NEED TO KNOW

IFRS 9 *Financial Instruments* –
Impairment of Financial Assets

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1. INTRODUCTION

In July 2014, the International Accounting Standards Board (IASB) completed its project on financial instruments by publishing IFRS 9 *Financial Instruments* (2014). IFRS 9 (2014) incorporates the final requirements of all three phases of the financial instruments projects – classification and measurement, impairment, and hedge accounting.

This *Need to Know* sets out the requirements in respect of accounting for the impairment of financial assets that are measured at amortised cost or fair value through other comprehensive income (FVOCI).

IFRS 9 (2014) sets out a new 'expected loss' impairment model for those financial assets and will replace the existing 'incurred loss' model in IAS 39 *Financial Instruments: Recognition and Measurement*. Under IFRS 9 (2014), the impairment model is more forward looking, in that a credit event (or impairment 'trigger') no longer has to occur before credit losses are recognised. For financial assets that are measured at amortised cost or FVTOCI, an entity will now always recognise (at a minimum) 12 month expected losses in profit or loss. Lifetime expected losses will be recognised on assets for which there is a significant increase in credit risk after initial recognition.

For many trade receivables a 'day 1' provision of lifetime expected credit losses would be recognised. There is a practical expedient to calculate expected credit losses using a provision matrix based on historical loss patterns or customer bases, provided that this is consistent with the measurement principles in IFRS 9. These principles are that the measurement is an unbiased and probability weighted amount which reflects the time value of money and is based on reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. Consequently, those historical provision rates would require adjustments to take into account current and forward looking information.

While all entities that hold financial assets, or have issued commitments to extend credit or financial guarantee contracts (that are not accounted for at fair value through profit or loss) will be affected by the proposals, the most significant effects will be on financial institutions and other entities with significant holdings of portfolios of debt instruments (including bonds, debentures, and loans to third parties).

For financial institutions, the new impairment model is likely to require significant changes to internal systems and processes. It is expected that the model will also require systems changes, and the closer linking of credit risk management and financial reporting systems of organisations. The extent of changes required will vary from organisation to organisation.

Entities will be required to make continuous judgements, assumptions, and estimates in areas such as:

- What constitutes a significant increase in credit risk
- When a significant increase in credit risk has occurred
- Determining expected future cash flows in order to calculate impairment charges.

Entities, and in particular financial institutions, will need to develop systems and policies to ensure that the relevant information is captured for calculating expected credit losses, and that the new disclosure requirements are complied with. Entities will also need to ensure that policies and documentation are also updated to demonstrate compliance with the new requirements.

Although provisions for trade receivables may be relatively straightforward to calculate, new systems and approaches may still be needed.

US GAAP impairment project

The IASB and the US Financial Accounting Standards Board (FASB) were previously working together on a joint project for financial instruments. However, the FASB is currently working on refining their current expected credit loss (CECL) model, which is different from the IASB's IFRS 9 model. Under the CECL model, the credit impairment allowance always reflects the current estimate of lifetime expected credit losses at each reporting date. This results in a 'day 1' loss recognised for full lifetime credit losses. It is unlikely that any final financial instruments standard issued by the FASB on financial instruments will converge with IFRS 9.

2. EFFECTIVE DATE

The effective date for the new impairment model is for annual reporting periods beginning on or after 1 January 2018.

3. EXISTING GUIDANCE AND THE RATIONALE FOR CHANGE

The existing requirements for the impairment of financial assets are set out in IAS 39 *Financial Instruments: Recognition and Measurement*. Under this model, entities recognise a loss provision when there is objective evidence of impairment.

The incurred loss model was subject to criticism during and after the onset of the Global Financial Crisis for recognising losses 'too little, too late'. In addition, although (from a commercial perspective) for interest bearing assets an element of the interest charge is set by a lender to compensate it for expected losses, interest income was recognised in full. This had the effect, in particular for higher risk lending (for which the 'expected loss credit spread' is higher), of entities recognising interest income at the full contractual rate for an initial period (arguably overstating profits), followed by impairment losses as the expected (and other) losses emerged.

In addition, the IASB has found during the course of its project to replace IAS 39 with IFRS 9 that the incurred loss model resulted in inconsistent accounting for similar assets, because different entities have used different trigger events to identify objective evidence of impairment, or have assessed the same trigger events differently.

4. PROJECT BACKGROUND

In response to the global financial crisis of 2008/2009, the International Accounting Standards Board (IASB) accelerated its comprehensive project to replace IAS 39 *Financial Instruments: Recognition and Measurement* with a new financial instruments standard, IFRS 9 *Financial Instruments*. The project contained three phases:

– Phase I: Classification and measurement
– Phase II: Impairment
– Phase III: Hedge accounting.

Phase I: Classification and measurement

In November 2009, the IASB published its first version of IFRS 9 containing the requirements for classification and measurement of financial assets. This was supplemented in October 2010 by the accounting requirements for financial liabilities. The October 2010 version of IFRS 9 also carried over the scope and recognition and derecognition requirements from IAS 39. For more information about the previous finalised version of IFRS 9 (2010), please refer to BDO's publication *Need to Know* – IFRS 9 (2010) *Financial Instruments – Classification and Measurement*, available from the IFRS section of our website (www.bdointernational.com) at the link below:

http://www.bdointernational.com/Services/Audit/IFRS/Need%20to%20Know/Documents/NTK_IFRS9_print.pdf

Following the publication of IFRS 9, the IASB received questions on the application of IFRS 9 to certain types of financial instruments and, in particular, how to apply the 'solely payments of principal and interest' notion to particular types of financial instruments. The IASB was also asked to consider the interaction of IFRS 9 for financial assets with the insurance project which deals with the accounting for insurance liabilities. In light of the feedback that the IASB received, the IASB decided to reconsider limited aspects of accounting for financial assets and issued Exposure Draft ED/2012/4 *Limited Improvements to IFRS 9* in November 2012. The proposals in ED/2012/4 on have now been finalised with the issue of IFRS 9 (2014).

Phase II: Impairment

In March 2013, the IASB released an ED on impairment, Exposure Draft ED/2013/3 *Financial Instruments: Expected Credit Losses* proposing a three-stage credit deterioration model for impairment.

This followed two previous EDs; the need for additional exposure drafts arose from modifications which were found necessary to make the IASB's original expected credit loss proposals operational, together with a desire to reach a converged solution with the FASB (prior to the FASB withdrawing from the project and developing a US specific proposal). The proposals in ED/2013/3 have now being finalised with the issue of IFRS 9 (2014).

Phase III: Hedge Accounting

The hedge accounting model in IAS 39 has been criticised as being complex, rules based, and failing to reflect risk management activities of organisations. In November 2013, the IASB published IFRS 9 (2013) which added a new hedge accounting model to IFRS 9. The new hedge accounting model is easier to implement and links better to the risk management activities of organisations.

For more information about the hedge accounting chapter of IFRS 9 (2013), please refer to BDO's publication *Need to Know – Hedge Accounting* (IFRS 9 *Financial Instruments*), available from the IFRS section of our website (www.bdointernational.com) at the link below:

http://www.bdointernational.com/Services/Audit/IFRS/Need%20to%20Know/Documents/Need%20to%20Know%20-%20Hedge%20Accounting%20%28IFRS%209%29%20%28print%29.pdf

5. SCOPE

The following financial assets and other instruments are included within the scope of the impairment requirements in IFRS 9 (2014):

- Originated, purchased, reclassified or modified debt instruments that are measured at amortised cost in accordance with IFRS 9 (2014)
- Financial assets that are required to be measured at fair value through other comprehensive income (FVTOCI) in accordance with in accordance with IFRS 9 (2014)
- Loan commitments (except those measured at fair value through profit or loss)
- Financial guarantee contracts (except those measured at fair value through profit or loss)
- Lease receivables within the scope of IAS 17 *Leases*.

In addition, although contract assets recorded in accordance with IFRS 15 *Revenue from Contracts with Customers* are excluded from the scope of IFRS 9 (2014), they are within the scope of its impairment requirements. For those entities that apply IFRS 9 (2014) before adopting IFRS 15, the impairment requirements apply to receivables arising from transactions within the scope of IAS 18 *Revenue* and IAS 11 *Construction Contracts*.

6. THE GENERAL THREE STAGE APPROACH

IFRS 9 (2014) establishes a three stage approach for impairment of financial assets, based on whether there has been a significant deterioration in the credit risk of a financial asset. These three stages then determine the amount of impairment to be recognised (as well as the amount of interest revenue).

At initial recognition of a financial asset, an entity recognises a loss allowance equal to 12-month expected credit losses. These are the credit losses that are expected to result from default events that are possible within 12 months from the entity's reporting date. This means that the actual loss does not need to take place within the 12 month period; it is the occurrence of the default event that ultimately results in that loss.

After initial recognition, the three stages under the proposals would be applied as follows:

- ***Stage 1***: Credit risk has not increased significantly since initial recognition – recognise 12-month expected credit losses
- ***Stage 2***: Credit risk has increased significantly since initial recognition – recognise lifetime expected losses (this is recognising a provision earlier than under IAS 39 *Financial Instruments: Recognition and Measurement*) with interest revenue being calculated based on the gross amount of the asset
- ***Stage 3***: There is objective evidence of impairment as at the reporting date (using the criteria currently included in IAS 39) – recognise lifetime expected losses, with interest revenue being based on the net amount of the asset (that is, based on the impaired amount of the asset).

For financial assets that are in ***Stages 1*** and **2**, interest revenue recognition remains unchanged from IAS 39 *Financial Instruments: Recognition and Measurement* today, meaning that interest revenue would be calculated before credit losses are taken into account (gross basis).

The following table sets out how the three stages of the impairment model are applied after initial recognition:

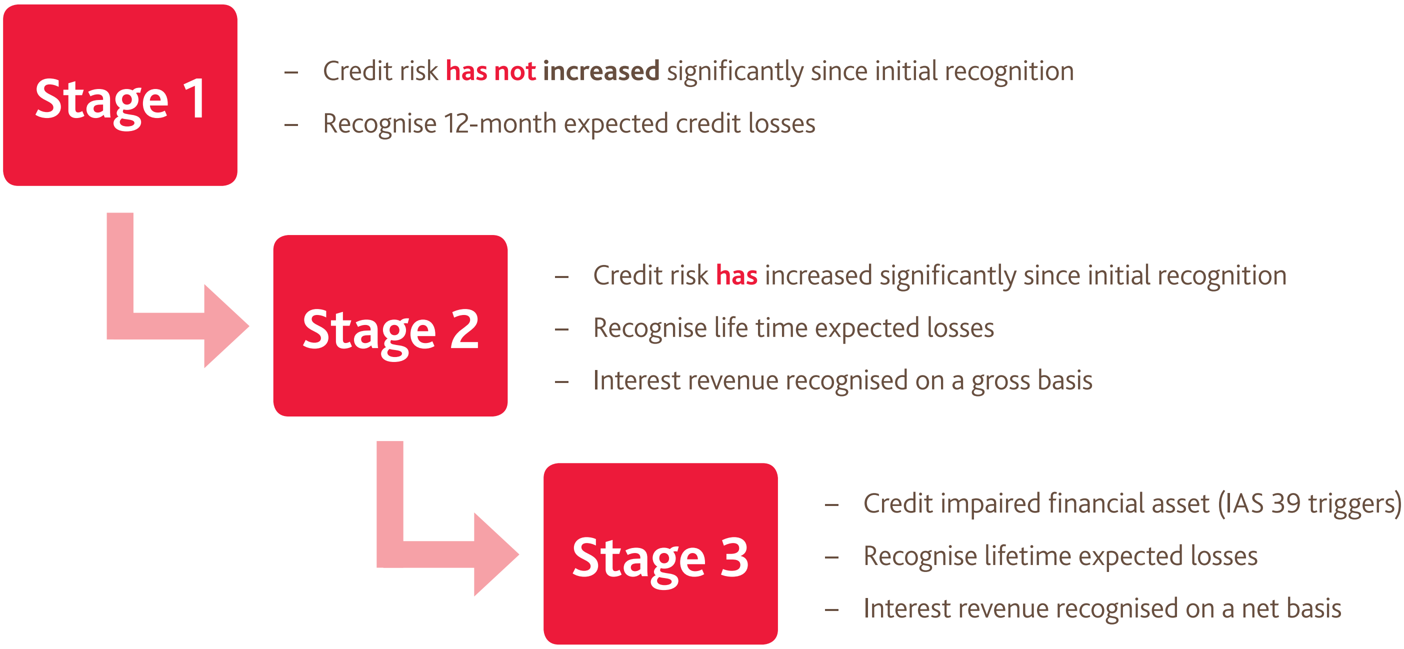

Figure 1: Summary of the three stage general approach for impairment of financial assets under IFRS 9

The recognition of impairment (and interest revenue) is summarised in the table below:

Stage	1	2	3
Recognition of impairment	12 month expected credit loss	Lifetime expected credit loss	
Recognition of interest	Effective interest on the gross amount		Effective interest on the net (carrying) amount

Figure 2: Summary of the recognition of impairment (and interest revenue)

BDO comment

*The gross presentation of interest revenue for financial assets in **Stages 1** and **2** provides important systems relief for financial institutions, as many of these entities have separate systems calculating effective interest rates (and related interest revenue) and expected losses.*

Because the new model is forward looking, expected credit losses will be recognised from the point at which the financial assets are originated or purchased. This means that a Day 1 loss will be recognised for 12-month expected credit losses. Although this might appear counter intuitive from an individual asset perspective, from a portfolio perspective this is intended to approximate a more sophisticated approach which identifies the amount of the interest charge that relates to expected credit losses (the 'credit spread' – for example, 2% out of an interest charge of 8%) and accounts for interest revenue at 6% and credits the 2% credit spread to an expected loss impairment account.

Example

Background

- Bank A lends CU100 to Company X for 5 years with 10% interest (unsecured)
- On initial recognition there is a 5% probability of the loan defaulting in the next 12 months with a 100% loss
- At the end of year 1, there is 0.5% probability the loan defaulting in the next 12 months with a 100% loss
- At the end of year 2, Company X is expected to have cash flow problems due to deterioration in economic conditions and is expected to breach its loan covenants. Probability that the loan will default over the remaining life of the loan is 35%
- At the end of year 3, Company X breached its banking covenants, Bank A estimates that the probability of loan will default over the remaining life the loan is 60%.

The following table shows the stage the loan is classified, the gross amount, the allowance account and the interest revenue recognised:

	Stage	Gross amount	Allowance account		Interest	
Initial recognition	***Stage 1***	CU100	CU5	(CU100x5%)		
End of year 1	***Stage 1***	CU100	CU0.50	(CU100x0.5%)	CU10	(CU100x10%)
End of year 2	***Stage 2***	CU100	CU35	(CU100x35%)	CU10	(CU100x10%)
End of year 3	***Stage 3***	CU100	CU60	(CU100x60%)	CU4	[(CU100-CU60)x10%]

BDO comment

For loans with 'front loaded' loss patterns such as car loans, where a majority of the losses tend to occur in the first couple of months after a loan is advanced, applying the 3 stage model would be likely to result in a substantial loss on initial recognition for 12-month expected credit losses. This would be followed by recognition of actual credit losses, and a release of the provision.

6.1. Recognition of impairment – '12-month expected credit losses'

12-month expected credit losses are calculated by multiplying the probability of a default occurring in the next 12 months with the total (lifetime) expected credit losses that would result from that default, regardless of when those losses occur. Therefore, 12-month expected credit losses represent a financial asset's lifetime expected credit losses that are expected to arise from default events that are possible within the 12 month period following origination of an asset, or from each reporting date for those assets in ***Stage 1***.

BDO comment

The distinction between 12-month expected credit losses to be calculated in accordance with IFRS 9 (2014) and the cash shortfalls that are anticipated to arise over the next 12 months is important.

As an example, the death of a credit card borrower does lead, in a number of cases, to the outstanding balance becoming impaired. Linking this to the accounting requirements, the IFRS 9 (2014) model therefore requires the prediction on initial recognition (and at each reporting date) of the likelihood of the borrower dying in the next 12 months and hence triggering an impairment event. Given the very large number of balances, it is likely that this would be calculated on a portfolio basis and not for each individual balance.

There are some similarities between the IASB's 12-month expected credit loss calculation and some prudential regulatory requirements for the 12 month probability of default. Financial institutions may therefore be able to use their internal ratings based systems under Basel II as a starting point in determining 12-month expected credit losses. However, those regulatory measurements of probability of default are typically not the same as those in IFRS 9 (2014), and would need to be adjusted in order to comply with the requirements in IFRS 9 (2014).

6.2. Recognition of impairment – 'Lifetime expected credit losses'

Lifetime expected credit losses are the present value of expected credit losses that arise if a borrower defaults on its obligation at any point throughout the term of a lender's financial asset (that is, all possible default events during the term of the financial asset are included in the analysis). Lifetime expected credit losses are calculated based on a weighted average of expected credit losses, with the weightings being based on the respective probabilities of default.

6.3. Definition of default

The standard includes guidance about what constitutes default. When considering the probability of default, an entity should apply the definition used for its own internal credit risk management purposes. However, there is a rebuttable presumption that default occurs when amounts are no later than 90 days past due (unless there is other reasonable and supportable information to indicate a more lagging default criterion is appropriate).

7. DETERMINING SIGNIFICANT INCREASES IN CREDIT RISK

The transition from recognising 12-month expected credit losses (i.e. ***Stage 1***) to lifetime expected credit losses (i.e. ***Stage 2***) in IFRS 9 (2014) *Financial Instruments* is based on the notion of a significant increase in credit risk over the remaining life of the instrument. The focus is on the changes in the risk of a default, and not the changes in the amount of expected credit losses. For example, for highly collateralised financial assets such as real estate backed loans when a borrower is expected to be affected by the downturn in its local economy with a consequent increase in credit risk, that loan would move to ***Stage 2***, even though the actual loss suffered may be small because the lender can recover most of the amount due by selling the collateral.

Entities are permitted to use changes in the risk of default over the next 12-month as a reasonable proxy for changes in credit risk over the remaining life of the instrument. However, this would not be appropriate for financial assets where there is only one significant payment obligation after 12 months.

BDO comment

The IASB has noted that the assessment and measurement of credit losses is an inherently subjective area, and therefore expects that different indicators will be appropriate for different types of financial assets. This would mean that judgement will be required and implies that there may be a degree of diversity in practice with different expected losses being recorded by different entities for similar financial assets. This is an inevitable consequence of a more forward looking 'expected loss' model. However, for many entities the IASB's model will require only 12-month expected losses to be recognised for the majority of their financial assets, meaning that the diversity in reported results may be reduced in comparison with an approach which required the immediate recognition of lifetime expected losses.

7.1. Possible 'lifetime expected credit loss' indicators

IFRS 9 (2014) sets out guidance to assist entities in identifying information to be used to determine when a provision for lifetime expected credit losses is required. The application guidance sets out a wide range of potential sources of such information which includes:

- Changes in internal pricing indicators
- Changes in external market indicators of credit risk
- Credit rating changes
- Changes to contractual terms that would be made if the financial asset was newly originated
- Adverse changes in general economic and/or market conditions
- Significant changes in the operating results or financial position of the borrower
- Increase in credit risk of other financial instruments of the same borrower
- Changes in the borrower's regulatory, economic or technological environment
- Changes in the value of collateral or guarantees (including those provided by a related party of the borrower)
- Changes in the amount of financial support available to an entity (for example, from its parent)
- Expected or potential breaches of covenants
- Changes in the expected behaviour of the borrower, and past-due information
- Changes in the credit management approach.

Appendix A sets out in more detail a number of factors that entities will need to consider when making the determination of whether lifetime expected credit losses should be recorded.

BDO comment

*Entities will need to develop clear policies to identify the transitioning between **Stage 1** and **Stage 2**, incorporating some of the indicators set out in the application guidance as appropriate.*

7.2. Rebuttable presumption – significant increase in credit risk

The standard contains a rebuttable presumption that credit risk has increased significantly when contractual payments are more than 30 days past due. This means that when payments are 30 days past due, the financial asset is considered to have moved from ***Stage 1*** to ***Stage 2***, and lifetime expected credit losses are recognised. Past due is defined as failure to make a payment when that payment was contractually due. Feedback received by the IASB during the development of the new impairment model indicated than many entities manage credit risk on the basis of past due information, and have a limited ability to assess credit risk on an instrument by instrument basis in more detail on a timely basis.

The 30 days past due presumption can be rebutted if other reasonable and supportable information is available that demonstrates that, even if payments are 30 days or more past due, this does not represent a significant increase in the credit risk of the financial asset. This might be the case if the late payment was an administrative oversight which was subsequently rectified. Alternatively, the entity's historical experience may indicate that the fact that amounts are more than 30 days past due does not provide evidence of a significant increase in the probability of default occurring, whereas amounts that are more than 60 days past due do.

BDO comment

It is expected that the 30 day rebuttable presumption will only be rebutted in limited situations. The 30 day past due is meant to act as a backstop indicator for when there has been a significant increase in credit risk.

IFRS 9 (2014) is clear that the 30 days past due test is not the only one to be applied if other information is readily available. Consequently, if credit risk management monitors forward looking macro information, or that information is available without undue cost or effort, entities are required to take that information into account and cannot solely rely on past due information. Therefore, even if information is not yet available on an individual loan by loan basis, entities should still group loans together based on shared risk characteristics such as instrument type, credit risk ratings, collateral type, date of initial recognition, remaining term to maturity, or by industry or by location, and provide for lifetime expected credit losses at portfolio level for those portfolios where the entity can identify a significant increase in credit risk. This is likely to result in more segmented portfolios.

BDO comment

Entities are likely to need to develop processes to enable their accounting systems to capture more credit risk monitoring and management information.

EXAMPLE - Portfolio of retail mortgages and personal loans

- Bank ABC provides mortgages and personal loans in Region Z
- As part of the loan application process, customers are required to provide information such as the industry within which the customer is employed, and the post code of the property that serves as collateral on the mortgage (when applicable)
- The average loan to value ratio for all its mortgage loans is 70%
- Bank ABC tracks probability of default occurring by using past-due information
- A number of car manufacturers have production plants located within Region Z
- Bank ABC becomes aware of the declining profit of several major car manufacturers and, as a result of a number of public statements, expects the closure of several of the production plants in Region Z. It is expected that in addition to the closure of production plants, a number of service providers to the car manufacturers will also close
- Bank ABC also considers other forward looking information in addition to the past due status (to the extent that such information is available)
- Bank ABC segments the mortgage portfolio to identify borrowers who work at the car production plants and borrowers who are employed by service providers to the car manufacturers, takes into account any other relevant forward looking information, and recognises lifetime expected credit losses for those mortgages (i.e. ***Stage 2***) (even if no loans are yet past due)
- For the mortgage loans portfolio, in estimating lifetime credit losses, Bank ABC takes into account the expected recovery from the real estate. This may result in expected credit losses on mortgage loans being very small, even though the loans are in ***Stage 2***.

7.3. Exception for low credit risk financial instruments

IFRS 9 (2014) includes a practical expedient for low credit risk financial instruments. Characteristics of low credit risk financial instruments include:

– Strong capacity to meet its contractual cash flow obligations in the near term
– Adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the borrower's ability to pay
– External rating of investment grade or an internal credit rating equivalent.

The instrument must be considered to have low credit risk from a market participant's perspective.

For low risk credit instruments, it is assumed that credit risk has not increased significantly at each reporting date. This means that only 12 month expected credit losses will be recorded for these financial instruments.

8. PURCHASED AND ORIGINATED CREDIT-IMPAIRED FINANCIAL ASSETS

Credit-impaired financial assets are those for which one or more events that have a detrimental impact on the estimated future cash flows have already occurred. If these financial assets had been originated or purchased before becoming credit impaired, they would be in ***Stage 3*** and lifetime expected losses would be recognised.

Indicators that an asset is credit-impaired would include observable data about the following events:

- Significant financial difficulty of the issuer or the borrower
- Breach of contract
- The lender has granted concessions as a result of the borrower's financial difficulty which the lender would not otherwise consider
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation
- The disappearance of an active market for that financial asset because of financial difficulties
- The financial asset is purchased or originated at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event. It could be the combined effect of several events may have caused financial assets to become credit-impaired.

For purchased and originated credit-impaired financial assets, a 'day 1 loss' is not recognised. Instead:

- Lifetime expected credit losses would be included in the estimated cash flows for the purposes of calculating the effective interest rate – resulting in a credit-adjusted effective interest rate
- Interest revenue would be calculated on the net carrying amount at the credit-adjusted effective interest rate i.e. including expected credit losses
- Expected credit losses would be discounted using the credit-adjusted effective interest rate
- Any subsequent changes (favourable or unfavourable) from the initial expected credit losses would be recognised immediately in profit or loss.

Purchased credit-impaired financial assets are recorded on initial recognition at the transaction price without presentation of an allowance for expected contractual cash shortfalls that are implicit in the purchase price, but disclosures are required of contractual cash shortfalls that are implicit in the purchase price.

The IASB has noted in its *Basis for Conclusions* that it is only in unusual circumstances that originated financial assets would be regarded as being credit impaired. Simply because originated assets might be of high credit risk does not mean that they are credit impaired.

9. MEASUREMENT OF EXPECTED CREDIT LOSSES

The measurement of expected credit losses is based on the present value of cash shortfalls, and takes into account both the amount and timing of contractual payments. Therefore a credit loss will arise in instances where there is a delay in the payment of contractually required amount, even if all contractual cash payments are ultimately expected to be received in full.

For financial assets, a cash shortfall is the difference between:

– The present value of the principal and interest cash flows due to an entity under the contract; and
– The present value of the cash flows that the entity expects to receive.

In estimating expected credit losses, entities are required to consider more than one outcome and consider the likelihood of a number of potential outcomes occurring in practice. An expected loss estimate should reflect:

– An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes, and
– The time value of money.

This means that entities need to consider:

– All reasonable and supportable information that is relevant in making the forward-looking estimate
– A range of possible outcomes and the likelihood and reasonableness of those outcomes (that is, not merely an estimate of the 'most likely outcome').

IFRS 9 (2014) does not require entities to identify every possible scenario, but at least two outcomes need to be considered:

(i) The probability that a credit loss occurs, and
(ii) The probability that no credit loss occurs.

This approach is required even if the most likely outcome is no loss or that the probability of credit losses occurring is very low.

The calculation of a probability weighted amount does not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount. Entities need to ensure that the observed historical credit loss rates are applied consistently to groups of financial assets with similar risk characteristics.

Various sources of data can be used to estimate expected credit losses. Entities should consider both borrower specific factors, macroeconomic conditions, and internal and external information such as internal historical credit loss experience, internal ratings, and external reports and statistics. Entities should also take into account both the current and future forecast direction of conditions at the reporting date.

An entity is not required to incorporate forecasts of future conditions over the entire remaining life of a financial instrument. For long dated instruments, the standard does not require a detailed estimate for periods that are far in the future – for such periods, an entity may extrapolate projections from available, detailed information.

Entities can use historical data as a starting point and adjust for current conditions and forecasts of future conditions. Entities need to ensure that the adjustments to historical data are directly consistent with other observable data (e.g. changes in unemployment rates, property prices, commodity prices and payment status), and are of similar magnitude. In some cases, if conditions and forecast future conditions are not expected to change, then the unadjusted historical information may be sufficient.

IFRS 9 (2014) requires entities regularly to review their methodology and assumptions to reduce any differences between estimated and actual credit loss experience.

BDO comment

The standard clarifies that the intention is not always to require a complex statistical analysis, but that entities should consider information that is reasonably available without undue cost and effort. However, it is likely that different entities may have different thresholds on what would be considered reasonably available information.

Similar to IAS 39 *Financial Instruments: Recognition and Measurement*, for collateralised financial instruments, the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from obtaining and selling the collateral. Any collateral obtained as a result of foreclosure is not recognised as an asset that is separate from the collateralised financial instrument unless it meets the recognition criteria for an asset in other Standards.

The maximum period over which to consider expected credit losses is the contractual period of the financial instrument that the entity is exposed to, and no longer (even if business practice suggests that a longer exposure period may apply). For example, a loan where the lender can contractually demand repayment within a short period will be assessed for expected losses over that short period, even if the lender expects to maintain the loan for a longer period. Similarly, a loan commitment that can contractually be withdrawn within a short period will be assessed for expected losses over that short period, and not for the longer period during which the potential lender expects to continue to make the facility available. However, there is an exception for revolving credit facilities such as credit cards and overdraft facilities (see Section 13 Loan commitments and financial guarantees).

At initial recognition (except for (i) undrawn loan commitments and financial guarantee contracts, and (ii) purchased or originated credit-impaired financial assets) an entity is required to discount the expected credit losses using the financial instrument's initial effective interest rate.

The credit adjusted effective interest rate is used to discount cash flows for purchased or originated credit impaired financial assets (see Section 7 Purchased and originated credit-impaired financial assets).

10. MODIFICATIONS (RENEGOTIATIONS) OF CONTRACTUAL CASH FLOWS THAT DO NOT RESULT IN DERECOGNITION

If the contractual cash flows of a financial asset are modified or renegotiated in such a way that does not result in derecognition of that financial asset under IFRS 9 *Financial Instruments*, entities should recalculate the gross carrying amount of the financial asset on the basis of the renegotiated or modified contractual cash flows. A modification gain or loss would be recognised in profit or loss.

An entity would also be required to consider whether the modification (renegotiation) provides evidence that there may have been a significant increase in credit risk. It is necessary to compare:

– The credit risk at the reporting date (based on the modified contractual terms), and
– The credit risk at initial recognition (based on the original, unmodified contractual terms).

If there has been a significant increase in credit risk, the modified financial instrument would be in ***Stage 2***, and lifetime expected credit losses would be required to be recognised.

If subsequently, credit risk is considered to have decreased after the modification e.g. the customer has demonstrated consistent good payment behaviour over a period of time then the modified financial instrument might move back to ***Stage 1***.

11. WRITE-OFFS

When the entity has no reasonable expectations of recovery, a write-off event occurs. A write-off constitutes a derecognition event (either in full or in part). Therefore the gross carrying amount of a financial asset is reduced by the amount of the write-off that has been recognised in profit or loss.

Example

An entity plans to enforce the collateral on a financial asset and expects to recover no more than 30%. If the entity has no reasonable prospects of recovering any further cash flows from the financial asset, it writes off the remaining 70% of the financial asset.

12. ACCOUNTING FOR TRADE RECEIVABLES, CONTRACT ASSETS AND LEASE RECEIVABLES

IFRS 9 (2014) *Financial Instruments* sets out a simplified approach for the accounting for trade receivables, contract assets and lease receivables.

12.1. Trade receivables and contract assets that do not contain a significant financing component

For trade receivables and contract assets that do not contain a significant financing component in accordance with IFRS 15 *Revenue from Contracts with Customers* (so generally trade receivables and contract assets with a maturity of 12 months or less), 'lifetime expected credit losses' are recognised. Because the maturities will typically be 12 months or less, the credit loss for 12-month and lifetime expected credit losses would be the same.

This approach also applies if the practical expedient in IFRS 15 for contracts that have a duration of one year or less is applied. Under this practical expedient, no adjustment is made for a significant financing component.

When calculating expected credit losses, IFRS 9 (2014) permits the use of a provision matrix.

Many entities estimate credit losses using a provision matrix where trade receivables are grouped based on different customer bases and different historical loss patterns (e.g. geographical region, product type, customer rating, collateral or trade credit insurance, or type of customer). Under the simplified model, entities could adjust the historical provision rates (which are an average of historical outcomes) for their trade receivables to reflect relevant information about current conditions and reasonable and supportable forecasts about the future. A similar approach might be followed for contract assets.

BDO comment

There are two key differences between the IAS 39 impairment model and the new model for impairment of trade receivables:

- *Entities will not wait until the receivable is past due before recognising a provision, and*
- *The amount of credit loss recognised is based on forward looking estimates that reflect current and forecast credit conditions.*

Example

- Company M has a portfolio of trade receivables of CU30 million at 31 December 2014
- The customer base consists of a large number of small clients
- To determine the expected credit losses for the portfolio, Company M uses a provision matrix
- The provision matrix is based on its historical observed default rates, adjusted for forward looking estimates
- At every reporting date, the historical observed default rates are updated Company M estimates the following provision matrix at 31 December 2014:

	Expected default rate	Gross carrying amount	Credit loss allowance (Default rate X Gross carrying amount)
Current	0.3%	CU15,000,000	CU45,000
1-30 days past due	1.6%	CU7,500,000	CU120,000
31-60 days past due	3.6%	CU4,000,000	CU144,000
61-90 days past due	6.6%	CU2,500,000	CU165,000
More than 90 days past due	10.6%	CU1,000,000	CU106,000
		CU30,000,000	**CU580,000**

At 31 December 2015, Company M revises its forward looking estimates, which include a deterioration in general economic conditions. Company M has a portfolio of trade receivables of CU34million in 2015.

	Expected default rate	Gross carrying amount	Credit loss allowance (Default rate X Gross carrying amount)
Current	0.5%	CU16,000,000	CU80,000
1-30 days past due	1.8%	CU8,000,000	CU144,000
31-60 days past due	3.8%	CU5,000,000	CU190,000
61-90 days past due	7.0%	CU3,500,000	CU245,000
More than 90 days past due	11.0%	CU1,500,000	CU165,000
		CU34,000,000	**CU824,000**

The credit loss allowance is increased by CU244,000 from CU580,000 at 31 December 2014 to CU824,000 as at 31 December 2015. The journal entry at 31 December 2015 would be:

			DR	CR
DR		**Expected credit losses**	CU244,000	
	CR	**Credit loss allowance**		CU244,000

12.2. Other long term trade receivables, long term contract assets and lease receivables

For other long term trade receivables and lease receivables, entities have an accounting policy choice to either apply the general three stage approach or the 'simplified approach' of recognising lifetime expected losses.

13. LOAN COMMITMENTS AND FINANCIAL GUARANTEES

Provisioning for off-balance sheet financial items such as loan commitments and financial guarantees (that is, when those items are not measured at fair value through profit or loss) are currently within the scope of a different standard, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* which results in a different recognition approach from the incurred loss model in IAS 39 *Financial Instruments: Recognition and Measurement* applies.

Under IFRS 9 (2014), the scope of the three-stage impairment approach is extended apply to such off-balance sheet items. An entity would consider the expected portion of the loan commitment that will be drawn down within the next 12 months when estimating 12-month expected credit losses (***Stage 1***), and the expected portion of the loan commitment that will be drawn down over the remaining life of the loan commitment when estimating lifetime expected credit losses (***Stage 2***).

The following table summarises the requirement for loan commitments and financial guarantees:

Stage	Apply to	Recognise
Stage 1 – No significant increase in credit risk	Expected portion to be drawn down within the next 12 months	12-month expected credit losses
Stage 2 – Significant increase in credit risk	Expected portion to be drawn down over the remaining life of the facility	Lifetime expected credit losses

Expected credit losses are an estimate of the present value of all cash shortfalls over the remaining life of the financial instrument arising either from defaults within the next 12 months (***Stage 1***) or over the life of the instrument (***Stage 2***). A cash shortfall for undrawn loan commitments is the difference between:

– The present value of the principal and interest cash flows due to the entity if the holder of the loan commitment draws down the loan; and
– The present value of the cash flows that the entity expects to receive if the loan is drawn down.

The remaining life of a loan commitment and of financial guarantees is the maximum contractual period during which an entity has exposure to credit risk. Consequently, if a lender has the ability to withdraw a loan commitment, the maximum period to consider when estimating credit losses is the period up to the date on which the entity is able to cancel the facility and not a longer period, even if that would be consistent with its business practice.

Example

Bank A extends credit to Company C. Bank A can cancel the commitment by giving one day's notice. Company C's financial position is poor and is deteriorating, and there is a significant risk that it will enter bankruptcy. Bank A would only estimate one day of expected losses because Bank A does not have a contractual obligation to provide credit beyond that one day. This approach is followed, even if Bank A might not (for commercial/business reasons) cancel the arrangement.

BDO comment

The International Accounting Standards Board (IASB) noted that for credit exposure management purposes, loan commitments and financial guarantee contracts are managed no differently to loans, and so the IASB concluded that for financial reporting purposes those off-balance sheet financial items should be subject to the same impairment model as other 'on balance sheet' financial items. This aligns financial reporting more closely with credit risk management practices. This means that an additional provision for amounts that have been approved but not drawn down is recognised under the new model.

Example

Overdraft facilities

- At 30 June 2014 Bank A approved a total of CU5 million overdraft facilities which have not yet been drawn
- Bank A considers that CU4 million is in ***Stage 1*** (i.e. no significant increase in credit risk). Of that CU4 million in ***Stage 1***, CU2 million is expected to be drawn down within the next 12 months, with a 5% probability of default over the next 12 months
- Bank A considers that CU1 million is in ***Stage 2*** and CU1 million is expected to be drawn down over the remaining life of the facilities, with a probability of default of 15%.

Stage		Expected credit loss
Stage 1	CU2 million x 5%	CU100,000
Stage 2	CU1 million x 15%	CU150,000
Total allowance (presented as a separate line item)		CU250,000

- Under the new model, Bank A recognises a provision of CU250,000 for the undrawn portion of its overdraft facilities.

In terms of presentation, because the allowance would not relate to any balance sheet line item, the expected loss estimate would be recognised and presented as a separate liability line item.

The discount rate used to discount expected credit losses is the effective interest rate for the financial asset that results from the loan commitment. If the effective interest rate cannot be determined, then an entity discounts using a rate that reflect the current market assessment of the time value of money and the risks that are specific to the cash flows.

As an exception to the maximum contractual period, it is noted that some financial instruments (such as revolving overdraft facilities and balances arising from credit cards) include both a loan and an undrawn commitment component, and that the lender's ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For those instrument only, the period over which expected credit losses is measured can be extended beyond the maximum contractual period, if expected credit losses would not be mitigated by credit risk management actions.

14. DISCLOSURES

New disclosures have been added to IFRS 7 *Financial Instruments* in relation to the new impairment model.

The amendments made to IFRS 7 require entities to disclose:

- Information about an entity's credit risk management practices and how they relate to the recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses,
- Quantitative and qualitative information about expected credit losses including changes in the amount of expected credit losses and the reasons for those changes, and
- Information about an entity's credit risk exposure (including significant credit risk concentrations).

Appendix B sets out a summary of the disclosure requirements that accompany the new impairment model.

15. EFFECTIVE DATE AND TRANSITION

15.1. Effective date

IFRS 9 (2014) *Financial Instruments* applies for annual reporting periods beginning on or after 1 January 2018. Early application is permitted. If an entity's date of initial application (the start of the period in which IFRS 9 is adopted) is before 1 February 2015, there is a choice of which version of IFRS 9 to adopt (2009, 2010, 2013 or 2014). The 2009 version covered financial assets only, with the 2010 version adding financial liabilities and derecognition, and the 2013 version added hedge accounting.

IFRS 9 (2014) includes the final requirements from all three phases of the financial instrument project (classification and measurement, impairment and hedge accounting). Therefore, if an entity early adopts the impairment requirements, it must also early adopt the complete standard i.e. all the other requirements contained in IFRS 9 (2014).

15.2. Transition

The new requirements apply retrospectively, which is consistent with the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, there are some special transition rules and concessions that are available.

As a practical expedient, entities may on transition, use the 30 day past due rebuttable presumption (refer to Section 7.2) and provide:

– Lifetime expected credit losses for those financial instruments that are 30 days past due, and
– 12-month expected credit losses for the remaining financial instruments that are not 30 days past due.

If initial credit quality information cannot be gathered without undue cost or effort for the retrospective application of the 3-stage approach, then the entity would assess whether the credit risk of the financial asset is low (i.e. investment grade) at the date of initial application:

– If credit risk is low at the date of initial application, then 12-month expected credit losses would be recognised at that point
– If credit risk is not low then lifetime expected credit losses would be recognised at each reporting date until derecognition.

On the date of initial application, an entity is required to disclose information that permits the reconciliation of the ending impairment allowance under IAS 39 *Financial Instruments: Recognition and Measurement* or the provisions under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to the opening loss allowance or provision determined in accordance with the new model in IFRS 9 (2014). The disclosure would be provided by the related measurement categories in accordance with IAS 39 and IFRS 9 *Financial Instruments* for financial assets, and the effect of changes in the measurement category on the loss allowance at that date would be shown separately.

BDO comment

Entities will need to decide on their transition policy, assess what information is available and whether additional information needs to be gathered for transition to the new model. It will also be necessary to consider what new systems and processes need to be implemented to enable transitioning to the new model.

APPENDIX A – POSSIBLE 'LIFETIME EXPECTED CREDIT LOSS' INDICATORS

IFRS 9 (2014) sets out guidance (IFRS 9.B5.5.17) to assist entities in determining when a provision for lifetime expected credit losses is required. Entities may consider the following factors when making this determination:

- Significant changes in internal pricing indicators of credit risk for a particular financial instrument or similar financial instruments with the same term
- Other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated or issued at the reporting date (such as more stringent covenants, increased amounts of collateral or guarantees, or higher income coverage) because of changes in the credit risk of the financial instrument since initial recognition
- Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same term. Changes in market indicators of credit risk include, but are not limited to:
  - Changes in credit spread
  - Changes in credit default swap prices for the borrower
  - The length of time and extent to which the fair value of a financial asset has been less than its amortised cost
  - Other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.
- An actual or expected significant change in the financial instrument's external credit rating
- An actual or expected internal credit rating downgrade for the borrower or decrease in behavioural scoring used to assess credit risk internally
- Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in a borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates
- Significant changes in operating results of the borrower. Examples include actual or expected declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality, increased balance sheet leverage, liquidity, management problems or changes in the scope of business or organisational structure (such as the discontinuance of a segment of the business) that results in a significant change in a borrower's ability to meet its debt obligations
- A significant increase in credit risk on other financial instruments of the same borrower
- An actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology
- Significant changes in the value of the collateral supporting the obligation and the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments or to otherwise have an effect on the probability of a default occurring. For example, if the value of collateral declines because house prices decline, borrowers in some jurisdictions have a greater incentive to default on their mortgages
- A significant change in the quality of the guarantee provided by a shareholder (or an individual's parents) if the shareholder (or parents) have an incentive and financial ability to prevent default by capital or cash infusion

- Significant changes, such as reductions in financial support from a parent entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in securitisations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security)
- Expected changes in the loan documentation including an expected breach of contract that may lead to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees, or other changes to the contractual framework of the instrument
- Significant changes in the expected performance and behaviour of the borrower, including changes in the payment status of borrowers in the group (for example, an increase in the expected number or extent of delayed contractual payments or a significant increase in the expected number of credit card borrowers who are expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount)
- Changes in the entity's credit management approach in relation to the financial instrument, i.e. based on emerging indicators of changes in credit quality of the financial instrument, the entity's credit risk management practice is expected to become more active or focused on managing the instrument, including an instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower
- Past due information, including the rebuttable presumption based on when contractual payments are more than 30 days past due.

APPENDIX B – SUMMARY OF THE DISCLOSURE REQUIREMENTS

Appendix B provides a high level summary of the disclosure requirements added to IFRS 7 *Financial Instruments: Disclosures* that accompanies the new impairment model in IFRS 9 (2014) *Financial Instruments*.

B.1. Credit risk management practices

An entity is required to disclose:

- How it determines whether the credit risk has increased significantly (i.e. transfer between ***Stage 1*** and ***Stage 2***) including if and how:
  - Financial instruments are considered to have low credit risk (refer to Exception for low credit risk financial instruments),
  - The 30 day rebuttable presumption has been rebutted.
- The entity's definition of default and the reasons for selecting this definition
- How the financial instruments were grouped (if assessed on a collective basis)
- The entity's write off policy
- For financial assets that have been modified (renegotiated) during the period how the entity determines whether there has been an significant increase in credit risk.

B.2. Inputs, assumptions and estimation techniques

An explanation is required of the inputs, assumptions and estimation techniques used including:

- The basis of inputs used for ***Stages 1***, ***2*** and ***3***
- The estimation techniques used for ***Stages 1***, ***2*** and ***3***
- An explanation of the changes in the estimates of credit risk and the cause of those changes to ***Stages 1***, ***2*** and ***3***
- How forward-looking information has been used to determine expected credit losses (including how macroeconomic information has been used)
- Any changes in the estimation technique and the reasons for those changes.

B.3. Reconciliations

A reconciliation is required between the opening and closing balances of the gross carrying amount and the associated loss allowance for:

- Financial assets with a loss allowance measured at an amount equal to 12-month expected credit losses i.e. ***Stage 1***
- Financial assets with a loss allowance measured at an amount equal to lifetime expected credit losses but are not credit impaired i.e. ***Stage 2***
- Financial assets that are credit impaired at the reporting date (but that are not purchased or originated credit-impaired financial assets)
- Purchased or originated credit-impaired financial assets. In addition to the reconciliation for these assets, an entity is required to disclose the total amount of undiscounted expected credit losses at initial recognition
- Trade receivables, contract assets or lease receivables.

The standard also requires an explanation of how significant changes in the gross carrying amount contributed to changes in the loss allowance. For example, the changes could be due to:

- Newly originated or acquired financial instruments
- Modifications
- Financial instruments that have been derecognised
- Transfers between ***Stage 1***, ***Stage 2*** and ***Stage 3*** of the loss allowance accounts.

Refer to Appendix D1 for an example of these disclosure requirements.

B.4. Modifications (renegotiations)

Disclosure is required, for financial assets that have been modified (renegotiated) during the period, of the amortised cost and the modification gain or loss where the financial assets had an impairment allowance equal to lifetime expected credit losses.

B.5. Collateral or other credit enhancements

IFRS 7 requires the following disclosures:

- A description of the collateral held as security and other credit enhancements (including a discussion on the quality of the collateral held and an explanation of any changes in credit quality as a result of deterioration or changes in the collateral policies of the entity)
- The gross carrying amount of financial assets that have an expected credit loss of zero because of collateral
- For financial instruments in ***Stage 3***, quantitative information about the extent to which collateral and other credit enhancements reduce the extent of expected credit losses.

IFRS 7 also requires disclosure of the amounts that best represent the entity's maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements.

B.6. Write-offs

An entity is required to disclose the contractual amount of financial assets written off that are still subject to enforcement activity.

B.7. Credit risk concentrations

IFRS 7 requires an entity to disclose its credit risk exposure and significant credit risk concentrations. Disclosure is required, by credit risk rating grade, of the gross carrying amount of financial assets and the amount recognised as a provision for loan commitments and financial guarantee contracts in a particular grade.

This analysis is disclosed separately for:

- Financial assets with a loss allowance measured at an amount equal to 12-month expected credit losses i.e. ***Stage 1***
- Financial assets with a loss allowance measured at an amount equal to lifetime expected credit losses but are not credit impaired ***Stage 2***
- Financial assets that are credit impaired at the reporting date (but that are not purchased or originated credit-impaired financial assets) ***Stage 3***
- Purchased or originated credit-impaired financial assets. In addition to the reconciliation for these assets, an entity is required to disclose the total amount of undiscounted expected credit losses at initial recognition
- Trade receivables, contract assets or lease receivables.

As a practical expedient, for trade receivables and lease receivables to which an entity applies the simplified approach (i.e. the loss allowance is measured as the amount equal to lifetime expected credit losses), this disclosure may be based on a provision matrix.

The number of grades used is required to be consistent with the number of grades that the entity uses to report internally to key management personnel.

If information about credit risk rating grades is not available without undue cost and effort and an entity uses the 30 days rebuttable presumption to assess whether credit risk has increased significantly, it is necessary to provide an analysis of the financial assets with past due status.

Refer to Appendix D2 for an example of these disclosure requirements.

APPENDIX C – FASB'S PROPOSED MODEL

On 20 December 2012 the US Financial Accounting Standards Board (FASB) issued an exposure draft for comment based on a different impairment model – the current expected credit loss (CECL) model.

C.1. Proposed current expected credit loss (CECL) model

Like the International Accounting Standards Board's (IASB's) proposals, the CECL model would apply to all financial assets carried at amortised cost and at fair value through other comprehensive income (FVTOCI).

Unlike the IASB's model which contains a dual measurement model, the FASB's proposed model contains a single measurement requirement. It requires an entity to recognise an impairment loss on financial assets based on its current estimate of all contractual cash flows not expected to be collected. Because the model only contains a single measurement approach it does not (nor would it require) any transfer criteria.

The CECL model provides a practical expedient for financial assets measured at fair value through other comprehensive income. For those assets, entities may choose to not recognise expected credit losses if both of the following conditions are met:

- The fair value of the financial asset is greater than (or equal to) its carrying amount, and
- The expected credit losses on the financial asset are insignificant.

The following table summarises ,at a high level, the main differences on recognition, measurement and transfer criteria between the IFRS 9 (2014) Financial Instruments and FASB's proposals for the impairment of financial assets.

	IFRS 9 (2014)	FASB's proposed model
Measurement	General approach: – Typically, 12-month expected credit losses at initial recognition, and – If transfer criteria are met, lifetime expected credit losses.	All contractual cash flows that the entity does not expect to collect.
Transfer criteria	When there has been significant increase in credit risk since initial recognition.	No transfer criteria.
Recognition exceptions	No recognition exception.	For financial assets at fair value through other comprehensive income, an entity may choose not to recognise expected credit losses if: – Its fair value is greater than the amortised cost, and – The expected credit losses are insignificant.

Figure C1: High level summary of the key differences between the IASB and FASB model

APPENDIX D – EXAMPLES IFRS 7 DISCLOSURES

Appendix D sets out examples of the reconciliation account and credit risk concentration disclosures as required by IFRS 7 *Financial Instruments: Disclosures*.

D.1. Reconciliation accounts

IFRS 7 requires entities to disclose reconciliation between the opening balance and the closing balance of the gross carrying amount and the associated loss allowance. The standard also requires an explanation of how significant changes in the gross carrying amount contributed to changes in the loss allowance.

Mortgage loans – Loss allowance	12-month expected credit losses	Lifetime expected credit losses		
		Collectively assessed	Individually assessed	Credit-impaired financial assets
Loss allowance at 1 January	**XXX**	**XXX**	**XXX**	**XXX**
Changes from updating the expected credit losses	XXX	XXX	XXX	XXX
Transfer to lifetime expected credit losses	(XXX)	XXX	XXX	-
Transfer to credit-impaired financial assets	(XXX)	-	(XXX)	XXX
Transfer to 12-month expected credit losses	XXX	(XXX)	(XXX)	-
Loans that have been derecognised during the period	(XXX)	(XXX)	(XXX)	(XXX)
Newly originated/purchased loans	XXX	-	-	-
Write-offs	-	-	(XXX)	(XXX)
Changes in models/risk parameters	XXX	XXX	XXX	XXX
Loss allowance as at 31 December	**XXX**	**XXX**	**XXX**	**XXX**

Significant changes in the gross carrying amount of mortgage loans that contributed to changes in the loss allowance were due to:

– Acquisition of the ABC prime mortgage portfolio increased the residential mortgage book by x percent, with a corresponding increase in the 12-month expected credit loss allowance
– Write-off of the XYZ portfolio following the collapse of the local market reduced the credit-impaired financial assets loss allowance by CUXXX
– Expected increase in unemployment in Region X caused a net increase of CUXXX in the lifetime expected credit loss allowance.

Mortgage loans – Gross carrying amount	12-month expected credit losses	Lifetime expected credit losses		
		Collectively assessed	Individually assessed	Credit-impaired financial assets
Gross carrying amount as at 1 January	**XXX**	**XXX**	**XXX**	**XXX**
Individual loans transferred to lifetime expected credit losses	(XXX)	-	XXX	-
Individual loans transferred to credit-impaired financial assets	(XXX)	-	-	XXX
Individual loans transferred from credit-impaired financial assets	XXX	-	XXX	(XXX)
Loans assessed on a collective basis transferred to lifetime expected credit losses	(XXX)	XXX	-	-
Newly originated/purchased loans	XXX	-	-	-
Write-offs	-	-	(XXX)	(XXX)
Loans that have been derecognised during the period	(XXX)	(XXX)	(XXX)	(XXX)
Modified loans that did not result in derecognition	(XXX)	-	*XXX*	*XXX*
Other changes	XXX	XXX	XXX	XXX
Loss allowance as at 31 December	**XXX**	**XXX**	**XXX**	**XXX**

D.2. Credit risk concentrations

IFRS 7 requires entities to disclose its credit risk exposure and significant credit risk concentrations of its financial assets.

Consumer loan credit risk exposure by internal rating grades

	Consumer – Credit card Gross carrying amount		Consumer – Automotive Gross carrying amount	
	Lifetime	12-month	Lifetime	12-month
Internal Grade 1-2	XXX	XXX	XXX	XXX
Internal Grade 3-4	XXX	XXX	XXX	XXX
Internal Grade 5	XXX	XXX	XXX	XXX
Total	**XXX**	**XXX**	**XXX**	**XXX**

Corporate loan credit risk exposure by external rating grades

	Corporate - Equipment Gross carrying amount		Corporate - Construction Gross carrying amount	
	Lifetime	12-month	Lifetime	12-month
AA - A	XXX	XXX	XXX	XXX
BBB-B	XXX	XXX	XXX	XXX
CCC-C	XXX	XXX	XXX	XXX
D	XXX	XXX	XXX	XXX
Total	**XXX**	**XXX**	**XXX**	**XXX**

Trade receivables

	Days past due					
	Current	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due	Total
Expected credit loss rate	0.5%	1.8%	3.8%	7.0%	11.0%	
Estimated total gross carrying amount	CU16,000,000	CU8,000,000	CU5,000,000	CU3,500,000	CU1,500,000	**CU34,000,000**
Lifetime expected credit losses	CU80,000	CU144,000	CU190,000	CU245,000	CU165,000	**CU824,000**

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For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below. Alternatively, please visit **www.bdointernational.com/Services/Audit/IFRS/IFRS Country Leaders** where you can find full lists of regional and country contacts.

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