IFRS

STAFF PAPER

March 2019

IFRS Interpretations Committee Meeting

Project	**Curing of a credit-impaired financial asset (IFRS 9)**		
Paper topic	Agenda decision to finalise		
CONTACT(S)	Angie Ah Kun	aahkun@ifrs.org	+44 (0) 20 7246 6418
	Elizabeth Figgie	efiggie@ifrs.org	+44 (0) 20 7246 6410

Objective

1. This paper considers feedback on the IFRS Interpretations Committee's (Committee) tentative agenda decision on IFRS 9 *Financial Instruments*—Curing of a credit-impaired financial asset. The purpose of this paper is to:
   (a) analyse the comments received on the tentative agenda decision, and
   (b) ask the Committee if it agrees with the staff recommendation to finalise the agenda decision.
2. Appendix A to the paper contains the proposed wording of the agenda decision.
3. Agenda Paper 13A for this meeting reproduces the comment letters.

Introduction

4. At its November 2018 meeting, the Committee discussed a request about how an entity presents amounts recognised in the statement of profit or loss when a credit-impaired financial asset is subsequently cured (ie paid in full or no longer credit-impaired).

5. When a financial asset becomes credit-impaired, paragraph 5.4.1(b) of IFRS 9 requires an entity to calculate interest revenue by applying the effective interest rate (EIR) to the amortised cost of the financial asset. This results in a difference between (a) the interest that would be calculated by applying the EIR to the gross carrying amount (GCA) of the credit-impaired financial asset, and (b) the interest revenue recognised for that asset. The request asked whether, following the curing of the financial asset, an entity can present this difference as interest revenue or, instead, is required to present it as a reversal of impairment losses.

6. In November 2018, the Committee published a tentative agenda decision. In that tentative agenda decision, the Committee concluded that, in the statement of profit or loss, an entity is required to present the difference described in the request as a reversal of impairment losses following the curing of a credit-impaired financial asset. The Committee concluded that the requirements in existing IFRS Standards provide an adequate basis for an entity to recognise and present the reversal of expected credit losses (ECL) following the curing of a credit-impaired financial asset in the fact pattern described in the request. Consequently, the Committee tentatively decided not to add this matter to its standard-setting agenda.

Comment letter summary

7. We received eleven comment letters on the tentative agenda decision. The comment letters are available on our website and have been reproduced in Agenda Paper 13A for ease of reference.

8. Four respondents (Malaysian Accounting Standards Board, Global Financial Reporting Collective, Deloitte Touche Tohmatsu Limited and Accounting Standards Committee of Germany) agree with the Committee's decision not to add the matter to its standard-setting agenda for the reasons described in the tentative agenda decision.

9. Two respondents (World Savings and Retail Banking Group, and European Savings and Retail Banking Group [WSBI-ESBG] and Institute of Chartered Accountants of India [ICAI]) broadly agree with the Committee's technical analysis of the requirements in IFRS 9. However, they say the conclusion described in the tentative agenda decision—ie an entity is required to present the difference described in the

request as a reversal of impairment losses in the statement of profit or loss following the curing of a credit-impaired financial asset—might not faithfully reflect the economic substance of that amount and, for that reason, they disagree with the tentative agenda decision.

10. Five respondents (Organismo Italiano di Contabilità [OIC] (Italian Standard Setter), Société Générale, Petróleo Brasileiro S.A. - Petrobras [Petrobras], Autorité des Normes Comptables [ANC] (French Standard Setter) and Mazars) disagree with the Committee's technical analysis of the requirements in IFRS 9 and the conclusions reached in the tentative agenda decision.

11. ICAI, OIC, ANC and Société Générale say the Committee should consider referring this matter to the Board so the Board can consider making a narrow scope amendment to IFRS 9.

12. Respondents' comments, together with our analyses, are presented below.

Staff analysis of the comments received

Disagreements with the Committee's technical analysis and conclusions

Respondents' feedback

13. OIC disagrees with the Committee's conclusion that the requirements in IFRS Standards provide an adequate basis for an entity to recognise and present the difference described in the request as a reversal of impairment losses in the statement of profit or loss following the curing of a credit-impaired financial asset. Specifically this respondent says that IFRS 9 is not sufficiently clear whether this amount is included in the adjustment described in paragraph 5.5.8 of IFRS 9.[1] This respondent says there are diverging views on this issue; ie some agree with the Committee's view but others think this amount should be presented as interest revenue. OIC says both views are correct because IFRS 9 is not sufficiently clear. This respondent says that the Committee should propose an amendment to IFRS 9 to clarify this matter and, in

[1] Paragraph 5.5.8 of IFRS 9 requires an entity to recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.

the meantime, permit entities to present this amount as either interest revenue or a reversal of impairment losses (as an accounting policy choice). Similarly Petrobras disagrees with the Committee's conclusion that existing IFRS Standards provide an adequate basis to address this request.

14. ANC and Mazars say that, in order to properly analyse the accounting for the difference described in the request, it is important to clarify how this amount was initially recorded and thus encourage the Committee to analyse the matter in a more comprehensive way. ANC expresses the view that there is no evidence that the GCA of a credit-impaired asset must reflect the contractual interest accrued instead of the interest revenue determined by applying paragraph 5.4.1(b) of IFRS 9. ANC also says that IFRS 9 is not sufficiently clear about how the difference described in the request interacts with the GCA and amortised cost of the financial asset, and how that difference must be presented in the balance sheet or in profit or loss. It expresses the view that there may be circumstances in which it is impossible for an entity to comply with both the requirements in paragraph 5.4.1(b) of IFRS 9 and the requirements in paragraph 5.5.8 of IFRS 9.

15. Mazars says an entity cannot initially account for the difference described in the request as part of its impairment allowance. It says that amount is not an impairment gain or loss because it is created by a change in the way the entity calculates interest revenue rather than by a change in expected cash shortfalls. Therefore, in Mazars' view, no additional impairment gain or loss needs to be recorded when the difference arises—and, as a result, applying paragraph 5.5.8 of IFRS 9 that difference should not be included in the loss allowance amount nor should it be recognised as an impairment gain or loss. Consequently Mazars says it disagrees that the reversal of that amount following the curing of the credit-impaired financial asset should be presented as a reversal of impairment losses. Instead it says this amount should be presented as interest revenue because it views the amount as a reversal of the specific interest revenue computation mechanism that IFRS 9 requires for credit-impaired financial assets.

16. ANC, Société Générale and Mazars also express concern about presenting a reversal of impairment losses that exceeds the impairment losses recognised in profit or loss over the life of the financial asset.

17. Mazars says the agenda decision should address only cured assets that are paid in full. For assets that are not paid in full but instead are transferred from Stage 3 back to either Stage 2 [2] or Stage 1[3], this respondent says that there is an additional question about the timing of the reversal of the difference described in the request.

18. Société Générale says that the Committee's tentative agenda decision seems to be based on the application of conclusions set out in previous agenda papers for the Transition Resource Group for Impairment of Financial Instruments (ITG) that addressed the measurement of the loss allowance for credit-impaired financial assets. This respondent questions those previous conclusions because, assuming no further loss is expected, the approach endorsed by the ITG results in an increase in the allowance over time that is not presented as an impairment loss, even though paragraph 82(ba) of IAS 1 *Presentation of Financial Statements* requires an entity to present a separate line in the income statement for impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of IFRS 9. Société Générale expresses the view that there should be no further increase of allowances when expectations of cash-flow recoveries remain unchanged (because the creditworthiness of the borrower remains unchanged). Société Générale also says the ITG is not supposed to issue guidance or assimilated interpretation.

19. ANC, Société Générale and Mazars describe alternative approaches to account for credit-impaired financial assets, which they believe are consistent with the requirements in IFRS 9.

20. ANC and Société Générale say that a financial asset that is temporarily credit-impaired and subsequently cured should depict the same cumulative economic return as a financial asset that is maintained in Stage 2. In summary, under their alternative approach, the ECL balance remains the same over the period that the financial asset is credit-impaired if there is no change in expected cash flows (ie if credit risk remains stable). Therefore the ECL balance is not increased by the unwinding of any discount

[2] Stage 2 financial assets are financial assets for which there has been a significant increase in credit risk since initial recognition, but which are not yet credit-impaired.

[3] Stage 1 financial assets are financial assets for which there has not been a significant increase in credit risk since initial recognition.

while the financial asset is credit-impaired. The GCA is increased by the amount of interest calculated by applying the EIR to the amortised cost during the period that the financial asset is credit-impaired. During the period that the financial asset is credit-impaired, interest revenue is recognised in profit or loss by applying the EIR to the amortised cost of the financial asset. If there is a full recovery of the contractual amount due, then the cumulative amount in the impairment line in profit or loss for the credit-impaired financial asset is nil. This alleviates the concern about presenting a reversal of impairment losses that exceeds the impairment losses recognised in profit or loss over the life of the financial asset. After curing (full recovery or movement back to Stage 2), the difference between the interest calculated by applying the EIR to the GCA of the financial asset and the interest calculated by applying the EIR to the amortised cost of the financial asset during the period the financial asset is credit-impaired—ie the difference described in the request—is recognised in profit or loss as interest revenue. This results in the same amount of cumulative interest revenue being recognised that would have been recognised if the loan had remained performing during the period between issuance and full payment.

21. Mazars' alternative approach is similar to the approach suggested by ANC and Société Générale in that the GCA is effectively increased only by interest calculated on the amortised cost of the financial asset. However, applying Mazars' approach, the ECL balance is increased for the unwinding of the discount and a corresponding entry is recognised in profit or loss as an impairment loss (as set out in the numerical example describing their alternative approach in their comment letter).

Staff analysis

22. The GCA of a financial asset is defined in Appendix A to IFRS 9 as 'the amortised cost of a financial asset, before adjusting for any loss allowance'. Taking into consideration the definition of amortised cost in Appendix A to IFRS 9, the GCA is in effect the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, before adjusting for any loss allowance.

23. Paragraph 5.5.1 of IFRS 9 requires an entity to recognise a loss allowance for expected credit losses. If the credit risk on a financial asset has increased significantly since initial recognition, paragraph 5.5.3 of IFRS 9 requires an entity to measure the loss allowance at an amount equal to the lifetime expected credit losses. Paragraph 5.5.17 of IFRS 9 requires that the measurement of expected credit losses reflects the time value of money. In addition, Appendix A to IFRS 9 defines a credit loss as (emphasis added):

> The difference between **all** contractual cash flows that are due to an entity in accordance with the contract and **all** the cash flows that the entity expects to receive (ie all cash shortfalls), **discounted at the original effective interest rate**…

24. Consistent with the staff's analysis in Agenda Paper 7 for the November 2018 Committee meeting, we think it is clear based on the measurement requirements in IFRS 9 and these definitions in Appendix A to IFRS 9 that the GCA, amortised cost and the ECL balance are discounted amounts and that changes in these amounts during a reporting period include the effect of the unwinding of the discount.

25. As discussed during the November 2018 Committee meeting, the staff's analysis is consistent with the ITG's discussion of the measurement of the loss allowance for credit-impaired financial assets at its meeting in December 2015 (Agenda Paper 9). While we acknowledge that the ITG discussion and related meeting summary are not part of IFRS Standards, we have included that discussion as background in this paper because it was based on analysing the requirements in IFRS 9.

26. Consistent with the IFRS 9 requirements summarised above, ITG members noted that IFRS 9 requires:

    (a) the ECL balance to be discounted to the reporting date using the EIR determined at initial recognition or an approximation thereof; and

    (b) the GCA of a financial asset to be calculated by discounting estimated contractual cash flows (without considering ECL) at the original EIR.

27. One of the approaches that the ITG discussed for measuring the GCA and the ECL balance was similar to the alternative approach proposed by ANC and Société Générale--ie the ECL balance remains constant (assuming no cash settlements and no

change in the expected timing or amount of cash flows on the financial asset) and the GCA is calculated as the balancing figure of the amortised cost and the ECL balance. In other words, the GCA is increased by the amount of interest revenue calculated by applying the EIR to the amortised cost of the asset. Mazars also proposed this calculation of the GCA.

28. At the meeting in December 2015, ITG members observed that only one of the approaches submitted would meet the requirements in IFRS 9 (see paragraph 26). Under this approach there would be an increase in the ECL balance due to applying the original EIR (or an approximation thereof) and there would also be an increase in the GCA due to applying the original EIR to the GCA.

29. Therefore, consistent with the staff's analysis in Agenda Paper 7 for the November 2018 Committee meeting, we think the unwinding of the discount on the ECL balance is recognised as part of the ECL balance regardless of what stage the asset is in for impairment purposes or how interest revenue is calculated (ie on the basis of applying the EIR to the GCA or applying the EIR to the amortised cost of the financial asset). This ensures the loss allowance is measured consistently irrespective of whether the financial asset is credit-impaired or not. This is consistent with the observation in paragraph BC5.75 of the Basis for Conclusions in IFRS 9 that the requirements for calculating interest revenue on credit-impaired financial assets affects only the calculation and presentation of interest revenue and not the measurement of the loss allowance. We therefore disagree with ANC and Société Générale that, applying IFRS 9, the ECL balance remains constant when there is no deterioration or improvement in the borrower's creditworthiness. We also disagree with OIC that IFRS 9 is not sufficiently clear that the amount of the adjustment described in paragraph 5.5.8 of IFRS 9 includes the effect of the unwinding of the discount on the loss allowance.

30. In addition, consistent with the staff's analysis in Agenda Paper 7 for the November 2018 Committee meeting, we think IFRS 9 requires the GCA to be increased with the unwinding of the discount--ie by applying the original EIR to the GCA. Therefore we think the alternative approaches proposed by ANC, Société Générale and Mazars are inconsistent with the requirements in IFRS 9.

31. Consequently, based on the analysis above and consistent with our analysis in Agenda Paper 7 for the November 2018 Committee meeting, we think that, applying paragraph 5.5.8 of IFRS 9, an entity recognises in profit or loss as a reversal of ECL the adjustment required to bring the loss allowance to the amount that is required to be recognised in accordance with IFRS 9 (zero if the asset is paid in full). The amount of this adjustment includes the effect of the unwinding of the discount on the loss allowance during the period that the financial asset was credit-impaired. This means that the reversal of impairment losses may exceed the impairment losses that were recognised in profit or loss over the life of the asset. This is a consequence of the requirement in paragraph 5.4.1(b) of IFRS 9 that, for credit-impaired financial assets, interest revenue is calculated by applying the EIR to the amortised cost of the financial asset.

32. In addition, consistent with the Committee's discussion at the November 2018 meeting, we think it is not necessary to address how the difference described in the request was initially recorded (ie the specific journal entries, or bookkeeping, over the life of the credit-impaired financial asset) in order to answer the specific question submitted to the Committee.

33. Lastly, we do not think it is necessary to limit the scope of the agenda decision to specific types of curing as suggested in paragraph 17 of this paper. That is because the technical analysis is the same. Applying paragraph 5.4.2 of IFRS 9, if a financial asset is no longer credit-impaired and the improvement in credit risk can be related objectively to an event occurring after the requirements in paragraph 5.4.1(b) of IFRS 9 were applied, then an entity calculates interest revenue by applying the EIR to the GCA in subsequent reporting periods. IFRS 9 does not permit or require the entity to reclassify to the interest revenue line item the amount that was previously recognised as an unwinding of the discount on the ECL balance while the financial asset was credit-impaired. In other words, there is no requirement in IFRS 9 to 'reinstate' interest to reflect the position as if the financial asset was never credit-impaired.

34. Consequently, we continue to agree with the Committee's technical analysis and conclusions at the November 2018 meeting and recommend no change to the agenda decision. We note that respondents have not provided information that has changed

our analysis of the requirements in IFRS 9 related to the request submitted and therefore our analysis in this paper is the same as in Agenda Paper 7 for the November 2018 Committee meeting.

Presenting a credit impairment gain following the curing of a financial asset does not faithfully reflect the economic return or nature of those cash flows

Respondents' feedback

35. ICAI and WSBI-ESBG express the view that the Committee's technical analysis and conclusions set out in the tentative agenda decision do not reflect the nature of the cash flows recovered. These respondents express the view that presenting the difference described in the request as interest revenue following the curing of a credit-impaired financial asset would better reflect the nature and economic substance of the cash flows being recovered.

36. In addition, as discussed in paragraph 20 of this paper, both ANC and Société Générale express the view that a financial asset that is temporarily credit-impaired and subsequently cured—ie transferred from Stage 3 to Stage 2 or fully recovered out of Stage 3—should have the same cumulative economic return as a financial asset that stays in Stage 2.

Staff analysis

37. We think the requirements in IFRS 9 are clear with respect to the matter submitted. The impairment approach in IFRS 9 intentionally has recognition and measurement consequences when there is a significant increase in credit risk on a financial asset. Specific to this matter, interest revenue is calculated differently for a credit-impaired financial asset than for a financial asset that is not credit-impaired, and that difference has consequences for the accounting for impairment losses. Those differences in accounting reflect intentional differences in the respective requirements. The Board considered how best to reflect the substance of, and provide useful information about, credit-impaired financial assets when it developed those specific and detailed requirements. IFRS 9 neither permits nor requires an entity to change its interest revenue recognition for a financial asset solely because that asset is ultimately cured.

38. In addition, we agree with the observations made at the November 2018 Committee meeting that, if an entity collects more cash flows than it thought it would, then those amounts do not reflect additional amounts of interest revenue but instead reflect a credit recovery event.

39. Furthermore, there is no requirement in IFRS 9 that the cumulative interest revenue recognised following the curing of a credit-impaired financial asset should be the same as it would have been if the financial asset had remained performing throughout its life. That is, applying IFRS 9, there is not a 'catch-up' adjustment in interest revenue following the curing of a credit-impaired financial asset in order to treat that asset as if it had not previously been credit-impaired. We also observe that IFRS 9 has specific requirements for recognising interest revenue applying amortised cost measurement and this approach results in the recognition of interest revenue over time at the relevant EIR. We think recognising a 'lump sum' amount as if it were interest revenue is inconsistent with the amortised cost mechanics required by IFRS 9.

40. Consequently, we recommend no changes to the agenda decision in response to the concerns raised about reflecting the economic return or nature of the cash flows following the curing of a credit-impaired financial asset.

Staff recommendation

41. On the basis of our analysis, we recommend that the Committee finalise the agenda decision as published in the November 2018 IFRIC Update. Appendix A to this paper sets out the proposed wording for the final agenda decision.

Question for the Committee
Does the Committee agree with the staff recommendation to finalise the agenda decision set out in Appendix A to this paper?

Appendix A––Proposed wording of the agenda decision

A1. We propose the following wording for the final agenda decision which is unchanged from the tentative agenda decision except to remove the square brackets in the last paragraph.

> **IFRS 9 *Financial Instruments* — Curing of a credit-impaired financial asset**
>
> The Committee received a request about how an entity presents amounts recognised in the statement of profit or loss when a credit-impaired financial asset is subsequently cured (ie paid in full or no longer credit-impaired).
>
> When a financial asset becomes credit-impaired, paragraph 5.4.1(b) of IFRS 9 requires an entity to calculate interest revenue by applying the effective interest rate to the amortised cost of the financial asset. This results in a difference between (a) the interest that would be calculated by applying the effective interest rate to the gross carrying amount of the credit-impaired financial asset, and (b) the interest revenue recognised for that asset. The request asked whether, following the curing of the financial asset, an entity can present this difference as interest revenue or, instead, is required to present it as a reversal of impairment losses.
>
> Appendix A to IFRS 9 defines a credit loss as ‘the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls), discounted at the original effective interest rate...’. Appendix A also defines the gross carrying amount as ‘the amortised cost of a financial asset, before adjusting for any loss allowance’. The Committee noted that, based on the definitions in Appendix A to IFRS 9, the gross carrying amount, amortised cost and loss allowance are discounted amounts, and changes in these amounts during a reporting period include the effect of the unwinding of the discount.
>
> Paragraph 5.5.8 of IFRS 9 requires an entity to ‘recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard’.

The Committee observed that, applying paragraph 5.5.8 of IFRS 9, an entity recognises in profit or loss as a reversal of expected credit losses the adjustment required to bring the loss allowance to the amount that is required to be recognised in accordance with IFRS 9 (zero if the asset is paid in full). The amount of this adjustment includes the effect of the unwinding of the discount on the loss allowance during the period that the financial asset was credit-impaired, which means the reversal of impairment losses may exceed the impairment losses recognised in profit or loss over the life of the asset. Accordingly, the Committee concluded that, in the statement of profit or loss, an entity is required to present the difference described in the request as a reversal of impairment losses following the curing of a credit-impaired financial asset.

The Committee concluded that the requirements in existing IFRS Standards provide an adequate basis for an entity to recognise and present the reversal of expected credit losses following the curing of a credit-impaired financial asset in the fact pattern described in the request. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.