27 September 2023

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

Via online submission: www.ifrs.org

Dear Andreas

Request for Information – Post-implementation Review (PIR): IFRS 9 *Financial Instruments* - Impairment

CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) represent over 300,000 professional accountants who work in diverse roles across public practice, commerce, industry, government and academia throughout Australia, New Zealand and internationally. We welcome the opportunity to provide feedback on the above Request for Information (the RFI) and make this submission on behalf of our members and in the public interest.

Our main observations and recommendations based on stakeholder outreach activities undertaken as part of developing this submission are set out below:

- In general, the impairment requirements based on the expected credit loss model (ECL) in IFRS 9 *Financial Instruments* (IFRS 9) work as intended for financial institutions and represent an improvement to the incurred loss model prescribed in IAS 39 *Financial Instruments* (IAS 39). Nevertheless, entities other than financial institutions have found implementing the ECL impairment requirements a challenging and costly exercise.

- Feedback we have received indicates there is diversity in the application of the IFRS 9 impairment requirements between financial institutions and other entities. Some concerns have been expressed around the appropriateness of the ECL model for *all* types of entities as the requirements appear more fit-for-purpose for entities that undertake lending as part of their ordinary activities (i.e., financial institutions). Given the nature and focus of these businesses, by necessity, they have the financial and technical capabilities including the ability to use mature statistical measurement models to apply the IFRS 9 impairment requirements.

- Given the bifurcation in ability to apply the IFRS 9 impairment requirements, we suggest the IASB undertakes research to identify how best to simplify the requirements for entities that are not financial institutions. Whilst we agree that it is inappropriate for the IASB to develop sector or industry-specific requirements, a business model-based approach could be considered. We recommend the existing requirements continue to apply to entities that undertake lending as part of their ordinary activities (i.e., financial institutions) and the current simplified approach for trade receivables, contract assets and lease receivables is extended to all loans and receivables held by entities that do not undertake lending as part of their ordinary activities (i.e., non-financial institutions).

- There is a lack of clarity around the requirement to ascertain a “significant increase” in credit risk, i.e., what are the circumstances that indicate there is a significant increase in credit risk and when to recognise any impairment arising from this. We suggest clarifying this term and including additional guidance to support its application in practice. We also recommend developing additional guidance to clarify the accounting requirements for modifications of contracts and derecognition of financial assets when accounting for a significant increase in credit risk.

- We understand the IASB’s approach to conducting the post-implementation review of IFRS 9 in three different stages, given the complexity of the standard and the history of its development. However, as recommended in our submission to the Request for Information – Post-implementation Review: IFRS 9 Financial Instruments - Classification and Measurement, we would like to reinforce the importance of taking a holistic approach to consider stakeholder feedback not only in relation to all aspects of IFRS 9 but also to review other related projects which interact with IFRS 9 (e.g., the post-implementation reviews of IFRS 15 *Revenue from Contracts with Customers* (IFRS 15) and IFRS 16 *Leases* (IFRS 16)).

Our responses to the specific questions raised in the RFI are included in the **Attachment** to this letter. Should you have any questions about the matters raised in this submission or wish to discuss them further, please contact either Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au or Amir Ghandar (CA ANZ) at amir.ghandar@charteredaccountantsanz.com.

Yours sincerely

Elinor Kasapidis
Head of Policy and Advocacy
CPA Australia

Simon Grant FCA
Group Executive – Advocacy and International Development
Chartered Accountants Australia and New Zealand

Attachment

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?

Overall, we agree that IFRS 9 results in more timely recognition of credit losses compared to IAS 39. We are also of the view that the IFRS 9 expected credit loss (ECL) model provides more useful information to users of financial statements about the effects of credit risks on the amount, timing and uncertainty of future cash flows compared to the IAS 39 incurred loss model.

Prior to the introduction of IFRS 9, we understand financial institutions in Australia and New Zealand had an approach that involved provisioning for credit losses which included forward looking information. Although this prior approach did not involve the level of detail associated with the impairment requirements in IFRS 9, this existing practice enabled financial institutions to incur less challenges and cost compared to other entities when adopting the new impairment requirements in IFRS 9.

Feedback we have received indicates the impairment requirements in IFRS 9 provide useful information for most financial instruments except for related party loans and lending on non-commercial terms (see our response to Q2 below).

Question 2—The general approach to recognising expected credit losses

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

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

Our outreach activities did not identify any fatal flaws in the general approach to recognising ECL. In particular, it was observed that the ECL model works well within financial institutions. However, for other entities significant inconsistencies were observed in terms of incorporating forward-looking information into the impairment model. One end of the spectrum being that some entities continue to primarily focus on historical information (i.e., incurred losses) rather than forward looking information. In this context, it is not clear whether the ECL model is working as intended.

Feedback we have received indicates there are challenges in applying the requirements to related party loans and lending on non-commercial terms. We note that the US Financial Accounting Standards Board (FASB) has excluded loans and receivables between entities under common control from the scope of its ECL model (ACS 326, paragraph 326-20-15-3). We recommend the IASB consider introducing similar simplified requirements for intra-group and below-market rate loans.

Chartered Accountants Australia and New Zealand
33 Erskine Street, Sydney, NSW 2000
P: +61 1 9290 1344
W: charteredaccountantsanz.com
ABN: 50 084 642 571

CPA Australia
L20, 28 Freshwater Place, Southbank
Victoria 3006
P: +1300 73 73 73
W: cpaaustralia.com.au
ABN 64 008 392 452

Question 3—Determining significant increases in credit risk

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

Our stakeholder feedback highlighted that there is divergence in practice around how entities determine the point in time where a customer becomes a significant increase in credit risk, as this term is not defined or described in IFRS 9. Whilst it is noted that the principle-based nature of the standard is appropriate, there are interpretative challenges associated with the term in many instances as a significant increase in credit risk is an entity-specific measure which depends on type, size, maturity and credit management practices of an entity. While we accept this will remain an area of judgement, additional guidance with practical examples on how to apply the term to different circumstances would be welcomed.

There is some concern about the rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due (IFRS 9, paragraph 5.5.11). It was noted that there are a range of judgemental factors that are built into the statistical models used for ECL calculations and that there are different fact patterns within financial institution to which the 30 day past due approach cannot always be applicable. We recommend the IASB clarifies this requirement with some additional examples for circumstances where the 30 days past due presumption is not applicable.

We understand the assessment of significant increase in credit risk is also challenging for entities other than financial institutions. In particular, one of the characteristics of related party lending, including loans given to subsidiaries, joint ventures and associates, is that they are repayable on demand. In such circumstances, it is not clear how the assessment of a significant increase in credit risk should apply as it is generally unknown as to when the lender will call on the loans to be repaid. In addition, in a situation where a collective assessment of significant increase in credit risk is considered for a portfolio of loans and/or receivables (financial assets), allocation of such credit risk assessment to an individual level can be challenging.

One potential solution to address some of the above concerns could involve a differential impairment approach based on the entity's business model. For entities that do not consider lending to be part of their ordinary activities, the ECL model could focus on lifetime ECL so that such entities do not have to assess at what point there is significant increase in credit risk (also see our response to Q4 below).

Question 4—Measuring expected credit losses

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

Our outreach activities did not identify any fatal flaws in the general approach to measuring ECL. However, there is diversity in the application of the ECL model between financial institutions and other entities. Generally, financial institutions operate sophisticated and complex statistical models to assess the credit risk movements to measure ECL. However, non-financial institutions do not always possess similar levels of financial and technical capabilities to apply the requirements for measuring ECL.

This observed bifurcation in the ability to apply the ECL model indicates that it may be necessary for the IASB to undertake research to identify how best to simplify the requirements for non-financial institutions. A principles-based solution could include developing different impairment requirements based on entity business models. We recommend retaining the current approach for entities that lend as part of their ordinary activities (i.e., financial institutions) and extending the current simplified approach for for trade receivables, contract assets and lease receivables to all loans and receivables held by entities that do not lend as part of their ordinary activities (i.e., non-financial institutions).

We have heard that there has been an increased use of post-model adjustments or management overlays in recent years due to the increased economic uncertainty (e.g., impact of COVID-19, supply chain disruptions). We understand this approach is preferred over incorporating adjustments into underlying ECL models because the prudential regulator must approve any updates to the base ECL model, which could delay getting timely information to market. However, we do not believe that this can be efficiently addressed through standard-setting.

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

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

As mentioned in our response to Q4 we recommend extending the simplified approach to all loans and receivables held by entities that are not financial institutions. However, feedback from our outreach activities indicates that there is need for further simplification of the simplified approach. Many entities that are not financial institutions find the simplified approach too complex, including the requirement to consider forward-looking information, and continue to rely on historical losses to estimate future losses as forward-looking information is either immaterial or expensive to obtain. There is also a view that this approach still provides more relevant and useful information than the previous incurred loss model under IAS 39.

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?

No comments.

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?

Feedback we have received indicates that there is a lack of specific guidance that clarifies how to apply the impairment requirements in IFRS 9 with modifications of contracts or the derecognition of financial assets, especially in relation to accounting for a significant increase in credit risk. We suggest developing clarifications to address this. The IASB should also consider stakeholder feedback for its post-implementation review of IFRS 15 and IFRS 16 as these may provide relevant insights to this consultation.

CHARTERED ACCOUNTANTS AUSTRALIA • NEW ZEALAND

Chartered Accountants Australia and New Zealand
33 Erskine Street, Sydney, NSW 2000
P: +61 1 9290 1344
W: charteredaccountantsanz.com
ABN: 50 084 642 571

CPA AUSTRALIA

CPA Australia
L20, 28 Freshwater Place, Southbank
Victoria 3006
P: +1300 73 73 73
W: cpaaustralia.com.au
ABN 64 008 392 452

Question 8—Transition

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

We understand non-financial institutions incurred significant costs and put in considerable effort in transitioning to IFRS 9. We heard that many entities adopted the practical expedients and chose not to restate the comparative information, although it was noted that having the option would have been well received for those entities that had the required information.

Question 9—Credit risk disclosures

(a) Are there fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk? If yes, what are those fundamental questions?
(b) Are the costs of applying these disclosure requirements and auditing and enforcing their application significantly greater than expected? Are the benefits to users significantly lower than expected?

Our stakeholders have observed diversity in practice in the level of detail provided in disclosures about the assumptions made, credit risk management policies, methodologies and models applied. Therefore, the level of disclosures provided is not always sufficient to understand the high levels of uncertainty arising from the level of judgement required by IFRS 9 for recognition of ECL.

We support the use of disclosure objectives accompanied by some minimum disclosure requirements to achieve a consistent baseline in the information disclosed thus enhancing comparability. As noted in our response to Q1 there is a divergence in the ability to apply the IFRS impairment requirements depending on whether an entity is a financial institution or not. In light of this, any changes to the disclosure requirements would need to be underpinned by a more fundamental consideration of the ECL model.

Question 10—Other matters

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

As recommended in our submission to the Request for Information – Post-implementation Review: IFRS 9 Financial Instruments - Classification and Measurement, we would like to reinforce the importance of taking a holistic approach to consider stakeholder feedback not only in relation to all aspects of IFRS 9 but also other related projects which interact with IFRS 9 (e.g., post-implementation reviews of IFRS 15 and IFRS 16).