addition, the following **other application matters** were identified:

(a) Expected credit losses **(ECL) for intragroup financial instruments** and initial ECL for **purchased financial assets -** identified in EFRAG comment letter as a **medium priority issue**; and

(b) **ECL for loan commitments**, reflecting the effect of some financial guarantees in the measurement of ECL and application questions on purchased or originated credit-impaired (POCI) financial assets - identified in EFRAG comment letter as a **medium priority issue**.

Status of the IASB redeliberations

11 In February 2024 the IASB discussed two topics:

(a) General approach to recognising ECL and its application to intragroup loans, some non-commercial financial instruments and purchased assets that are not credit-impaired - Question 2 of the RFI; and

(b) Guidance for determining significant increases in credit risk ('SICR') - Question 3 of the RFI.

12 After analysing the feedback received, the IASB decided not to undertake standard setting for these two topics for the following reasons:

(a) General approach to recognising ECL for particular instruments:

(i) The principles-based and 'methods agnostic' general approach in IFRS 9 provides an adequate basis for recognising ECL for the above instruments; and

(ii) Addressing the 'double-counting' issue for purchased assets would require an overhaul to the ECL model, which is not justified by the overall positive PIR feedback.

(b) Determining significant increases in credit risk:

(i) More explicit guidance would result in little incremental benefits which are unlikely to outweigh the operational costs from a change; and

(ii) Application of judgement will still be required.

13 The IASB Agenda Papers AP27A and AP27B provide detailed IASB analysis of these issues.

14 In addition, the issues discussed in this paper were discussed with IFRS IC on 5 March 2024. The outcome of this discussion will be provided orally.

EFRAG discussions

15 EFRAG FR TEG discussed the overall summary of the feedback received by the IASB in December 2023.

16 Members noted low involvement of users in the consultation and suggested alternative ways of engaging with users, for example through consultative groups, such as CMAC.

17 Some members suggested that it could be useful to leverage the work performed by the Taskforce on Disclosures about Expected Credit Losses.

18 It was also noted that proportionality and materiality should be considered for disclosure requirements for non-financial entities.

19 EFRAG is planning to discuss general approach to recognising ECL and SICR at EFRAG FR TEG meeting on 14 March 2023.

Questions for EFRAG FR TEG-CFSS

20 Does EFRAG FR TEG-CFSS have any questions or comments regarding the IASB's discussions to date?

21 In the light of the IASB's tentative decision to take no standard-setting action in response to the PIR feedback on these matters, does EFRAG FR TEG-CFSS have any comments about other actions the IASB could take that might reduce the common application challenges for intragroup financial instruments?

Other matters

22 The IASB is seeking the views of ASAF members on the other application matters:

Lack of definition for loan commitments (not raised by EFRAG)

23 The feedback showed that lack of a definition gives rise to application questions e.g., whether a commitment to enter into a convertible bond is a loan commitment subject to ECL or is it a derivative.

24 The IASB staff acknowledges there is no definition but does not consider the matter pervasive. The IASB staff further notes that paragraph 2.3 of IFRS 9 requires loan commitments that can be settled by delivering or issuing another financial instrument to be accounted as derivatives.

Period over which to estimate ECL for individually managed instruments (identified as a medium priority issue by EFRAG)

25 The respondents asked to clarify the scope of the exception in paragraph 5.5.20 of IFRS 9 - specifically, whether facilities, such as corporate overdrafts, that are managed on an individual basis are outside the scope of this exception and, thus, their ECL is required to be measured over the maximum contractual period.

26 In paragraph B5.5.39(c) of IFRS 9, 'managed on a collective basis' is described as one of the characteristics of the financial instruments that generally fall in the scope of the exception.

27 The IASB staff notes that the exception was designed to address specific concerns - that, for loan commitments managed on a collective basis, an entity usually has no practical ability to withdraw the commitment before a loss event occurs and to limit the exposure to credit losses to the contractual period over which it is committed to extend the credit.

28 The IASB staff further noted that feedback did not indicate whether the accounting outcome is inadequate.

Credit enhancement in the measurement of ECL (identified as a medium priority issue by EFRAG)

29 Feedback suggested the IASB add application guidance for determining the credit enhancements that are considered part of 'integral to' the contractual terms for the purposes of measuring ECL applying paragraph B5.5.55 of IFRS 9.

30 Respondents also noted that accounting firms developed broadly consistent guidance on this assessment.

31 The IASB staff considers that application guidance might be helpful but will not eliminate judgement. Adding application guidance is a standard-setting activity and is therefore costly. Therefore, more evidence is needed that the benefits would outweigh the costs.

Accounting for premiums received over time for financial guarantees issued (identified as medium priority issue by EFRAG)

32 Respondents noted that paragraph 4.2.1(c) of IFRS 9 or the related requirements are not sufficiently clear for entities to determine the accounting outcome for financial guarantee contracts for which the premiums are received over time, rather than upfront. This results in diversity in practice.

33 IASB staff is looking for evidence whether such diversity results in substantial consequences and, if yes, why.

Accounting for subsequent improvements in credit risk of POCI assets

34 Diversity in practice was reported on the accounting for decreases in credit risk since initial recognition - specifically, some entities adjust the gross carrying amount of a POCI financial asset, others recognise it as a negative entry to the ECL allowance.

35 Mostly the presentation issue, but affects ratios (e.g., coverage ratio).

36 The IASB staff questions whether the diversity results in substantial consequences in practice.

Questions for EFRAG FR TEG-CFSS

37 Considering the PIR criteria, does EFRAG FR TEG-CFSS think any of the application matters identified above:

(a) are pervasive and have substantial consequences; and

(b) if yes, what is the root cause for the matter?

38 Does EFRAG FR TEG-CFSS think the benefits of any standard-setting action would be expected to outweigh the costs, considering the extent of disruption and operational costs from change and the importance of the matter to users of financial statements?

Next steps

39 In addition to the IFRS IC discussion of 5 March 2024, the IASB will discuss the credit risk disclosures with CMAC on 8 March 2024.

40 The IASB project plan is presented below.

Topics for discussion in PIR Phase 2	Expected timing
ECL measurement	March 2024
ECL and other requirements	April 2024
Credit risk disclosures	Q2 2024
Purchased or originated credit-impaired assets and other matters	Q2 2024

41 EFRAG will start detailed discussions on the project at its tomorrow EFRAG FR TEG meeting, which will be followed up by its working groups discussions.

Agenda Papers

42 In addition to this cover note, agenda paper 06-02 – *IASB AP4 IFRS 9 PIR Impairment ASAF March 2024* – has been provided for the session.