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PIR IFRS 9 Impairment

General approach to ECL recognition – feedback analysis

Objective

1 The objective of this session is to seek EFRAG FR TEG views on the IASB staff feedback analysis and recommendations and the IASB tentative decisions on the general approach to recognition of the expected credit loss ('ECL').

Summary of the feedback received

2 Almost all respondents supported the general approach, did not identify any fatal flaws and stated that the approach generally achieves an appropriate cost-benefits balance.

3 However, in context of costs - benefits balance, respondents suggested the IASB reconsider the application of the approach to:

(a) financial instruments between entities under common control (intragroup financial instruments);

(b) financial instruments issued on non-commercial terms or for reasons that are not purely commercial (non-commercial financial instruments); and

(c) purchased financial assets that are not credit impaired.

4 Appendix A to this paper shows the IASB staff assessment of the above issues against PIR criteria.

5 Appendix B to this paper summarises other comments received and the IASB staff analysis of those comments. By comparison, the comments in Appendix B represent a mixture of application questions and different matters raised by a few respondents.

6 Based on the analysis of those comments, the IASB staff recommend no action by the IASB.

Intragroup financial instruments

Summary of the feedback received by the IASB

7 Many respondents said the costs of applying the general approach to intragroup loans and receivables or financial guarantee contracts often outweigh the benefits gained by investors from the resulting information. They said this problem mostly arises in jurisdictions where separate financial statements are prepared in accordance with IFRS Accounting Standards.

8 These respondents consider that the risk of credit losses from these instruments is generally low (e.g., because of financial support from a parent entity or other group entity) and therefore the costs of determining significant increases in credit risk (SICR) and measuring ECL are not justified.

9 The following **root causes of the issue** were mentioned:

(a) *subjective terms and conditions*. Some contractual terms are not at arm's length basis, such as interest-free or below-market interest rate loans. In addition, some terms are not enforceable between intragroup entities (e.g., parent entity will not demand repayment of a loan of a subsidiary in financial difficulty).

(b) *no experience of credit losses*. Generally, there is no historical experience of, or future expectations for, credit losses, including peer group experience for comparable financial instruments.

10 Respondents noted that **these characteristics** make it challenging to apply the general approach to intragroup financial instruments and might lead to accounting outcomes that do not capture the underlying economics of a transaction, such as:

(a) current statistical models lack reasonable and supportable information about credit losses for intragroup instruments. This results in high operational costs to develop specific statistical models and search for information.

(b) the assumption that the initial expectations about credit risk were reflected in the transaction price, generally, does not hold for intragroup assets, making it challenging and artificial to determine SICR since initial recognition.

(c) measuring ECL requires an entity to consider *contractual* versus *expected* cash flows. However, contractual terms might not always be enforced between intragroup entities or might not be sufficiently specific. In this context, two application questions were also asked by a few respondents about determining ECL for particular intragroup on-demand loans and joint financial guarantee contracts.

11 Respondents provided **several suggestions** to resolve these application issues:

(a) *extend the scope of the simplified approach or provide additional guidance.* It would reduce costs, because entities would not need to assess SICR or measure ECL using forward-looking scenarios. Alternatively, these respondents suggested to add application guidance to support entities in applying the judgements required for assessing SICR and measuring ECL of intragroup instruments, for example similar to paragraph B5.5.17 and paragraphs B5.5.49-B5.5.54 of IFRS 9.

(b) *scope out of the impairment requirements*. A few respondents suggested removing intragroup instruments from the scope of IFRS 9, similar to the exemption in US GAAP, because of the limited usefulness of information from the resulting ECL to users of separate financial statements.

(c) *provide educational material.* A few respondents suggested to provide explanatory material that highlights how entities can use of the simplifications and practical expedients in IFRS 9 to estimate ECL for intragroup financial instruments.

12 A few respondents who commented on this topic considered that addressing this matter should be of medium priority for the IASB. Although intragroup instruments are prevalent, the issue only affects entities that prepare separate financial statements applying IFRS

Accounting Standards and while application challenges arise, the ECL model is 'adaptable'. Other respondents did not comment on potential prioritisation.

EFRAG comment letter

13 EFRAG has identified this issue as medium priority in its comment letter and suggested the IASB provides simplified rules for accounting for these loans.

IASB staff analysis and recommendations

14 In the IASB staff view estimating ECL or SICR should not be done mechanically and IFRS 9 requirements allow entity to adjust its ECL approach to make it cost-effective and refers to its educational material published in March 2020. The most appropriate approach applied would vary depending on the entity's credit risk management sophistication, the characteristics of a financial instrument and the availability of data. For example:

(a) *Assessing SICR* - Paragraph B5.5.12 of IFRS 9 lists various approaches for assessing SICR, including those that do not include explicit probability of default as inputs (e.g. credit loss rate approach). Furthermore, paragraph B5.5.18 of IFRS 9 explicitly notes that what types of information are relevant for SICR depend on the credit risk characteristics at initial recognition.

(b) *Undue costs in measuring ECL* - paragraph B5.5.42 of IFRS 9 states that estimating a probability weighted ECL **may not need to be a complex analysis**. In some cases, relatively **simple modelling** may be sufficient, without the need for a large number of detailed simulations of scenarios.

15 IASB staff notes that both the assessment of SICR and the measurement of ECL are required to be based on **reasonable and supportable information that is *available without undue cost or effort*.** Paragraphs B5.5.49-B5.5.54 of IFRS 9 describe these principles and note that **an entity may use internal data** and that, in some cases, the best reasonable and supportable information could be **the unadjusted historical information**. Considering paragraph B5.5.18 of IFRS 9 an entity might determine that the more relevant information in that case is the **qualitative and nonstatistical quantitative information available internally.**

16 The IASB staff further notes that for instruments with low credit risk at the reporting date **paragraph 5.5.10 of IFRS 9 provides the exemption which allows an entity to not recognise lifetime ECL**. Paragraphs B5.5.22-B5.5.24 of IFRS 9 describe the characteristics of the eligible instruments.

17 In addition, paragraph 8 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* permits entities **not to apply accounting policies** set out in accordance with IFRS Accounting Standards **when the effect of applying them is immaterial**.

18 In the IASB staff view the **following IFRS 9 requirements** are also **relevant for intragroup financial assets**:

(a) *the assessment of SICR is separate to the measurement of ECL* - the assessment of whether lifetime ECL should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition not on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring (paragraph B5.5.7 of IFRS 9).

(b) *credit risk analysis is a multifactor and holistic analysis*, considering both quantitative and qualitative factors (paragraphs B5.5.16-B5.5.18 of IFRS 9).

(c) *measuring ECL considers the amount as well as timing* of payments - a credit loss arises even if the entity expects to be paid in full but later than when contractually due because ECL consider the amount and timing of payments (paragraph B5.5.28 of IFRS 9).

(d) *low credit risk* for the purposes of the exemption in paragraph 5.5.10 of IFRS 9 *is not the same as low risk of loss* - financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk (paragraph B5.5.22 of IFRS 9).

19 On the concerns of respondents about the **terms and conditions** of an intragroup instrument might **not being at arm's length basis**, the IASB staff responds that paragraph B5.1.1 of IFRS 9 requires that, even if part of the consideration given or received is for something other than the financial instrument, an entity measures the fair value of the financial instrument. For example, measuring the fair value of a below-market interest rate loan as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset (e.g. an additional investment in the subsidiary).

20 To respond to the concerns about difficulties of **estimating SICR since initial recognition** (see paragraph 10(b) of this paper), IASB staff noted that **assessment of SICR should not only be based on quantitative factors,** according to paragraph B5.5.18 of IFRS 9 **qualitative factors** considering the credit risk characteristics at initial recognition **should also be taken into account.**

21 The IASB staff does not share the views of some respondents that intragroup instruments as 'low risk' instruments and hence the costs of determining the risk of default or estimating ECL are not justified. In the IASB staff view, a **financial instrument does not automatically have low risk** simply by virtue of **arising from transactions between entities under common control**. Facts and circumstances would need to be considered, for example, whether the borrower has a strong capacity to meet its contractual cash flow obligations.

22 The IASB staff **considered and rejected extending the scope of the simplified approach** to all intragroup instruments on the grounds that:

(a) it would not resolve the problem of lack of information noted in paragraph 9(b) of this paper which would be required to measure ECL.

(b) It might complicate the problem as recognising lifetime ECL requires to estimate the expected credit losses that result from all possible default events over the expected life of a financial instrument, rather than only within the 12 months after the reporting date.

23 IASB staff **considered adding an application guidance** in addition to what is already in paragraph B5.5.17 of IFRS 9. In the IASB staff view **adding a few more factors** that may be relevant **in assessing changes in credit risk is unlikely to help all intragroup instruments**

and will not remove the need to holistically consider the characteristics of the financial instrument being assessed. Adding more guidance about 'what constitutes reasonable and supportable information without undue cost or effort' to what is already in paragraphs B5.5.49-B5.5.54 of IFRS 9 is unlikely to result in significant incremental benefits. As a result, the IASB staff **concluded that the benefits of amending IFRS 9 to add further application guidance would not outweigh the costs, considering the extent of potential disruption and operational costs from the change.**

24 The IASB staff **also considered that an exemption** from the impairment requirements in IFRS 9 **is not justified** for intragroup financial instruments, because:

(a) one of the main benefits of the principles-based IFRS 9 requirements is that one impairment model applies to all economically similar financial instruments, regardless of whether they are issued to third parties or entities under common control. In the IASB staff view, **intragroup financial instruments can be economically similar to instruments issued to third parties**.

(b) IASB staff also **disagree that all intragroup instruments have low loss risk**, thus an exemption might lead to **material ECL being omitted**. This rationale is consistent with the IASB reasoning not to provide an exemption from recognition and measurement requirements for intragroup financial guarantee contracts (see paragraph BCZ2.14 of IFRS 9).

25 The IASB staff also **considered but decided not to provide educational material** on this matter, because they are non-authoritative and therefore not enforceable and are not commonly translated or applied in some jurisdictions. The IASB noted the request from respondents to incorporate key conclusions from specific educational material into the Standard, to achieve the intended effects.

26 Based on the above analysis, **IASB staff concluded that IFRS 9 provides an adequate basis for entities to determine ECL for intragroup financial instruments, applying the general approach. The application costs can be proportionate to the benefits of the resulting information, provided the requirements are not applied mechanically and estimating ECL is based on reasonable and supportable information without undue cost or effort.**

27 The IASB also consulted the IFRS IC on these issues on 5 March 2024 which agreed with the IASB conclusion.

Non-commercial financial instruments

Summary of the feedback received by the IASB

28 A few respondents raised similar concerns about financial instruments such as loans to employees or sovereign debts and application challenges to assess SICR or measure ECL in a cost-effective way for these instruments. Even if there is a default, the amount is typically recovered, albeit later than contractually due.

EFRAG comment letter

29 EFRAG did not raise this issue in its comment letter.

IASB staff analysis and recommendations

30 An entity will need to assess whether a statutory receivable meets the definition of a financial asset in paragraph 11 of IAS 32 *Financial Instruments: Presentation*. Statutory

receivables that arise from an imposition of an obligation by law or regulation and do not represent a contractual right to receive cash are not considered financial assets. However, if such a receivable is a financial asset and subject to the impairment requirements in IFRS 9, the IASB staff considered that some of the principles highlighted in paragraphs 1414 to 2020 of this paper would also be relevant to these instruments.

31 Similarly, for an employee loan or sovereign debt, if they are in scope of the impairment requirements in IFRS 9, the applicable principles in IFRS 9, including those described in paragraphs 1414 to 201420 of this paper could allow an entity to adjust its approach to estimating ECL. IASB staff noted that paragraph B5.5.28 of IFRS 9 clarifies that because ECL considers both the amount and the timing of payments, a credit loss arises even if the entity expects to be paid in full but later than contractually due.

Purchased financial assets that are not credit-impaired

Summary of the feedback received by the IASB

32 Some respondents said that the requirement to recognise at least 12-month ECL at each reporting date results in partial double counting of ECL when a financial instrument is first recognised. This is because ECL expectations are already reflected in the fair value of the asset on initial recognition.

33 Despite the fact that this matter has been considered by the IASB when developing the impairment requirements (see paragraphs BC5.87–BC5.95 of the Basis for Conclusions on IFRS 9), a few respondents suggested to reconsider the requirement in the context of purchased financial assets that are **not** credit impaired. In their view, this problem is most pronounced for such assets and the reporting outcome reduces the usefulness of information about acquisitions to investors (for example, in case of purchased assets as part of a business combination).

34 The suggestions from respondents included:

(a) to apply POCI approach or use a similar approach to US GAAP (referred to as the 'gross-up' approach) to **all** purchased assets.

(b) to add specific disclosure requirements to facilitate investors' analysis about these assets, instead of amending IFRS 9.

35 Some respondents considered that double-counting effect is not significant and any action would outweigh the benefits.

EFRAG comment letter

36 EFRAG did not report this issue in its comment letter. The EFRAG high priority issue about "all cash shortfalls" was considered by the IASB in analysing Question 7.

IASB staff analysis and recommendations

37 The IASB staff noted that a few respondents suggested to apply the approach similar to the model proposed by the IASB in 2009[1] to the purchased financial assets.

[1] That model would require an entity to recognise the initial ECL over the life of the asset through the credit-adjusted EIR; and any changes in ECL when occurred. In the IASB's view, the 2009 model would most faithfully represent ECL as it would determine the carrying amount, interest revenue and impairment gains or losses to be recognised through a single, integrated calculation. However, this model was rejected because of significant operational challenges, such as estimating the full expected cash flows for all financial instruments; and applying a credit-adjusted EIR to those cash flow estimates.

38 At the time, the IASB had acknowledged that the recognition of 12-month ECL would result in an overstatement of ECL, and a resulting understatement of the value of a financial instrument, immediately after initial recognition. In particular, the initial carrying amount of financial assets would be below their fair value. However, isolating initial credit loss expectations for recognition over the life of all financial instruments was considered operationally complex. The IASB concluded the general approach to be superior to all the practical alternatives considered at the time (paragraphs BC5.198-BC5.213 of the Basis for Conclusions on IFRS 9).

39 In the IASB staff view, changing the general approach to achieve a more conceptually faithful outcome only for purchased assets would not be justified. It would create an arbitrary distinction between originated and purchased assets, which does not exist in IFRS 9 because the nature and underlying economics between these assets are similar. The IASB staff is of a view that, if the IASB were to reconsider the general approach, it should do so for all relevant financial instruments.

40 However, PIR feedback showed that the general approach generally works as intended with no fatal flaws identified. In addition, some respondents considered that the 'double-counting' is unlikely to be substantial to warrant a major overhaul of the general approach.

41 The IASB staff also **considered, but rejected**, the suggestion to add **a specific disclosure about initial ECL for purchased assets** to facilitate investors' analysis. In the IASB staff view, the requirements in IFRS 7 *Financial Instruments: Disclosures* already require to provide information about the effect from the initial ECL for purchased assets (paragraphs 35B and 35H-35I of IFRS 7).

The IASB tentative decision

42 Based on the above analysis, the IASB staff recommend the IASB **does not take any further action on matters identified with regards to the general approach in IFRS 9.**

43 Following the IASB staff recommendation, the IASB tentatively decided **to take no standard-setting action on matters related to the general approach to recognising ECL**. All 14 IASB members agreed with this decision.

EFRAG Secretariat assessment

44 The EFRAG Secretariat notes that overall feedback received did not indicate any fatal flaws in the general model requirements and that applying the general model to intragroup financial instruments represents an application issue for the separate financial statements.

45 The EFRAG Secretariat acknowledges the IASB staff arguments that the general model should not be applied mechanically and that the assessment of SICR and the measurement of ECL should be based on reasonable and supportable information that is available without undue cost or effort.

46 The EFRAG Secretariat further notes the IASB staff arguments that IFRS 9 does not list acceptable techniques or methods for assessing SICR or measuring ECL, that the use of statistical model is not obligatory, internal data can be used and that practical expedients when measuring ECL if they are consistent with the principles in IFRS 9 may be applied (see paragraph B5.5.35 and B5.5.42 of IFRS 9).

47 The EFRAG Secretariat also notes that there is a variety of intragroup instruments with different terms and conditions and agrees with the IASB not providing specific exception for such instruments, because they do not necessarily have low risk.

48 In its comment letter EFRAG suggested the IASB to consider introducing simplified rules for intra-group loans. The IASB staff argues that applying existing impairment requirements entities can already apply some sort of simplified approach to intragroup instruments. However, given that questions still arise about the application matters, the EFRAG Secretariat is of view that the issue is pervasive and that additional illustrative examples or educational material to help the consistent application of the impairment requirements to intragroup financial instruments will be useful.

49 The EFRAG Secretariat agrees with the IASB staff conclusions on non-commercial financial instruments and purchased financial assets.

Questions to EFRAG FR TEG

Does EFRAG FR TEG agree with the IASB staff analysis and the IASB tentative decision not to take standard-setting action on matters related to the general approach to recognising ECL?

Does EFRAG FR TEG agree with the EFRAG Secretariat analysis?

Appendix A - IASB staff assessment—Is further action needed?

PIR evaluation requirements	Staff assessment	
	Intragroup and non-commercial financial instruments	***Purchased financial assets that are not credit-impaired***
Are there fundamental questions (i.e. 'fatal flaws') about the clarity and suitability of the core objectives or principles in the new requirements?	**No.** PIR feedback and the staff analysis in this paper on the matters identified indicated that the general approach requirements are working as intended and that there are no fundamental questions about the clarity and suitability of the core objectives or principles in IFRS 9.	
Are the benefits to users of financial statements of the information arising from applying the new requirements significantly lower than expected?	**No.** PIR feedback did not provide any evidence that the benefits to users of financial statements of information arising from applying the general approach requirements to intragroup or non-commercial financial instruments are significantly lower than expected.	**No.** Although a few respondents raised concerns about the counter-intuitive outcome and the reduced usefulness of information about purchased assets, majority of these respondents did not indicate that the issue significantly lowers the benefits of the resulting information to users of financial statements
Are the costs of applying the new requirements and auditing and enforcing their application significantly greater than expected?	**It depends**. Feedback indicates that, in some cases, the application costs for intragroup financial instruments might exceed the benefits of the resulting information if requirements are applied mechanically. In our view, IFRS 9 provides an adequate basis for determining ECL for these instruments and applying the requirements mechanically would be inconsistent with the principles in IFRS 9 and might increase application	**No.** PIR feedback did not provide any evidence that the cost of applying, auditing or enforcing the application of the general approach requirements for purchased assets are significantly greater than the IASB expected when developing the requirements.

PIR evaluation requirements	**Staff assessment**	
	Intragroup and non-commercial financial instruments	***Purchased financial assets that are not credit-impaired***
	costs. The IASB staff, however, plan to seek further input from the IFRS IC to inform the IASB's assessment of this matter.	

Appendix B - Analysis of other comments

Feedback	Staff analysis	Conclusion
Determining ECL for on-demand intragroup loans		
A few respondents asked application questions regarding estimating ECL for particular on-demand intragroup loans. For example, a parent entity issues a loan that is contractually payable on demand to a subsidiary that is unable to pay it immediately. Realistically, the parent entity does not intend to demand the loan until a time that the subsidiary can repay it. In this context, they asked what is the maximum period over which the parent entity shall measure ECL—is it up to a day, reflective of the 'on demand' contractual term, or is it a longer period, reflecting the parent entity's intentions to not demand payment in near term.	We note that the maximum period applying paragraph 5.5.19 of IFRS 9 would be the maximum contractual period and not a longer period. An entity would reflect the expected time to recover the loan in the measurement of ECL (see paragraph B5.5.28 of IFRS 9). Other factors would also require consideration, including the effective interest rate on which the ECL are discounted to the reporting date. Unlike paragraph 5.5.19 of IFRS 9, paragraph 5.5.20 of IFRS 9 allows a loss allowance to be measured over a period longer than the contractual period if the financial instrument has both a loan and an undrawn commitment component. For the purpose of this question, we have assumed there is no loan commitment, thus paragraph 5.5.20 of IFRS 9 would not apply.	No action.
Determining ECL for joint financial guarantees		
A few respondents also asked about determining ECL for joint financial guarantees. For example, when two entities under common control jointly provide a guarantee over a loan issued to an intragroup debtor by a third-party bank. A national standard-setter said these types of contracts	Determining ECL for a joint financial guarantee contract issued by two entities under common control would depend on the terms and conditions of the contract. For example, if a guarantor can be individually held liable for all the losses that the guarantee holder incurs because a specified debtor fails to make payment when due, the amount of such	No action.

Feedback	Staff analysis	Conclusion
generally do not contain specific terms about the share of losses to be borne by each guarantor, making it challenging to determine the respective exposure at default and thus, could result in under/overestimated ECL. They suggested the IASB provide application guidance on measuring ECL for each guarantor in their respective separate financial statements. They, however, did not comment on what basis would the IASB provide guidance given that the exposure at default is based on contractual and legal terms.	losses would be the exposure at risk for the purposes of its separate financial statements. Based on our analysis, we think this is not necessarily a financial reporting issue arising from the impairment requirements in IFRS 9 and as such, cannot be resolved by the IASB.	
Scope of general approach versus the simplified approach		
A few respondents asked whether intragroup short-term receivables are in scope of the simplified or the general approach in IFRS 9.	We note the simplified approach only applies to trade receivables or contract assets that result from transactions that are within the scope of IFRS 15 *Revenues from contracts with customers* and lease receivables that result from transactions that are within the scope of IFRS 16 *Leases*. Therefore, the general approach would apply to intragroup receivables, unless they arise from transactions in scope of IFRS 15 or IFRS 16.	No action.
Convergence with US GAAP		
A few respondents raised concerns that the different approaches under IFRS 9 and US GAAP to account for expected credit losses reduce international comparability, suggesting the IASB and FASB explore potential convergence. One of these respondents suggested the IASB reconsider the general approach of the ECL model and instead consider applying the gross-up approach in US GAAP. This respondent	We agree that convergence would have yielded positive effects towards international comparability. However, as explained in paragraphs BC5.109-BC5.117 of the Basis for Conclusions on IFRS 9, the IASB and the FASB had examined ways of achieving convergence, without success. Furthermore, the IASB had considered, but rejected, the gross-up approach (see paragraphs BC5.219-BC5.220 of the Basis for Conclusions on IFRS 9).	No action.

Feedback	Staff analysis	Conclusion
had also suggested the FASB further extends the scope of the gross-up approach to include all financial instruments.	In the light of the feedback received (see paragraphs 6-8 of this paper), we do not think an overhaul of the general approach is justified.	