IFRS Accounting

Staff paper

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IASB® meeting

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Project	**Post-implementation Review of IFRS 9—Impairment**
Topic	**Analysis of outreach feedback—Disclosures**
Contacts	Iliriana Feka (ifeka@ifrs.org) Riana Wiesner (rwiesner@ifrs.org)

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Purpose and structure

1. This paper continues the analysis of feedback from outreach in phase 1 of the post-implementation review (PIR) of the expected credit losses (ECL) requirements in IFRS 9 *Financial Instruments*.

2. Agenda papers 27A–27B of this meeting provide the feedback analysis on the ECL requirements in IFRS 9. This paper analyses feedback from outreach related to the credit risk disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*.

3. This paper provides:

   (a) background information on the disclosure requirements in IFRS 7;

   (b) an overview of feedback from outreach on the application of these disclosure requirements;

   (c) staff analysis and recommendations on which matters to ask questions about in the Request for Information (RFI) for this area; and

   (d) questions for the IASB.

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Summary of staff recommendation

4. The staff recommend the IASB ask questions in the RFI about whether the objective-based disclosure requirements in IFRS 7 for credit risk are working well in practice. Specifically, whether the requirements result in entities providing information to users of financial statements that enable them to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows.

Questions for the IASB

Questions for the IASB
1. Do IASB members agree with the staff recommendation in paragraph 4 of the paper? 2. Are there any additional matters that the IASB should ask questions about in the Request for Information?

Background

– Objective-based disclosure requirements are included in paragraphs 35A–38 of IFRS 7 for credit risk disclosures.

– The IASB identified three objectives for these disclosure requirements and required both qualitative and quantitative information to assist users of financial statements to understand and identify:

(a) an entity's credit risk management practices;

(b) the amounts in the financial statements that arise from ECL; and

(c) an entity's credit risk profile, including significant credit concentrations at the reporting date.

– Considering the differences in how entities approach credit risk management, the IASB decided to include objective-based disclosure requirements which allow entities to decide how much detail to disclose and how much emphasis to place on different aspects of the disclosure requirements.

Overview of feedback

5. By far, the most feedback during outreach related to credit risk disclosures. Stakeholders across the various stakeholder groups were of the view that there is a lack of consistency in the type and granularity of information disclosed by different entities. In particular, users of financial statements said that this lack of consistency significantly impairs comparability between different entities and affects the quality of their analysis. Accordingly, some stakeholders think this is an area of high priority for the IASB to examine.

6. However, stakeholders expressed mixed views about the root cause for this lack of consistency:

   (a) some stakeholders, including standard-setters attributed the lack of consistency to the disclosure objectives being too principle-based and suggested the IASB adds further minimum disclosure requirements, specifies the format of some disclosures, and adds more illustrative examples in IFRS 7 to achieve greater consistency in the information provided, thus enhancing comparability.

   (b) some auditors said IFRS 7 provides clear disclosure objectives that are designed to enable entities to tailor the information disclosed to what is relevant in the context of their credit risk exposure. They further said that prescribing extensive disclosures to be provided by all entities, would be inconsistent with the objective-based approach to the requirements. In their view, the diversity in disclosures may be linked to a lack of compliance and thus should be mitigated through regulatory and auditing processes. This is consistent with observations from a few other stakeholders about the positive effect prudential regulatory recommendations about disclosure in some jurisdictions have had on the quality of the ECL disclosures. For example, stakeholders noted that the reports setting out recommendations on a

comprehensive set of ECL disclosures, issued by the UK regulators, has resulted in entities providing more qualitative and consistent ECL disclosures.[1]

(c) a few other stakeholders said that the lack of consistency in credit risk disclosures is also due to the different credit risk management practices applied by entities—the information disclosed may be reflective of the credit risk approach (for example, the lack of specificity from a credit risk management perspective, such as sector or sensitivity analysis, results in less granular information disclosed).

7. Most stakeholders said they generally observe a lack of consistency in the disclosures provided about the following areas:

(a) **post-model adjustments or overlays (PMA)**—consistent with feedback on the use of PMAs (see Agenda Paper 27A of this meeting), many stakeholders said that there is lack of appropriate, and entity-specific, information in the financial statements that would explain the reasons for using PMAs and the approach used for their estimation. A few stakeholders were of the view that IFRS 7 does not require any disclosures about PMAs, with some suggesting the IASB adds minimum disclosure requirements in IFRS 7 about PMAs.

(b) **determining significant increases in credit risk (SICR)**—some users of financial statements said they generally cannot compare information among entities in this area because of the different factors that entities apply to determine SICR and the different levels of disaggregation of the information provided. Some stakeholders suggested the IASB adds specific disclosure requirements about the factors considered in the SICR assessment. Others said it would be challenging to specify requirements that would result in meaningful information across multiple portfolios and all types of entities.

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[1] Three UK regulators, the Financial Conduct Authority, the Financial Reporting Council and the Prudential Regulatory Authority jointly established a UK taskforce on disclosures of ECL which publishes reports with recommendations describing a comprehensive set of ECL disclosures. These reports include recommendations on information to be provided on judgemental areas of ECL, along with illustrative best practice examples.

This is because, not only are different factors applied among different entities, but entities also apply different factors across their multiple portfolios.

(c) **changes in the loss allowance and the gross carrying amounts**—many stakeholders, including users of financial statements, said the disclosure required by paragraph 35H of IFRS 7 about reconciliation from the opening balance to the closing balance of the ECL allowance is one of the most useful disclosures. However, they mentioned some areas this disclosure requirement could be improved, for example, specifically requiring disclosure of the gross carrying amounts of financial instruments as part of this reconciliation, in tabular format.

(d) **sensitivity analysis**—some stakeholders noted that there is a lack of specific requirements to provide information about the sensitivity of the ECL allowance to changes in assumptions. They said that this information would enable them to better understand and analyse the effects of ECL in the financial statements. Stakeholders suggested the IASB requires a multi-factor sensitivity analysis be provided in the financial statements (for example, sensitivity of the weightings applied to economic scenarios used for the measurement of ECL) or requiring disclosure of the effects on ECL based on a 100% weighting of the downside scenario.

Staff analysis and recommendations

8. IFRS 7 sets out *principles* and *minimum requirements* applicable to all entities. It requires entities to provide information that allows users of financial statements to evaluate the *total ECL amount* in the financial statements, regardless of whether it is determined using statistical models or PMAs.

9. Furthermore, the disclosure requirements in IFRS 7 combine qualitative disclosures of the entity's exposure to risks arising from financial instruments, and the way management views and manages these risks, with quantitative disclosures about material risks arising from financial instruments.

10. As the IASB noted in paragraph BC42 of the Basis for Conclusions on IFRS 7, because entities view and manage risk in different ways, disclosures based on how an entity manages risk are unlikely to be comparable between entities. To overcome these limitations, the IASB decided to specify disclosures about risk exposures applicable to all entities to provide a common benchmark for financial statement users when comparing risk exposures across different entities. Entities with more developed risk management systems would provide more detailed information.

11. We note that feedback from outreach suggests there is significant lack of consistency and thus stakeholders suggest the IASB adds more specificity to these disclosure requirements—that is, the IASB considers additional minimum disclosure requirements, specifies the format in which entities shall provide disclosures and adds illustrative examples in order to enhance comparability.

12. In our view, gathering further information on the application of the credit risk disclosure requirements will help the IASB in assessing whether the objective-based disclosure requirements result in entities providing information to users of financial statements that enable them to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. Therefore, we recommend the IASB asks questions in the RFI on this matter. For example, we think it would be helpful to ask whether stakeholders think the combination of principles and minimum disclosure requirements in IFRS 7 about credit risk achieve an appropriate balance between users receiving:

    (a) comparable information—that is, consistent requirements apply to all entities so that users receive comparable information about the risks to which entities are exposed; and

    (b) relevant information—that is, the disclosures provided depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks.