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Introduction

Purpose of this paper

1. The Exposure Draft ED/2013/3 *Financial Instruments: Expected Credit Losses* ('the ED') proposed presentation and disclosure requirements to identify and explain:
 - (a) the amounts arising from expected credit losses ('ECL'); and
 - (b) the effect of the deterioration and improvement in the credit risk of financial instruments.
2. This paper analyses the feedback received on the proposed presentation and disclosure requirements, and considers whether any changes to the requirements should be made.
3. This paper is organised by the main revised disclosure requirements and addresses the feedback, staff analysis, and staff recommendations for each requirement. The structure of the paper is as follows:
 - (a) Presentation requirements; (paragraphs 5 - 6)
 - (b) Disclosure objectives; (paragraphs 7 - 13)

- (c) Qualitative disclosures; (paragraphs 14 - 25)
 - (d) Quantitative disclosures; (paragraphs 26 - 56)
 - (i) Reconciliation of gross carrying amount and loss allowance; (paragraphs 26 - 43)
 - (ii) Modifications; (paragraphs 44 - 48)
 - (iii) Collateral and credit mitigation; (paragraphs 49 - 56)
 - (e) Other disclosures; and (paragraphs 57 - 77)
 - (f) Disclosure requirements for the simplified approach for trade receivables and lease receivables. (paragraphs 78 - 81)
4. The staff recommendations are summarised in paragraphs 82 - 83, followed by the question to the IASB.

Presentation requirements

5. The ED proposed that interest revenue and impairment losses (including reversals of impairment gains or losses) should be presented in the statement of profit or loss and other comprehensive income as separate line items. Furthermore, Exposure Draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)) (the ‘Limited Amendments ED’) proposed that the carrying amount of financial assets measured at fair value through other comprehensive income (‘FVOCI’) should not be directly reduced by an accumulated impairment amount and that an entity should be prohibited from presenting the accumulated impairment amount in the statement of financial position. However, an entity should disclose the accumulated impairment amount in the notes to the financial statements.
6. The vast majority of respondents agreed with the proposed presentation requirements and we do not intend to discuss those aspects of the proposals again.

Disclosure objectives

What the ED proposed

7. The proposed disclosure requirements apply to all financial instruments that are in the scope of the ED and the following disclosure objectives are set out in the ED:

[Par 28] An entity shall disclose information that identifies and explains:

(a) the amounts in its financial statements that arise from expected credit losses that are measured in accordance with this [draft] IFRS; and

(b) the effect of deterioration and improvement in the credit risk of financial instruments that are within the scope of this [draft] IFRS.

8. In order to meet these objectives, the ED required financial assets, loan commitments and financial guarantee contracts to be grouped into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments (including their grouping into portfolios)¹. The ED also proposed that entities provide sufficient information to permit reconciliation to the line items that are presented in the statement of financial position.

Feedback

9. Some respondents commented that the proposed disclosure objectives are not clear enough for preparers to understand what information should be disclosed and the reasons for that. They recommended that the disclosure objectives be improved and/or clarified in order to demonstrate the relevance and usefulness of the information provided to users of financial statements.

¹ The classes of financial instruments required by the ED refer to the classes of financial instruments required by paragraph 6 of IFRS 7 *Financial Instruments: Disclosure*.

10. Respondents also questioned the interaction between the disclosure objectives, which appeared to be principles-based, and the list of required disclosures specified in the ED, which appeared to be rules-based. Others were concerned about the volume of disclosures required by the ED and the overlap with other requirements (such as by prudential regulators) and requested that the IASB consider the recommendations made by the Enhanced Disclosure Task Force ('EDTF')² before finalising the disclosure requirements.

Staff analysis

11. Information is useful if it enables users of financial statements to predict the likely amounts, timing and uncertainty of future cash flows. Users therefore need to understand:
- (a) how an entity manages credit risk;
 - (b) the methods, assumptions and information used to estimate ECL;
 - (c) an entity's credit risk profile (the credit risk inherent in the financial instruments), including significant credit concentrations; and
 - (d) changes, and the reasons for the changes, in the estimate of ECL during the period.
12. These factors are consistent with Recommendation 26 of the EDTF, which stated that credit risk disclosures should provide information that facilitates users' understanding of an entity's credit risk profile.
13. The staff therefore recommend to enhance the disclosure objectives listed in paragraph 7 above by expanding those objectives to emphasise that the information provided should enable a user of the financial statements to understand the items listed in paragraph 11 above.

² Refer to Section 5 of Enhancing the Risk Disclosures of Banks, published in October 2012 and publicly available at https://www.financialstabilityboard.org/publications/r_121029.pdf

Qualitative disclosures

What the ED proposed

14. Paragraphs 39 and 42 of the ED proposed that an entity be required to disclose the following qualitative information when estimating 12-month and lifetime ECL and when assessing significant increases in credit risk since initial recognition or determining whether there is objective evidence of impairment:
 - (a) the basis of inputs, assumptions and estimation techniques; and
 - (b) an explanation of the changes in estimates or estimation techniques and the causes of the change.
15. Other proposed qualitative disclosure requirements included:
 - (a) the write-off policy applied including whether there are any financial assets that have been written off that are still subject to enforcement activity (ED paragraph 37);
 - (b) information about the discount rate selected (ED paragraph 39(c));
 - (c) how the ‘more than 30 days past due’ presumption has been rebutted (ED paragraph 43);
 - (d) analyses of significant effects on the loss allowance that are caused by a particular portfolio or geographical area (ED paragraph 45).

Feedback

16. Many respondents who comment on ED paragraphs 39 and 42 stated their preference that these disclosures should be principle-based and qualitative in nature, and that detailed quantitative information should not be prescribed.
17. A few entities noted that the requirement to disclose the discount rate used would not be useful when an entity uses the effective interest rate or various different rates for different asset groups, and requested that the disclosure for discount rates be made more qualitative.

18. A number of respondents requested more qualitative disclosure requirements for modifications, with a focus on the objective for the modification disclosures.

Staff analysis

19. The staff note that the disclosures in ED paragraphs 39 and 42 were intended to be qualitative and principle-based. The disclosure of qualitative information is necessary for users to understand:
- (a) how an entity manages credit risk; and
 - (b) the methods, assumptions and information used to estimate ECL.
20. The EDTF Recommendation 27 recommended the following:
- Describe the policies for identifying impaired or non-performing loans, including how the bank defines impaired or non-performing, restructured and returned-to-performed (cured) loans as well as explanations of loan forbearance policies.
21. The staff note that the EDTF recommendations are provided in the context of the current incurred loss impairment model in IAS 39 *Financial Instruments: Recognition and Measurement*. In order to understand how an entity manages credit risk in the context of the proposed expected credit loss model, the staff believe the following information (as required in the ED) would be relevant and useful:
- (a) how significant increases in credit risk are assessed and identified;
 - (b) how default is defined and why that definition was selected;
 - (c) how objective evidence of impairment is assessed; and
 - (d) the write-off policy.
22. In addition, the staff believe that an explanation of the policy for the modification of financial instruments, including how it is assessed that credit risk of modified financial assets is no longer significantly increased compared to what it was at initial recognition (ie when the loss allowance for modified assets with lifetime

ECL revert back to 12-month ECL) would enhance the understanding of how an entity manages credit risk through modifications and restructurings.

23. Disclosures about the methods, assumptions and information used to estimate ECL have been a core part of the disclosure package since the 2009 expected credit loss ED. In addition to the information already proposed in paragraphs 39 and 42 of the ED about the basis of inputs and the estimation techniques used to estimate ECL, the staff believe that an explanation of how macroeconomic information has been incorporated in the estimates would provide relevant and useful information. The staff think that this is particularly important given the IASB's September 2012 tentative decision to emphasise that such factors need to be considered in assessing whether there has been a significant increase in credit risk.
24. In light of the IASB's tentative decision in October 2012 to require ECL to be discounted using the effective interest rate or an approximation thereof, the staff consider the proposed disclosure requirements relating to the discount rate selected, to be obsolete. We therefore recommend omitting the proposed requirements in paragraph 39(c) of the ED from the final IFRS.
25. We recommend retaining the requirement to provide an explanation of how an entity has rebutted the 'more than 30 days past due' presumption in paragraph 43 of the ED.

Quantitative disclosures

Reconciliation of the gross carrying amount and loss allowance

What the ED proposed

[Par 35] An entity shall provide a reconciliation from the opening balance to the closing balance of the gross carrying amount and the associated loss allowance for:³

³ This disclosure requirement, as well as all other disclosure requirements in this [draft] IFRS, also apply to financial assets that are mandatorily measured at FVOCI in accordance with the Limited Amendments ED (see paragraph 33).

- (a) financial assets with a loss allowance measured at an amount equal to 12-month expected credit losses;
- (b) financial assets with a loss allowance measured at an amount equal to lifetime expected credit losses;
- (c) financial assets that have objective evidence of impairment at the reporting date but that are not purchased or originated credit-impaired financial assets; and
- (d) purchased or originated credit-impaired financial assets. In addition to the reconciliation for these assets, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition.

[Par 36] An entity shall provide a reconciliation from the opening balance to the closing balance of the provision for loan commitments and financial guarantee contracts consistent with paragraph 35.

Feedback

- 26. A large number of respondents opposed the requirement for the reconciliation of the gross carrying amount for financial assets. The primary reason was that such a reconciliation is extremely onerous to produce and therefore very costly.
- 27. Respondents noted that the movement of the gross carrying amount is not readily available as it is not used for current credit risk management purposes (the carrying amount is a financial reporting number whereas credit risk managers focus on credit exposures) and cited the following operational difficulties:
 - (a) Credit risk systems do not contain cash receipt information. Therefore a significant amount of resources will need to be invested in order to develop new systems to produce the flow information solely for disclosure purposes; and
 - (b) Producing the reconciliation would require ECL to be calculated and changes in credit risk tracked at an individual exposure level.Respondents pointed out that the ED specifically permit ECL to be

estimated and significant increases in credit risk assessed on a portfolio/collective basis.

28. Some respondents also questioned the usefulness of reconciling the gross carrying amount of financial assets as it would require the reconciliation of transactional changes like gross acquisitions and repayments, and merges it with accounting adjustments (eg fees, transaction costs). Furthermore, respondents were concerned about the large volume of disclosures and that they do not provide insight as to the reason for the movement and how each change relates to the changes in the credit risk of the financial asset. A few respondents also commented that the level of detail in Illustrative Example 12 of the ED went beyond the disclosure requirement in being too prescriptive and complex.
29. The majority of respondents stated that the reconciliation of only the loss allowance would be more operational and provide useful information to users of financial statements. Some suggested that this could be accompanied by a qualitative discussion of reasons for changes in the gross carrying amount during the period. Those respondents believed that users could draw similar conclusions as they would from a full reconciliation of the gross carrying amount by using the reconciliation of the loss allowance along with the beginning and ending gross carrying amounts and other information such as credit quality profiles and delinquency.

Staff analysis

30. As mentioned in paragraph 11 above, one of the disclosure objectives is to provide information that enables users to understand changes, and the reasons for the changes in the estimate of ECL during the period (ie credit risk migration during the period).
31. Due to the nature of the model, information about movements within and between measurement objectives (ie between 12-month and lifetime ECL) and the key drivers for the change is particularly important to achieve this objective.
32. The EDTF recommended in Recommendation 28 to:
- Provide a reconciliation of the opening and closing balances of non-performing or impaired loans in the period

and the allowance for loan losses. Disclosures should include an explanation of the effects of loan acquisitions on ratio trends and qualitative and quantitative information about restructured loans.

33. The EDTF recommendation thus also incorporates a reconciliation of both the carrying amounts and the impairment allowances. The staff acknowledge that the EDTF recommendations were made in the context of the incurred loss impairment model, however, we remain of the view that disclosures about changes in the gross carrying amount of financial assets are essential to understand the changes in the ECL during the period. For example, comparing changes in the loss allowance to changes in the gross carrying amount of the financial assets provides useful information about whether an increase in the loss allowance is due to new originations or acquisitions (if in Stage 1), transfers between measurement objectives or increases in the credit risk of existing financial instruments. It also enables an assessment to be made of trends in the riskiness of financial assets on initial recognition.
34. The feedback about operational challenges is not new information. The staff note that the operational concerns related to the reconciliation disclosures were considered during the deliberations at the joint July 2012 meeting with the FASB, however the boards questioned the operational concerns raised and stated the importance of the reconciliation of the gross carrying amount and loss allowance for users' understanding of the model. As a result, the boards decided to require the reconciliations.
35. The majority of respondents did not raise any operational concerns and supported the reconciliation of the loss allowance. We therefore do not intend to discuss this requirement further and recommend that the proposed requirement be retained.
36. The staff think that the reconciliation of both the gross carrying amount and loss allowance as proposed in the ED provides the most useful information to users of financial statements and recommend retaining the requirement as proposed. However, based on the feedback received on the operational difficulties of providing a reconciliation of the gross carrying amount, we have considered whether it would be appropriate to modify the proposals. The staff have identified

the following two alternatives if the IASB determines to modify the proposals to address operational concerns:

Alternative A: Require the full reconciliation only for financial assets with lifetime ECL, and a simplified gross carrying amount reconciliation for assets with 12-month ECL

37. Alternative A would require the reconciliation of the gross carrying amount for financial assets for which the loss allowance is measured at lifetime ECL (Stages 2 and 3). For financial assets for which the loss allowance is measured at 12-month ECL (Stage 1), the IASB could require the disclosure of the opening and ending gross carrying amount and originations and purchases during the period. Essentially, this would mean that a full reconciliation would not be required for the assets with a 12-month ECL but key components of the change would be highlighted.
38. This alternative addresses the key operational concerns for a large population of assets, as the reconciliation of opening and closing balances are only required for financial assets with a lifetime ECL allowance. Because of the increased credit risk of these assets, we would expect that entities would generally have access to more detailed information than for those with a 12-month ECL allowance. At the same time, the disclosure of the originations and acquisitions during the year for these financial assets would allow users of financial statements to understand the key drivers of changes in the loss allowance for all assets.
39. The staff note that this alternative appears to be aligned with the EDTF recommendation quoted in paragraph 32 which recommends the reconciliation of impaired or non-performing loans.
40. Some of the staff prefer this approach because it addresses some of the operational concerns raised while retaining what is considered to be relevant information for financial assets with lifetime ECL allowances and it enables users to understand the credit risk profile of new originations and acquisitions of financial assets.

Alternative B: Reconciliation of the gross carrying amount focussing on the key drivers for changes in the loss allowance

41. Alternative B would require the reconciliation of the gross carrying amount for each measurement objective as proposed in the ED. However, given the feedback raised on the operational concerns, this approach would focus on the key drivers for changes in the loss allowance rather than all changes in the gross carrying amount (so a less detailed or granular reconciliation would be required).
42. The staff believe that this approach will be responsive to preparers' concerns discussed in paragraph 27 by only focussing on the changes in the gross carrying amount that relate to credit risk. Taking this approach would ideally result in the quality and detail associated with this disclosure improving as the quality of accounting and credit risk management systems improve. This approach is also consistent with the approach recommended by the EDTF for the reconciliation of risk-weighted assets as illustrated in Section 5, Figure 4 of the EDTF report⁴.
43. Some of the staff prefer this approach. They consider this the most appropriate approach to achieve the objectives as set out in paragraph 11, because it focusses on the key drivers for changes in the loss allowance without being distracted by other information, thereby providing the most useful and relevant information to users of the financial statements.

Modification disclosures

What the ED proposed

[Par 38] An entity shall disclose at the end of the reporting period during which the contractual cash flows on a financial asset have been modified the amortised cost and the modification gain or loss for financial assets that have been modified while they had a loss allowance at an amount equal to lifetime expected credit losses. The entity shall also disclose at each reporting date subsequent to

⁴ Refer to Section 5 of Enhancing the Risk Disclosures of Banks, published in October 2012 and publicly available at https://www.financialstabilityboard.org/publications/r_121029.pdf

such modification throughout the remaining life of the financial asset:

(a) the gross carrying amount of financial assets that have been modified during their life and for which the measurement of the loss allowance has changed from an amount equal to lifetime expected credit losses to an amount equal to 12-month expected credit losses; and

(b) the re-default rate on such financial assets that have been modified while in default (ie the percentage of financial assets that defaulted again subsequent to modification).

The disclosure requirements in this paragraph, other than paragraph 38(a), also apply to trade receivables or lease receivables on which lifetime expected credit losses are always recognised in accordance with paragraph 12 but only if modified while more than 30 days past due.

Feedback

44. Some respondents commented that the requirement to disclose the gross carrying amount of modified financial assets for which the measurement objective has changed from lifetime to 12-month ECL during the entire remaining lifetime of the asset (ie until derecognition), would be onerous as it would require the tracking of individual assets even after they have returned to a performing status and are no longer closely monitored for credit risk management purposes⁵.
45. Furthermore, respondents questioned the usefulness of such information for modifications undertaken a long time in the past, and observed that the usefulness would decrease over time as an increasing number of assets are required to be included in the disclosure. To address these concerns, a number of respondents suggested that the requirements in paragraph 38 be limited to a specified period

⁵ Refer to paragraph 38(a) of the ED

following a modification (eg one year to align it with the European Banking Authority⁶ proposals).

46. Several respondents questioned the use of the term “re-default” in paragraph 38(b) of the ED. These respondents were uncertain as to whether “re-default” referred to assets that have moved from Stage 1 back to Stage 2 or 3, or another population. It was also suggested that this requirement as drafted could result in the unintended consequence of “default” becoming synonymous with the transfer criteria for Stage 2 or 3.

Staff analysis

47. The proposed requirement to disclose the gross carrying amount of financial assets that have been modified (paragraph 38(a)) resulted from a request from users of financial statements to understand the amount of assets that have been modified and subsequently improved in credit quality. However, the staff acknowledge the operational concerns with tracking individual financial assets even after they have returned to a performing status. The staff therefore recommend to amend the requirement in ED paragraph 38(a) to require the disclosure of the gross carrying amount of financial assets that have been modified during their life and for which the measurement of the loss allowance has changed from an amount equal to lifetime expected credit losses to an amount equal to 12-month during the period.
48. The staff also acknowledge the concerns about the use of the term *re-default rate* in paragraph 38(b) and that the requirement as currently drafted may conflict with the use of term *default* in the rest of the proposed Standard. We believe that objective of the proposed requirement was to provide information about the financial assets which have been disclosed in accordance with paragraph 38(a) but for which credit risk has subsequently increased significantly, thereby requiring the loss allowance to change to lifetime ECL again during the remaining lifetime of the assets. We therefore recommend to clarify the requirement in ED

⁶ EBA FINAL draft Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013

paragraph 38(b) to refer to the *deterioration rate* (ie the percentage) of financial assets previously disclosed in accordance with paragraph 38(a) for which credit risk has subsequently increased significantly, resulting in the measurement of the loss allowance reverting to lifetime ECL. This would more clearly illustrate how modifications have migrated between the measurement objectives, and would better align the disclosure with the requirement in 38(a) and the model as a whole.

Collateral and credit risk mitigation disclosures

What the ED proposed

[Par 40] If an entity has financial assets, loan commitments or financial guarantee contracts secured by collateral or other credit enhancements, it shall disclose:

- (a) a description of the collateral held as security and other credit enhancements, including a discussion on the quality of the collateral held (for example, the stability of the asset value and liquidity) and an explanation of any changes in the quality as a result of deterioration or changes in the collateral policies of the entity;
- (b) the gross carrying amount of financial assets that have an expected credit loss of zero because of the collateral; and
- (c) for financial instruments that have objective evidence of impairment at the reporting date, quantitative information about the extent to which collateral and other credit enhancements reduce the severity of expected credit loss.

Feedback

49. A number of respondents expressed concern about the operational difficulty of providing quantitative information about collateral, and stated that the proposed disclosure requirements should generally be more qualitative in nature and take into consideration the wider range of credit risk mitigation factors. These respondents considered the current collateral requirements in IFRS 7,

supplemented by the proposed requirement in paragraph 40(a) of the ED to provide the most relevant and useful information.

50. Some respondents commented that the proposed requirement in paragraph 40(b) would require financial assets to be tracked on an individual basis to identify those assets that are fully collateralised and have an ECL of zero because they could be managed on a collective basis with other financial assets that are not fully collateralised.
51. Respondents also commented that the requirement in paragraph 40(c) would require them to perform their lifetime ECL calculations twice—firstly with the collateral proceeds included in the cash flows, and secondly with those proceeds excluded—to determine the extent to which collateral reduces the severity of the ECL. They viewed this as being burdensome.

Staff analysis

52. The EDTF recommended in Recommendation 30 to:
- Provide qualitative information on credit risk mitigation including collateral held for all sources of credit risk and quantitative information where meaningful. Collateral disclosures should be sufficiently detailed to allow an assessment of the quality of the collateral....
53. The staff believe that the requirement in paragraph 40(b) did not intend to identify individual financial assets that have an ECL of zero because they are fully collateralised. Rather, the staff believe the intention was to identify *asset classes* that have an ECL of zero because of the collateral. This is because the proposed disclosure requirements in paragraphs 40(a) and 40(c) were intended to provide information about the extent to which an entity is exposed to changes in ECL due to changes in collateral. The focus of the proposed requirement in paragraph 40(b) was therefore to provide information about asset classes (for example a repurchase agreement portfolio) where there might have been a significant increase in credit risk resulting in the measurement objective changing to lifetime ECL but with no increase in the actual loss allowance due to the value of the collateral. We recommend clarifying this in drafting.

54. The staff note that the proposal in the ED limited the disclosure of quantitative information about collateral to financial instruments that have objective evidence of impairment in order to address feedback the IASB received that the current collateral disclosure in IFRS 7 paragraph 36(b) (copied below) is onerous and costly to prepare. This was acknowledged in the Basis for Conclusions to the ED (ED BC114).

36 An entity shall disclose by class of financial instrument:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with IAS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

(b) a description of collateral held as security and other credit enhancements, and their financial effect (eg a quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument)... [emphasis added]

55. Paragraph 36(b) arose from the decision to remove the requirement in IFRS 7 to disclose the fair value of collateral and other credit enhancements as part of the 2010 *Improvements to IFRSs*. However, as reflected in the Basis for Conclusions to IFRS 7 excerpt below, the IASB considers that information about the financial effect of collateral is useful.

[BC55A] In *Improvements to IFRSs* issued in May 2010, the Board addressed a concern that the disclosure of the fair value of collateral was potentially misleading. Within a class of assets some might be over-collateralised while others might be under-collateralised. Hence, aggregate disclosure of the fair value might be misleading. Therefore,

the Board removed from paragraph 37(c) the requirement to disclose the fair value of collateral and other credit enhancements. However, the Board believes that information on the financial effect of such assets is useful to users. Hence, the Board included in paragraph 36(b) a requirement to disclose a description of collateral held as security and of other credit enhancements and to disclose their financial effect.

56. The staff remain of the view that information about the financial effect of collateral is useful. However, given the feedback from preparers on the difficulty of quantifying this information, the staff propose modifying the wording of the disclosure requirement to ease operational concerns while maximising the usefulness of the resulting disclosure. The staff think this can be accomplished by deleting the requirement in paragraph 40(c) to provide quantitative information (so require that 'information' be provided), while expanding it to apply to all financial instruments rather than just those that have objective evidence of impairment. This change would reduce the concerns that some preparers have about quantifying the effect of collateral on ECL, while capturing a much greater scope of financial assets by applying the collateral requirements to all financial assets.

Other disclosures

Write-off policy disclosures

What the ED proposed

37 ... In addition to including any write-offs and recoveries in the reconciliation in accordance with paragraph 35, an entity shall disclose the nominal amount of financial assets written off that are still subject to enforcement activity.

Feedback

57. Several respondents questioned the meaning of the term “nominal amount”, and stated that they were uncertain whether this referred to the gross or net carrying amount at write off, the original principal amount or the amount legally recoverable.
58. A few respondents felt that the disclosure of amounts written off that are still subject to enforcement activity would be both operationally burdensome and of limited use to users of financial statements. Some of these respondents felt it could mislead users of financial statements in cases when an entity has claims that remain legally open, but for which it has little or no actual expectation of recovery. Others noted that such information would be disclosed as part of amounts in the line item for the recovery of previously written-off loans. Operationally, it was noted it would require the use of information that currently isn't available in entities' systems after a write-off is performed, and the tracking of assets that are in some cases subject to lengthy recovery processes.

Staff analysis

59. Feedback from users indicated they would like to understand the extent of recoveries for written-off assets that are still possible. These users were concerned about having no further information on assets written-off, which would result in any recoveries being a ‘surprise’ from an accounting perspective. The nominal amount provides users with information about the possible upside if an entity can recover what is still subject to enforcement activity.
60. The staff acknowledge the need for users to capture forward-looking information in terms of what could be recovered in the future. However, disclosure of the aggregate nominal amount of financial assets that have been written-off and are subject to enforcement activity may not provide the most relevant information for this purpose. For example, the nominal amount could be very high (particularly as time passes if the asset legally continues to accrue interest) even though the prospect of recovering any of the amount outstanding may be extremely low.
61. The staff note that in other IFRSs the term ‘nominal amount’ has been used to refer to the contractual amount outstanding, and recommend to clarify this in

drafting. The staff further recommend to clarify that the requirement to disclose the nominal amount of assets subject to enforcement activity only applies to financial assets that have been written-off during the period, while narrative information is provided about financial assets that previously have been written-off but that are still subject to enforcement activity.

62. The staff also note that paragraph 35 of the ED currently requires write-offs and recoveries of amounts previously written-off to be disclosed as part of the reconciliation disclosure. Regardless of whether the IASB decides to retain the current reconciliation requirements or decides to apply either Approach A or B as set out in paragraphs 37-43, the staff recommend to retain this requirement.

Credit risk disaggregation disclosures

What the ED proposed

[Par 44] An entity shall disclose, by *credit risk rating grades*, the gross carrying amount of financial assets and the amount recognised as a provision for loan commitments and financial guarantee contracts in a grade. An entity shall disclose this analysis separately for financial assets, loan commitments and financial guarantee contracts for which the loss allowance or provision is measured in accordance with paragraphs 4, 5, 12 and 14–15. The number of credit risk rating grades used for this disclosure shall be sufficient to enable users of the entity's financial statements to assess the entity's exposure to credit risk. The number of grades shall not exceed the number that the entity uses for internal credit risk management purposes except that an entity shall always disaggregate its portfolio across at least three grades, even if that entity uses fewer credit risk rating grades internally. For trade receivables and lease receivables to which an entity applies paragraph 12, this disclosure may be based on a provision matrix (see paragraphs B34–B35).

Feedback

63. Some respondents commented that the requirement to disclose “credit risk rating grades” as defined in the ED would not be compatible with the credit risk management practices for some asset classes and for non-financial entities. These respondents recommended that the disclosure be aligned with internal credit risk approaches and the relevant indicators used for those purposes (eg delinquency).
64. Other respondents expressed concern about the requirement to disaggregate its portfolio across a minimum of three grades, and noted there are situations when fewer grades are used internally. These respondents felt that requiring the disclosure of more grades, beyond what is performed for internal credit risk management, could be both misleading to users of financial statements and operationally difficult. Additionally, a few respondents were concerned about the requirement to disclose what they consider to be proprietary information.
65. A few respondents also requested clarification on whether internal or external rating grades should be used.

Staff analysis

66. The staff believe that the objective of the disclosure of financial assets across credit risk rating grades was to provide information about the credit risk profile of the entity at the reporting date and to make it possible to see how it changes over time. This enables users of financial statements to understand how the exposure to credit risk is structured and to see concentrations of credit risk. Taken over time, this information can be used to infer the trend of credit risk migration and the drivers of the change in measurement of ECL.
67. The Basis for Conclusions to the ED further notes:

[BC118] Because the recognition of lifetime expected credit losses is based on significant deterioration in credit quality, there could be a wide range of initial credit qualities for which 12-month expected credit losses is required. To provide users of financial statements with information about the changes in the loss allowance and about the credit quality of the entity’s financial instruments, the IASB

proposes a disaggregation of the carrying amounts of financial instruments into credit risk categories, for both 12-month expected credit losses and lifetime expected credit losses.

68. When this disclosure requirement was being deliberated in July 2012, the staff noted that it only provides a ‘snapshot’ of the credit risk profile, and alone it cannot show credit risk migration. Feedback from users however supported the disclosure of credit risk profile information, and it was noted that the ability to perform a trend analysis on this data and see the shifts in the risk profile over time would be useful.
69. The staff remain of the view that the disclosure of the credit risk profile is useful information, and note that when considered together with the reconciliation disclosures provides relevant and useful information about credit risk migration and changes in the entity's overall credit risk over time.
70. The staff acknowledge the feedback that the risk disaggregation disclosure should be aligned to internal credit risk management. The staff therefore recommend expanding the requirement to allow the use of an aging analysis for financial assets for which delinquency information is the only borrower-specific information available to assess significant increases in credit risk. This will allow for a better alignment with the management of some assets, while preventing possible abuse by limiting it to those assets which are evaluated on a delinquency basis.
71. The staff note that the proposed requirement to disclose at least three credit risk rating grades evolved from the staff’s original consideration in July 2012 to have a reconciliation of internal credit rating grades to lower, moderate and higher risk categories (AP 5A). This reconciliation was eschewed due to concerns about the disclosure of commercially sensitive information.
72. The staff note that the objective of the proposed disclosure is to provide users of financial statements with information about the credit quality of an entity’s overall exposure to credit risk based on the criteria used internally (for example low, moderate and high risk) and to monitor how this changes over time. Given the staff’s preference of aligning this disclosure with internal credit risk management,

and the concern raised about a minimum number of credit risk rating grades, the staff are of the view that a minimum number should not be prescribed. This will ensure that the credit risk rating grade information disclosed is aligned to the way an entity manages credit risk internally. Additionally, the staff recommend that this disclosure require that an entity maintain a consistent approach over time so that users of financial statements can better evaluate trends.

Significant effects on the loss allowance

What the ED proposed

[Par 41] An entity shall disclose quantitative and qualitative analyses of significant positive or negative effects on the loss allowance that are caused by a particular portfolio or geographical area.

73. Some respondents questioned the usefulness of, and IASB's intention for, the disclosure requirement in ED paragraph 41. These respondents felt that such information would already be captured by the combination of ED paragraphs 34, 35 and 39, and suggested that paragraph 41 be deleted. It was also suggested that paragraph 41 be incorporated into paragraph 39, and that it be made broader in order to capture significant effects due to other factors.
74. The staff agree that the disclosure of how significant events have affected the entity's loss allowance calculation is already broadly captured by other disclosure requirements (in particular the qualitative disclosures in ED paragraph 39). The staff are therefore recommending to incorporate this requirement into the qualitative disclosures mentioned above that entities should disclose information about significant effects on the loss allowance that are due to a particular factor.

Amount of financial assets assessed on an individual basis

What the ED proposed

[Par 44] An entity shall disclose, by *credit risk rating grades*, the gross carrying amount of financial assets and the amount recognised as a provision for loan

commitments and financial guarantee contracts in a grade. An entity shall disclose this analysis separately for financial assets, loan commitments and financial guarantee contracts for which the loss allowance or provision is measured in accordance with paragraphs 4, 5, 12 and 14–15. The number of credit risk rating grades used for this disclosure shall be sufficient to enable users of the entity's financial statements to assess the entity's exposure to credit risk. The number of grades shall not exceed the number that the entity uses for internal credit risk management purposes except that an entity shall always disaggregate its portfolio across at least three grades, even if that entity uses fewer credit risk rating grades internally. For trade receivables and lease receivables to which an entity applies paragraph 12, this disclosure may be based on a provision matrix (see paragraphs B34–B35).

75. Several respondents thought that ED paragraph 45 was unnecessary because they considered it not relevant in an expected loss model. They noted that unlike in IAS 39, impairment allowances do not result from objective evidence of impairment on an individual asset, and that such a disclosure on an individual level is therefore of less importance.
76. This disclosure requirement resulted from feedback in July 2012 that some users were interested in understanding which assets are assessed on an individual basis, particularly when that assessment is due to a decline in credit quality.
77. The staff note that conceptually, under the proposed model, assessment on an individual or collective basis should render the same result. The disclosure requirement in ED paragraph 45 furthermore does not provide information on why assets are assessed at an individual basis, and only shows the amount of assets assessed individually for accounting purposes, which is not necessarily indicative of the amount managed individually for credit risk management. Overall, the staff think the requirement is of limited usefulness, and therefore suggest its removal.

Disclosure requirements for the simplified approach

78. The ED proposed reduced disclosure requirements for financial instruments accounted for using the simplified approach for trade receivables and lease receivables, under which those assets are always measured at an allowance equal to lifetime ECL. The ED proposed the following relief for financial assets measured using the simplified approach:
- (a) disclosures related to the effect of changes in the measurement objective are not applicable (ED paragraphs 42, 43 and 45);
 - (b) disclosures related to measurement at 12-month ECL are not applicable (ED paragraphs 35(a), 38(a));
 - (c) a provision matrix may be used as a basis for the disclosure of the risk profile (ED paragraph 44);
 - (d) the disclosure of modifications should be limited to assets that are more than 30 days past due (ED paragraph 38); and
 - (e) a description of collateral is not required for lease receivables due to overlap with Leases disclosures (ED paragraph 40(a)).
79. Few respondents commented on the proposed disclosures for the simplified approach. Those who did only focused on the proposed requirement in ED paragraph 35, and considered the reconciliation of gross carrying amounts to be excessive for financial instruments under the simplified approach.
80. As noted above, the staff consider the reconciliation disclosure to be a key requirement and would not recommend removing it for assets measured under the simplified approach. Operational concerns surrounding this reconciliation will furthermore be alleviated if the IASB decides on one of the staff's alternative analyses in this Agenda Paper.
81. The staff think that the exemptions to the disclosure requirements for assets measured under the simplified approach provide relief that is consistent with the intention of the exception to the general model to alleviate some of the practical concerns of tracking changes in credit risk. Given that there was little feedback, and that the main concern raised about the reconciliation requirement is being

addressed as part of the general disclosure package, the staff recommends confirming the disclosure requirements for the simplified approach.

Summary of staff recommendations

- 82. The staff are recommending to **confirm** the presentation requirements in the ED and Limited Amendments ED.
- 83. For disclosure, the staff recommend to **confirm** the requirements with the following recommendations:

Disclosure objectives

- (a) Enhance the objectives by expanding them to emphasise that the information provided should enable a user of the financial statements to understand:
 - (i) how an entity manages credit risk;
 - (ii) the methods, assumptions and information used to estimate ECL;
 - (iii) an entity's credit risk profile (the credit risk inherent in the financial instruments), including significant credit concentrations; and
 - (iv) changes, and the reasons for the changes, in the estimate of ECL during the period.

Qualitative disclosures

- (b) Remove the discount rate disclosure in paragraph 39(c).
- (c) Include an explanation of the policy for the modification of financial instruments.
- (d) Include an explanation of how macroeconomic information has been incorporated in the estimates.

Quantitative disclosures

- (e) **Reconciliation of the gross carrying amount and loss allowance:** the staff recommend to confirm the requirement in the ED to reconcile both

the gross carrying amount and the loss allowance. However, if the IASB decides to amend the gross carrying amount requirement to address operational concerns, the staff are suggesting either:

- (i) Alternative A: Require the full reconciliation only for financial assets with lifetime ECL, and a simplified gross carrying amount reconciliation for assets with 12-month ECL; or
 - (ii) Alternative B: Reconciliation of the gross carrying amount focussing on the key drivers for changes in the loss allowance.
- (f) **Modification disclosures:**
- (i) ED 38(a): Require disclosure of the gross carrying amount of financial assets that have been modified during their life for which the measurement changes from lifetime to 12-month ECL during the period.
 - (ii) ED 38(b): Clarify the requirement in ED paragraph 38(b) to refer to the *deterioration rate* (ie the percentage) of financial assets previously disclosed in accordance with paragraph 38(a) for which credit risk has subsequently increased significantly, resulting in the measurement of the loss allowance reverting to lifetime ECL.
- (g) **Collateral and credit risk mitigation disclosures:**
- (i) ED 40(b): Clarify that the disclosure requires providing information about asset classes where there might have been a significant increase in credit risk resulting in the measurement objective changing to lifetime ECL but with no increase in the actual loss allowance due to the value of the collateral.
 - (ii) ED 40(c): Delete the requirement to provide quantitative information (so require that 'information' be provided), while expanding it to apply to all financial instruments.

Other disclosures

- (h) **Write-off policy disclosures:**

- (i) Clarify the term ‘nominal amount’ in drafting.
 - (ii) Clarify that the requirement to disclose the nominal amount of assets subject to enforcement activity only applies to financial assets that have been written-off during the period, while narrative information is provided about financial assets previously written-off but still subject to enforcement activity.
 - (iii) Retain the requirement that write-offs and recoveries of amounts previously written-off be disclosed as part of the reconciliation disclosure.
- (i) **Credit risk disaggregation disclosures:**
- (i) Expand the requirement to allow the use of an aging analysis for financial assets for which delinquency information is the only borrower-specific information available to assess significant increases in credit risk.
 - (ii) Do not prescribe a minimum number of credit risk rating grades.
- (j) **Significant effects on the loss allowance:**
- (i) Incorporate this requirement into the qualitative disclosures mentioned above that entities should disclose information about significant effects on the loss allowance that are due to a particular factor.
- (k) **Amount of financial assets assessed on an individual basis:**
- (i) Remove this requirement.

Disclosure requirements for the simplified approach for trade and lease receivables

- (l) Confirm the disclosure requirements for the simplified approach.

Question for the IASB

Does the IASB agree with the recommendations in the summary of staff recommendations (paragraphs 82-83)? If not, what does the IASB prefer?