

STAFF PAPER

11 December 2015

Project	Transition Resource Group for Impairment of Financial Instruments		
Paper topic	Presentation of the loss allowance for financial assets measured at amortised cost		
CONTACT(S)	Bernadette Whittick Kumar Dasgupta	bwhittick@ifrs.org kdasgupta@ifrs.org	+44 (0)20 7246 0552 +44 (0)20 7246 6902

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the Transition Resource Group for Impairment of Financial Instruments. It does not represent the views of the IASB or any individual members of either the IASB or staff. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs.

Introduction

1. We have received a submission regarding whether an entity is required, for financial assets measured at amortised cost, to present the loss allowance separately in the statement of financial position.
2. This paper:
 - (a) sets out the relevant accounting requirements in IFRS 9 *Financial Instruments* (2014), IFRS 7 *Financial Instruments—Disclosures* and IAS 1 *Presentation of Financial Statements*;
 - (b) summarises the potential implementation issue raised by the submitter; and
 - (c) asks the members of the Transition Resource Group for Impairment of Financial Instruments (‘the ITG’) for their views on the issue identified.

Accounting requirements

3. Paragraph 54 of IAS 1 sets out the line items to be presented in the statement of financial position as a minimum and includes the following items:

54 The statement of financial position shall include line items that present the following amounts:

[...]

(d) financial assets (excluding amounts shown under (e), (h) and (i));

(e) investments accounted for using the equity method;

[.....]

(h) trade and other receivables;

(i) cash and cash equivalents;

[...]

(k) trade and other payables;

(l) provisions;

(m) financial liabilities (excluding amounts shown under (k) and (l));

[.....]

4. Paragraph 55 of IAS 1 further notes that an entity shall present additional line items, headings and subtotals when such presentation is relevant to an understanding of the entity's financial position:

55 An entity shall present additional line items (including by disaggregating the line items listed in paragraph 54), headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.

5. Further requirements regarding the presentation of separate line items are set out in paragraphs 57 and 58 of IAS 1. Paragraph 58 of IAS 1 further notes that an entity needs to apply judgement in this regard [emphasis added]:

57 This Standard does not prescribe the order or format in which an entity presents items. Paragraph 54 simply lists items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

- (a) line items are included when the size, nature or function of an item or aggregation of similar items **is such that separate presentation is relevant to an understanding of the entity's financial position**; and

[.....]

58 An entity **makes the judgement** about whether to present additional items separately on the basis of an assessment of:

- (a) the nature and liquidity of assets;
 (b) the function of assets within the entity; and
 (c) the amounts, nature and timing of liabilities.

6. Amortised cost is defined in Appendix A of IFRS 9 as:

The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

7. Paragraph 5.5.1 of IFRS 9 requires an entity to recognise a loss allowance for expected credit losses on specific financial instruments:

5.5.1 An entity shall recognise a *loss allowance* for *expected credit losses* on a financial asset that is

measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d).

8. Paragraph BC48P of IFRS 7 highlights that the mandatory use of a loss allowance account for credit losses was widely supported by respondents [emphasis added]:

BC48P The Supplementary Document proposed the mandatory use of a loss allowance account for credit losses, with separate disclosure of reconciliations for the two groups of financial assets that an entity would distinguish for the purpose of determining the loss allowance (ie assets in the ‘good book’ and assets in the ‘bad book’). **Almost all respondents supported the mandatory use of a loss allowance account.** Consequently, the 2013 Impairment Exposure Draft retained that proposal.

9. In respect of the loss allowance for financial assets measured at fair value through other comprehensive income (‘FVOCI’), paragraph 5.5.2 sets out the following requirement [emphasis added]:

5.5.2 An entity shall apply the impairment requirements for the recognition and measurement of a loss allowance for financial assets that are measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However, the loss allowance shall be recognised in other comprehensive income and **shall not reduce the carrying amount of the financial asset in the statement of financial position.**

10. In addition, paragraph and B5.6.1(b) of IFRS 9 notes the following in respect of the loss allowance upon reclassification of a financial asset out of, and into, the FVOCI measurement category:

B5.6.1(b) [...] However if a financial asset is reclassified out of the fair value through other comprehensive income measurement category and into the amortised cost measurement category, **a loss allowance would be recognised as an adjustment to the gross carrying amount of the financial asset from the reclassification date**. If a financial asset is reclassified out of the amortised cost measurement category and into the fair value through other comprehensive income measurement category, the loss allowance would be derecognised (**and thus would no longer be recognised as an adjustment to the gross carrying amount**) but instead would be recognised as an accumulated impairment amount (of an equal amount) in other comprehensive income and would be disclosed from the reclassification date.

11. Consistently with paragraph 5.5.2 and B5.6.1(b) of IFRS 9, paragraph 16A of IFRS 7 provides the following requirement in respect of the loss allowance on financial assets measured at FVOCI [emphasis added]:

16A The carrying amount of financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of IFRS 9 is not reduced by a loss allowance and an entity **shall not present the loss allowance separately in the statement of financial position as a reduction of the carrying amount of the financial asset**. However, an entity shall disclose the loss allowance in the notes to the financial statements.

12. In respect of loan commitments and financial guarantee contracts, paragraph B8E of IFRS 7 states that the loss allowances should be recognised as a provision:

BE8 For loan commitments and financial guarantee contracts the loss allowance is recognised as a provision.
[.....]

Potential implementation issue identified

13. The submitter notes that paragraph 5.5.1 of IFRS 9 requires an entity to recognise a loss allowance for expected credit losses in respect of financial assets measured at amortised cost or at FVOCI, and for a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply.
14. The submitter also notes that additional guidance regarding the recognition of the loss allowance for financial assets measured at FVOCI and loan commitments and financial guarantee contracts can be found in IFRS 9 and IFRS 7 respectively, specifically:
 - (a) paragraph 5.5.2 of IFRS 9 states that the loss allowance for financial assets that are measured at FVOCI shall be recognised in other comprehensive income and shall not reduce the carrying amount of the financial asset in the statement of financial position; and
 - (b) paragraph B8E of IFRS 7 states that the loss allowance for loan commitments and financial guarantee contracts is recognised as a provision.
15. However, the submitter observes that there is no such additional guidance in respect of the recognition of the loss allowance for financial assets measured at amortised cost, lease receivables or contract assets.
16. The submitter notes that in accordance with paragraph BC48P of IFRS 7, the mandatory use of a loss account (which was initially proposed in the *Supplementary Document*) was widely supported by respondents and consequently retained in the 2013 *Impairment Exposure Draft*, but that neither IFRS 9 nor IFRS 7 are explicit about requiring how the loss allowance should be presented in the statement of financial position. The submitter also observes that while IFRS 9 introduced a consequential amendment to IAS 1 requiring impairment losses to be shown as a separate line item in the statement of profit or loss (see paragraph 82(ba) of IAS 1), there was no similar consequential amendment made in respect of the statement of financial position.

17. Consequently, the submitter asks whether for financial assets measured at amortised cost, an entity is required to present the loss allowance separately in the statement of financial position and suggests two alternative views:
- (a) *View 1*—No, an entity is not required to present the loss allowance separately in the statement of financial position for financial assets measured at amortised cost.
 - (b) *View 2*—Yes, an entity is required to present the loss allowance separately in the statement of financial position for financial assets measured at amortised cost.
18. In support of View 1, the submitter notes that in accordance with paragraph 5.5.2 of IFRS 9, the loss allowance for financial assets that are measured at FVOCI is recognised in other comprehensive income and does not reduce the carrying amount of the financial asset in the statement of financial position. In the submitter's view, this could imply that for financial assets measured at amortised cost (and for trade receivables, contract assets and lease receivables) the loss allowance should reduce the carrying amount of the financial asset in the statement of financial position¹. The submitter considers that this could be further supported by paragraph B5.6.1(b) of IFRS 9, which notes that upon reclassification of a financial asset out of the amortised cost measurement category into the FVOCI measurement category, the loss allowance would no longer be recognised as an adjustment to the gross carrying amount.
19. Consequently, in accordance with this view, the submitter considers that an entity is not required to present the loss allowance separately in the statement of financial position for financial assets measured at amortised cost. However, the submitter observes that despite there being no general requirement to present the loss allowance for financial assets measured at amortised cost separately in the

¹ The staff note that the definition of amortised cost in Appendix A of IFRS 9 includes an adjustment for the loss allowance and consequently the carrying amount of a financial asset measured at amortised cost is *required* to be reduced by the loss allowance. However, the staff point out that this requirement is separate to the question of presentation of the loss allowance in the statement of financial position.

statement of financial position, an entity would be required to consider the requirements of paragraph 55 of IAS 1.

20. In support of View 2, the submitter highlights the following areas of guidance from various IFRSs which could be considered to support the requirement to present the loss allowance separately in the statement of financial position for financial assets measured at amortised cost²:
- (a) within the context of revolving credit facilities, paragraph IE65 of Illustrative Example 10 of IFRS 9 states that the expected credit losses for the undrawn commitment are recognised together with the loss allowance for the loan component in the statement of financial position—the submitter observes that this could imply the separate presentation of the loss allowance in the statement of financial position;
 - (b) paragraph 16A of IFRS 7 notes that the carrying amount of financial assets measured at FVOCI is not reduced by a loss allowance and that an entity shall not present the loss allowance separately in the statement of financial position as a reduction of the carrying amount of the financial asset—the submitter observes that this could be read to imply a contrasting requirement (ie separate presentation) in respect of the loss allowance for financial assets measured at amortised cost;
 - (c) paragraph 5.4.4 of IFRS 9 notes that an entity shall directly reduce the gross carrying amount of a financial asset³ when the entity has no reasonable expectation of recovering a financial asset (ie a write-off) and notes that this constitutes a derecognition event—the submitter observes that this could imply that in all other cases, the financial asset

² The submitter notes that the definition of amortised cost in Appendix A of IFRS 9 includes an adjustment for the loss allowance and consequently, in accordance with View 2, the carrying amount of a financial asset measured at amortised cost in the statement of financial position would be presented as a sub-total of the gross carrying amount reduced by the loss allowance as a separate line item.

³ The staff note that unlike the remainder of the analysis in this paper, which relates to the amount of the allowance balance, its presentation and the effect on the carrying amount of the financial asset, paragraph 5.4.4 of IFRS 9 refers to a *direct adjustment to the gross carrying amount*.

must be presented at its gross carrying amount with a separate line item for the loss allowance;

- (d) Scenarios 1, 2 and 4 of Illustrative Example 15 of IFRS 9, which sets out the journal entries for reclassification out of, and into, amortised cost measurement include the loss allowance as a separate line item (see paragraphs IE109, IE110 and IE112 of IFRS 9); and
- (e) paragraph BC48P of IFRS 7 discusses the Exposure Drafts that preceded IFRS 9 and notes that because of the wide support from respondents to the *Supplementary Document* regarding the mandatory use of a loss allowance account, the 2013 *Impairment Exposure Draft* retained this proposal.

Review of accounting requirements

- 21. We note that in accordance with paragraph 54 of IAS 1, the loss allowance is not included in the list of line items to be presented in the statement of financial position as a minimum. We also note that IFRS 9 did not make any consequential amendments to the list of line items to be presented in the statement of financial position in accordance with IAS 1.
- 22. We observe that, as highlighted in paragraph BC48P of IFRS 7, the mandatory use of a loss allowance account was widely supported by respondents to the *Supplementary Document* and that this proposal was carried forward into the final version of IFRS 9. We note, however, that this refers to the direct ‘calculation’ of the loss allowance rather than to how it is then presented on the face of the statement of financial position or how it relates to the carrying amount of the financial asset. In this regard, we note that neither IFRS 9 nor IFRS 7 contains any explicit requirements regarding the presentation of the loss allowance in respect of financial assets measured at amortised cost (or trade receivables, contract assets or lease receivables) in the statement of financial position.

23. We note that in referring to recognition, IFRS 9 is clear that a loss allowance must be *calculated and recognised* for all financial instruments within the scope of paragraph 5.5.1 of IFRS 9. This, however, is separate to the question of how this amount is treated in determining the carrying amounts of the relevant financial instruments and in their associated presentation. In this regard, we note that IFRS 9 sets out different requirements for how the loss allowance affects the carrying amount of financial instruments, depending on their classification. In particular, the carrying amount of amounts measured at amortised cost is expressly net of the loss allowance (which is consistent with the definition of the amortised cost of a financial asset set out in Appendix A of IFRS 9). In contrast, for financial assets measured at FVOCI, their carrying amount is their fair value and therefore the loss allowance is not an adjustment to the carrying amount, as noted in paragraph 5.5.2 of IFRS 9.
24. Consequently, we note that IFRS 9 does not require an entity to present the loss allowance in respect of financial assets measured at amortised cost separately in the statement of financial position. However, we observe that in accordance with paragraph 55 of IAS 1, an entity is required to present additional line items when such presentation is relevant to an understanding of the entity's financial position and that in accordance with paragraph 58 of IAS 1, an entity would be required to apply its judgement in deciding whether such separate presentation is considered necessary.
25. In contrast, we note that in accordance with paragraph 16A of IFRS 7, an entity is *prohibited* from presenting the loss allowance in respect of financial assets measured at FVOCI separately in the statement of financial position as a reduction of the carrying amount of the financial asset. Furthermore, paragraph B8E of IFRS 7 requires the loss allowance for loan commitments and financial guarantees to be recognised as a provision and in accordance with paragraph 54 of IAS 1,

provisions are required to be presented as a separate line item in the statement of financial position.⁴

26. Finally, we note that despite the differences regarding how the loss allowance relates to the carrying amount of a particular financial instrument or how that loss allowance is presented in the statement of financial position, IFRS 7 sets out disclosure requirements in respect of the loss allowance for *all* financial instruments within the scope of paragraph 5.5.1 of IFRS 9. For example, paragraph 35H of IFRS 7 applies to all financial instruments subject to the impairment requirements of IFRS 9 and thus includes for example, the loss allowances relating to financial assets measured at amortised cost, FVOCI and for loan commitments and financial guarantees.

Question for ITG members

What are your views on the issue discussed in this paper?

⁴ However, if a financial instrument includes both a loan and undrawn commitment component, and the entity cannot separately identify the expected credit losses on the loan commitment component from those on the financial asset component, the expected credit losses on the loan commitment component should be recognised together with the loss allowance for the financial asset.