



IFRS 9 Financial Instruments An Overview of the Impairment Requirements

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Introduction	2
Key Differences Between IAS 39 and IFRS 9 Impairment Models	2
General Impairment Approach	4
The Three Stages of Credit Risk Deterioration	4
Impairment Recognition	5
Interest Recognition	7
Increases/Decreases in Credit Risk.....	7
Presentation of Expected Credit Losses	9
Debt Investments Measured at FVOCI	9
Impairment Decision Tree	11
Exceptions	12
<i>Exception 1: Simplified Approach for Purchased or Originated Credit-Impaired Financial Assets</i>	12
<i>Exception 2: Simplified Approach for Trade and Lease Receivables and Contract Assets</i>	18
Financial Instruments with Low Credit Risk at the Reporting Date	21
Significant Increase in Credit Risk Since Initial Recognition.....	23
Credit-Impaired Financial Assets	27
Measurement of ECLs	28
Measurement Approaches	31
Time Value of Money	33
Reasonable and Supportable Information	33
Individual vs. Collective Assessments	34
Impairment of Loan Commitments	36
Impairment of Financial Guarantee Contracts	41
Modifications	43
Write-offs	46
Disclosure	46
Additional Resources	47
External Resources	47
Other MNP Technical Guidance	48
Appendix A: Information That May be Relevant in Assessing Changes in Credit Risk	49
Appendix B: Impairment Comprehensive Example	51
Appendix C: Application of the Impairment Requirements for Loan Commitments and Financial Guarantees Compared to Other Financial Assets	53

Introduction

In July 2014, the International Accounting Standards Board (IASB) completed Phase 2 of its financial instruments project related to impairment and, as such, published the final version of *IFRS 9 Financial Instruments*. IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement*, and is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

IFRS 9 uses an expected credit loss (ECL) model which replaces the current incurred loss model under IAS 39. The IFRS 9 impairment requirements aim to address concerns raised during the financial crisis relating to the current IAS 39 incurred loss impairment model which delays the recognition of impairment until there is objective evidence of impairment. The IFRS 9 requirements also reduce the complexity of impairment testing by requiring the same model for all financial instruments subject to impairment testing.

This guide highlights the objective of the impairment methodology and the key differences between the IAS 39 and IFRS 9 impairment models. It also provides an overview of the requirements and illustrative examples to assist in the application of the new IFRS 9 ECL model.

Note! IFRS 9 provides a simplified impairment approach for trade receivables and investments with low credit risk which will apply to most entities. While nearly all entities will be impacted by the impairment requirements of IFRS 9, it is expected that financial institutions particularly those involved in lending (e.g. Chartered Banks, Credit Unions, Mortgage Investment Companies and Auto-Vehicle Financing Companies) will be most affected.

Key Differences Between IAS 39 and IFRS 9 Impairment Models

The impairment requirements under IFRS 9 are significantly different from those under IAS 39. The following table highlights the key differences between the two standards:

IAS 39 Incurred Loss Model	IFRS 9 Expected Credit Loss Model
<ul style="list-style-type: none"> ▪ Delays the recognition of credit losses until there is objective evidence of impairment. 	<ul style="list-style-type: none"> ▪ ECLs are recognized at each reporting period, even if no actual loss events have taken place.
<ul style="list-style-type: none"> ▪ Only past events and current conditions are considered when determining the amount of impairment (i.e., the effects of future credit loss events cannot be considered, even when they are expected). 	<ul style="list-style-type: none"> ▪ In addition to past events and current conditions, reasonable and supportable forward-looking information that is available without undue cost or effort is considered in determining impairment.
<ul style="list-style-type: none"> ▪ Different impairment models for different financial instruments subject to impairment testing, including equity investments classified as available-for-sale. 	<ul style="list-style-type: none"> ▪ One model which applies to all financial instruments subject to impairment testing.

One of the main improvements in IFRS 9 relates to the application of one impairment model for all financial instruments, including:

- Financial assets measured at amortized cost.
- Debt investments measured at fair value through other comprehensive income (FVOCI).
- Trade receivables and contract assets (as defined in IFRS 15 *Revenue from Contracts with Customers*).
- Lease receivables within the scope of IAS 17/IFRS 16¹ *Leases*.
- Loan commitments that are not designated as at fair value through profit or loss (FVTPL).
- Financial guarantee contracts not designated as at FVTPL.

The following table compares which financial assets require impairment testing under IAS 39 vs. IFRS 9:

Financial Asset	IAS 39 Classification	Impairment Testing Required under IAS 39?	Impairment Testing Under IFRS 9
Debt Investment	Loans and Receivables	Yes	Impairment testing is required for debt investments (including hybrid instruments) measured at amortized cost or FVOCI.
	Available-for-sale	Yes	
	Held-to-maturity	Yes	No impairment testing required for those instruments measured at FVTPL.
	FVTPL	No	
Equity Investment	Available-for-sale, including equity investments measured at cost because its fair value is not reliably measurable	Yes	No impairment testing is required for equity investments which are all measured at FVOCI or FVTPL.
	FVTPL	No	
Lease Receivables	N/A – scoped out of IAS 39 except for the impairment and derecognition provisions	Yes	Although scoped out of IFRS 9, the impairment and derecognition requirements apply to lease receivables recognized by a lessor.

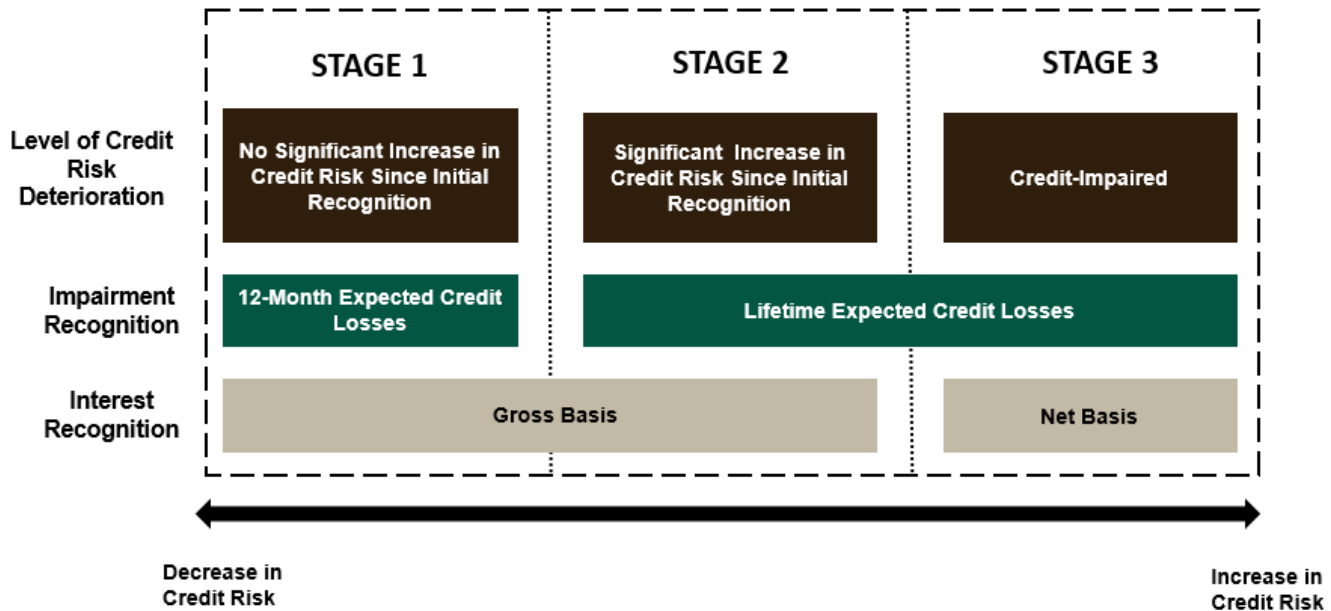
Loan commitments and financial guarantee contracts within the scope of IAS 39 were not subject to impairment testing under that standard. These financial instruments are recognized at the higher of their initial carrying amount and the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Conversely, the new IFRS 9 impairment model apply to these items.

¹ IAS 17 is being superseded by IFRS 16 *Leases* which is effective for annual reporting periods beginning on or after January 1, 2019.

General Impairment Approach

The following diagram provides a high-level overview of the general IFRS 9 impairment approach:

Diagram 1



Note! There is a general approach to impairment (presented in the diagram above and discussed in detail in this section) and there are two exceptions to the general approach. The first exception relates to purchased or originated credit-impaired financial assets and the second exception relates to a simplified approach that may apply to trade receivables, contract assets and lease receivables. The exceptions are discussed under the *Impairment Decision Tree* section of this guide.

The Three Stages of Credit Risk Deterioration

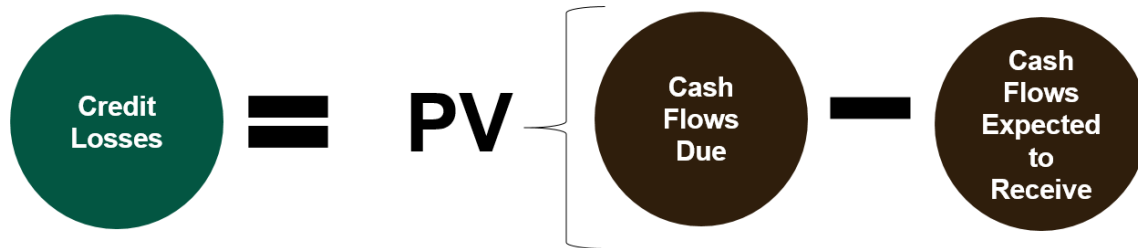
In Diagram 1, the three stages in the new impairment model reflect the general pattern of the deterioration in credit risk of a financial instrument that ultimately defaults. At each reporting period, an entity assesses which stage a financial instrument that is subject to impairment testing falls into. The stage determines the relevant impairment requirements.

Stage 1 includes financially healthy financial assets that are expected to perform in line with their contractual terms and which have no signs of increased credit risk. When the credit risk of a certain financial asset has significantly increased since initial recognition, the instrument no longer falls into Stage 1. In that case, if the instrument is not credit-impaired, the instrument will fall into Stage 2. Lastly, Stage 3 applies to credit-impaired financial instruments.

Note! A financial asset is considered to be credit-impaired when one or more events that have an unfavourable impact on its estimated future cash flows have occurred. The definition of credit-impaired is discussed further under the *Impairment Decision Tree* section of this guide. The definition is similar to the IAS 39 “objective evidence of impairment” definition. In other words, an actual impairment event has occurred.

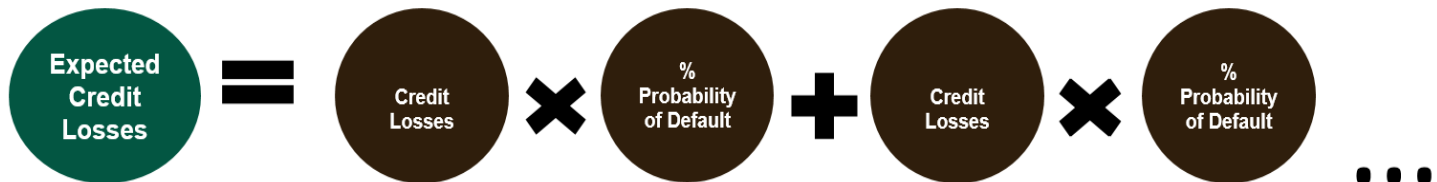
Impairment Recognition

Credit losses are the present value of the difference between all contractual cash flows that are due and all cash flows that the entity expects to receive (i.e., the cash shortfall). The effective interest rate used to discount the credit losses is discussed in the *Impairment Decision Tree* section of this guide.



Note! If payment from the customer is expected to be later than agreed, then there is an impairment loss on the financial asset (e.g. trade receivable) that needs to be recognized (if material) even if the entity expects to be paid in full. The expected delay in payment creates a difference between the present value of the cash flows due and the present value of the cash flows expected.

Expected credit losses (ECLs) are the sum of all possible credit losses, weighted based on their probability of occurrence.



The ECLs estimate should reflect an impartial and probability-weighted amount that is determined by evaluating a range of possible outcomes. Although every possible scenario is not required to be identified, the estimate should always reflect at least two scenarios:

- The probability that a credit loss occurs, even if this probability is very low; and
- The probability that no credit loss occurs.

Example of ECLs

A \$100 credit loss is expected with a 10% probability of default occurring. This implies that there is a 90% probability of no default occurring. What are the ECLs?

Assessment: The ECLs are calculated as follows: $ECLs = (10\% \text{ probability} \times \$100 \text{ credit loss}) + (90\% \text{ probability} \times \$0 \text{ credit loss}) = \10 .

As illustrated in Diagram 1, depending on the stage that the instrument falls into, an entity either recognizes 12-month ECLs or lifetime ECLs.

12-month ECLs	Lifetime ECLs
<ul style="list-style-type: none"> ▪ The portion of lifetime ECLs that result from possible default events within 12 months after the reporting period. ▪ Credit losses over the life of the financial instrument that result if a default occurs in the next 12 months x the probability of default in the next 12 months. 	<ul style="list-style-type: none"> ▪ The ECLs that result from all possible default events over the expected life of the financial instrument. ▪ Lifetime credit losses x lifetime probability of default.

Example of 12-month ECLs vs. Lifetime ECLs

Lender A originates a 10-year loan for \$1 million which equals its gross carrying amount. Lender A determines that 25% of the gross carrying amount will be lost if the loan defaults. At the reporting date, Lender A estimates that the loan has a probability of default of 0.5% over the next 12 months and a lifetime probability of default of 20%. What loss allowance should be recognized?

Assessment: The loss allowance recognized depends on whether there has been a significant increase in credit risk since initial recognition. This distinction determines whether the loss allowance represents 12-month ECLs or lifetime ECLs.

- If there has not been a significant increase in credit risk since initial recognition, then the loss allowance is based on 12-month ECLs calculated as follows: 0.5% probability of default over the next 12 months x 25% credit loss x \$1,000,000 loan = \$1,250.
- If there has been a significant increase in credit risk since initial recognition, then the loss allowance is based on lifetime ECLs calculated as follows: 20% probability of default over lifetime x 25% credit loss x \$1,000,000 loan = \$50,000.

The 12-month ECLs are just a portion of the lifetime ECLs as a result of defaults expected over the next 12 months. It is important to recognize that the 12-month ECLs are not:

- The credit losses that could occur relating to the contractual cash flows due in the next 12 months.
- Lifetime ECLs that an entity will incur on a financial instrument that it predicts will default in the next 12 months.
- The cash shortfalls that are predicted over the next 12 months.

The recognition of 12-month ECLs results in an overstatement of ECLs and an understatement of the related financial asset's carrying amount, immediately after the initial recognition of those financial instruments. This is because the 12-month ECLs' requirement effectively results in a day-one loss. However, this measurement of ECLs serves as a reasonable approximation of the impact of credit risk on the effective interest rate.

Note! The new model aims to achieve an appropriate balance between faithful representation of ECLs and the operational costs and complexity. The 12-month ECLs is a simplification included in IFRS 9 due to the cost-benefit of the lifetime ECLs requirement. Additionally, 12-month ECLs are already being computed by some regulated financial institutions, and hence, implementing this requirement would be less costly.

Interest Recognition

As illustrated in Diagram 1, the stage that the financial instrument is in also determines the interest that is recognized either on a gross or net basis².

Interest Rate	Gross Basis	Net Basis
The original effective interest rate is applied to the...	Gross carrying amount (which is the amortized cost before recognizing the impairment loss).	Amortized cost (which is after the impairment loss has been taken into account).

In subsequent periods, the basis on which interest is calculated may change as the financial asset moves from one stage to another. For example, if a financial asset's credit risk improves so that it is no longer considered credit-impaired, the recognition of interest will shift from the net basis to the gross basis, and vice versa.

Note! The above discussion relates to interest recognition under the general approach to impairment only. The recognition of interest related to purchased or originated credit-impaired financial assets (i.e., the first exception to the general impairment approach) is discussed under the *Impairment Decision Tree* section of this guide.

Increases/Decreases in Credit Risk

If the credit risk for a financial instrument improves, the instrument can move from Stage 2 back to Stage 1. Movements from Stage 3 back into Stage 2 or Stage 1 are rarer and harder to justify.

² The September 2015 IFRS Discussion Group (IDG) Meeting discussed how the effective interest rate method is applied to credit-impaired financial assets (i.e., financial assets in Stage 3) where interest is recognized on a net basis. The Group discussed whether, for financial assets in Stage 3, the gross carrying amount was adjusted with the amount of interest recognized or if the gross carrying amount was adjusted with the effective interest rate on the instrument as under the gross basis. The Group concluded, which was also supported by the *Transition Resource Group (TRG) for Impairment of Financial Assets*, that the gross carrying amount is not calculated differently because of recognizing interest on a net versus gross basis. Thus, the gross carrying amount will be adjusted with the effective interest rate on the instrument and not the actual interest recognized. Refer to the [IDG meeting report](#) or [TRG meeting summary](#) (agenda paper 9) for details and an example.

Example of General Impairment Approach

- Entity A provides a term loan to Entity B on January 1, 2018.
- The loan's principal amount is \$1,000,000 with 3% interest per year payable at the end of each month.
- The principal is due on December 31, 2021.
- The loan is secured by a portion of Entity B's fixed assets.

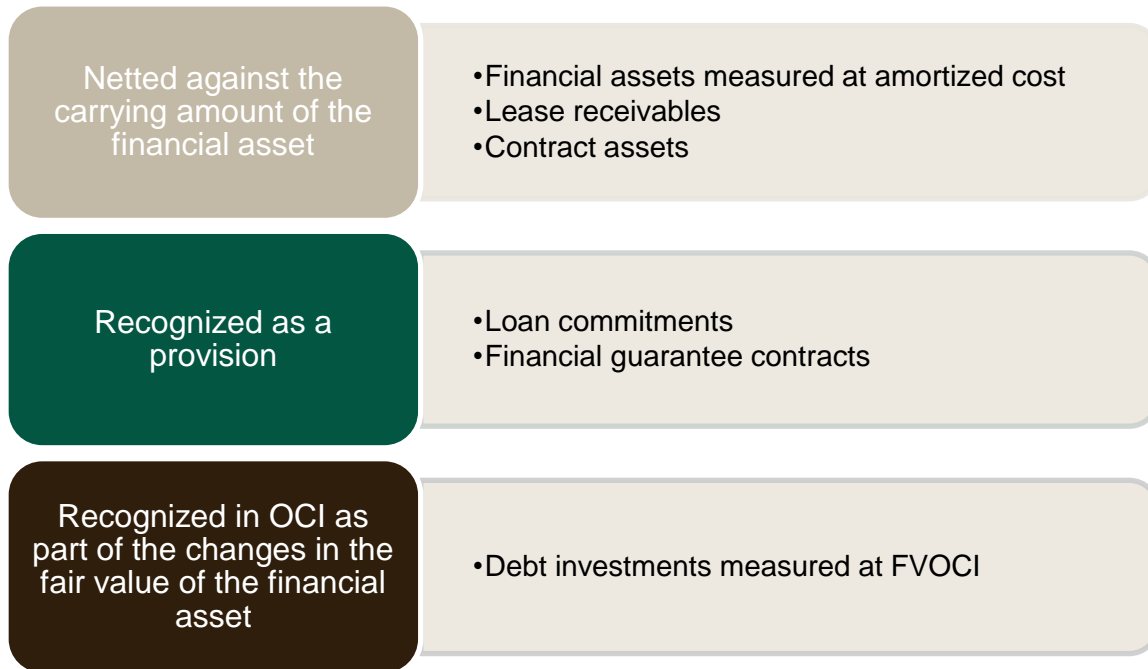
Stage 1	Stage 2	Stage 3
Deterioration of credit quality since initial recognition		
<p>On December 31, 2018, Entity A determines the credit risk of the loan has not increased significantly since initial recognition.</p> <p>Entity A estimates that the loan has a 10% probability of default in the next 12 months.</p> <p>Entity A calculates that \$50,000 will be lost if the loan defaults. The \$50,000 is calculated as the present value of the cash shortfalls expected over the life of the instrument if the default occurs in the next 12 months. The expectation is based on past experience updated for current conditions and forward-looking information.</p>	<p>On December 31, 2019, Entity A determines the credit risk of the loan has increased significantly*, as evidenced by:</p> <ul style="list-style-type: none"> ▪ Significant decline in Entity B's revenue. ▪ Significant adverse changes in the economic environment because of a shift in technology that reduces demand for products. ▪ Some interest payments were paid late during the year although there are no outstanding amounts. <p>Entity A estimates that the probability of default occurring over the remaining life of the loan is 50%. The ECLs from all possible default events over the life of the loan are expected to be \$100,000.</p>	<p>On December 31, 2020, Entity A determines the loan to be a credit-impaired financial asset, as evidenced by:</p> <ul style="list-style-type: none"> ▪ Entity B experienced significant financial difficulty and has been placed into receivership. ▪ The monthly interest payments were not made during the year. ▪ Significant reduction in the value of the collateral. <p>The estimated present value of the collateral that Entity A expects to recover minus associated costs is \$800,000.</p> <p>The gross carrying amount of the loan (which excludes the impairment allowance) is \$1,030,000 comprising of the loan amount and the unpaid interest for the year.</p>
<p>12-month ECLs = \$5,000 ($\\$50,000 \times 10\%$) which are the ECLs that result from default events on a financial instrument that are possible within the next 12 months.</p> <p>2018 interest revenue = \$30,000 ($3\% \times \\$1,000,000$) which is based on the effective interest rate applied to the gross carrying amount (which is the amortized cost before adjusting for any loss allowance).</p>	<p>Lifetime ECLs = \$50,000 ($\\$100,000 \times 50\%$) which are the ECLs that result from all possible default events over the expected life of the instrument.</p> <p>The change in the cumulative impairment allowance is recognized in profit or loss as \$45,000.</p> <p>2019 interest revenue = \$30,000 ($3\% \times \\$1,000,000$) which is based on the effective interest rate applied to the gross carrying amount (which is the amortized cost before adjusting for any loss allowance).</p>	<p>Lifetime ECLs = \$230,000 ($\\$1,030,000 - \\$800,000$)</p> <p>The change in the cumulative impairment allowance of \$180,000 is recognized in profit or loss.</p> <p>2020 interest revenue = \$30,000 ($3\% \times \\$1,000,000$) interest revenue in 2020.</p> <p>2021 interest revenue = \$24,000 ($3\% \times \\$800,000$) which is based on the effective interest rate applied to the amortized cost (gross carrying amount minus loss allowance) of the instrument from the date it became credit-impaired.</p>

* Only an increase in credit risk vs. credit-impaired because there is no conclusive evidence at that time that Entity B will not pay (i.e., although late on interest payments during the year, there are no outstanding amounts at the reporting date).

Presentation of Expected Credit Losses

The loss allowance is a cumulative amount. Increases or decreases in a loss allowance are recognized in profit or loss. This is the case for all financial instruments subject to impairment.

The presentation of the loss allowance varies depending on the type of instrument, as follows:



Note! It is not necessary to estimate a loss allowance on the date of initial recognition; it is only required at the end of each reporting period. However, recognizing an ECL allowance in profit or loss at the first reporting period following the initial recognition of the financial asset has the same effect as recognizing a day-one loss and adjusting the allowance at the end of the reporting period.

Debt Investments Measured at FVOCI

As indicated in the diagram above, for debt investments measured at FVOCI, the loss allowance is not netted against the carrying amount of the financial asset but instead is recognized in OCI. This is because the carrying amount of these assets is their fair value which would already include any impairment considerations. However, the loss allowance is tracked so that changes in the impairment allowance can be recognized in profit or loss and disclosed in accordance with IFRS 7.16A *Financial Instruments: Disclosures*.

Note! Some financial Institutions may offer a credit facility that includes both a loan (i.e., a financial asset) and an undrawn commitment (i.e., a loan commitment). If the ECLs on the loan commitment cannot be separately identified from those on the financial asset, then the ECLs are recognized together with the loss allowance for the loan. In the situation that the ECLs exceed the gross carrying amount of the loan, the excess ECLs should be recognized as a provision.

Example of Debt Investments Measured at FVOCI (Adapted from IFRS 9.IE78 – 81 Example 13)

A debt instrument measured at FVOCI has a fair value of \$10,000 at initial recognition. The instrument bears interest at 5%, has a 10-year term, and a 5% effective interest rate. The asset is not a purchased or originated credit-impaired financial asset. For simplicity, interest revenue journal entries have not been presented.

Entries:

To recognize the debt instrument at initial recognition.

Dr Financial asset – FVOCI	\$10,000	
Cr Cash		\$10,000

At the first reporting date, the debt instrument's fair value has decreased to \$9,500 as a result of increases in market interest rates. There has not been a significant increase in the credit risk of the debt investment since initial recognition; hence, 12-month ECLs of \$300 are recognized.

To recognize the total change in fair value from initial recognition.

Dr Other comprehensive income (OCI)	\$500	
Cr Financial asset – FVOCI		\$500

To recognize the change in the loss allowance.

Dr Impairment loss (profit or loss)	\$300	
Cr OCI		\$300

The cumulative loss in OCI at the reporting date is \$200. That amount consists of the total fair value change of \$500 (i.e., \$10,000 - \$9,500) offset by the change in the accumulated impairment of \$300. The loss allowance of \$300 would be disclosed.

At the next reporting date, the debt instrument's fair value has decreased further to \$9,250 as a result of increases in market interest rates. There has not been a significant increase in the credit risk of the debt investment since initial recognition; hence, 12-month ECLs of \$400 are recognized (i.e., a \$100 increase from the prior year).

To recognize the total change in fair value from initial recognition.

Dr OCI	\$250	
Cr Financial asset – FVOCI		\$250

To recognize the change in the loss allowance.

Dr Impairment loss (profit or loss)	\$100	
Cr OCI		\$100

Example of Debt Investments Measured at FVOCI *(continued from previous page)*

The cumulative loss in OCI at the reporting date is \$350 (i.e., \$200 cumulative loss from the previous reporting date + \$250 change in fair value - \$100 change in loss allowance). The loss allowance of \$400 would be disclosed.

Assume that subsequent to year-end the entity decides to sell the debt instrument for its fair value of \$9,250.

To derecognize the debt instrument and recycle the accumulated OCI amounts.

Dr Cash		\$9,250	
Dr Loss (profit or loss)		\$ 350	
	Cr Financial asset – FVOCI		\$9,250
	Cr OCI		\$ 350

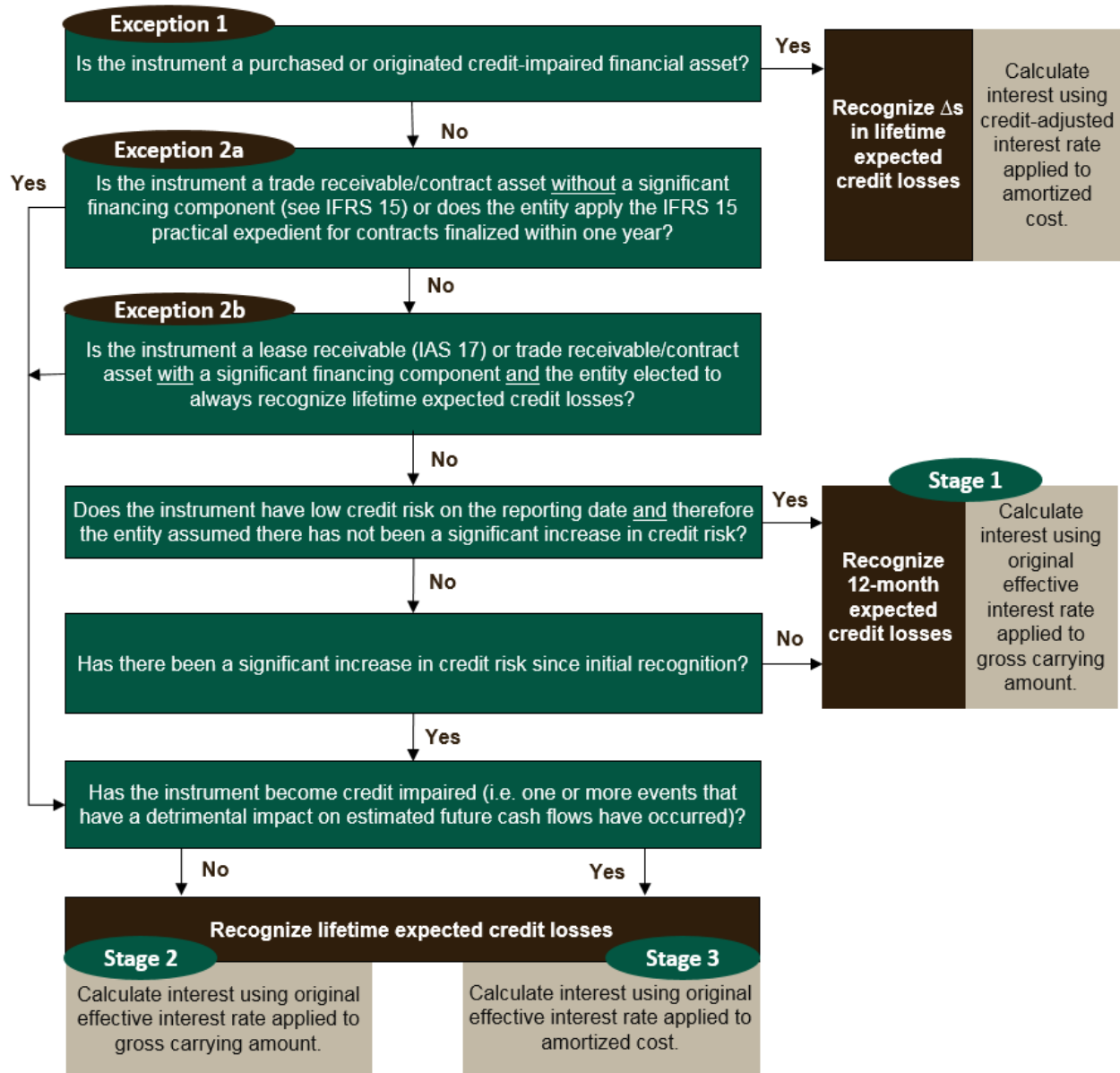
Note! The example above applies only to debt instruments measured at FVOCI. Equity instruments measured at FVOCI are not subject to impairment and no recycling is permitted for amounts sitting in OCI for such instruments.

Impairment Decision Tree

The decision tree in Diagram 2 below describes in more detail the thought process to follow when determining the impairment loss and how interest is recognized. It includes the general approach (i.e., the three stages) and the two exceptions to the general approach which apply to:

- Purchased or originated credit-impaired financial assets
- Trade receivables, contract assets *(as defined in IFRS 15)* and lease receivables *(within scope of IAS 17)*

Diagram 2



Refer to the *General Impairment Approach* section of this guide for a detailed discussion on the three stages. The other impairment requirements presented in the decision tree above, including the two exceptions, are discussed in further detail below.

Exceptions

Exception 1: Simplified Approach for Purchased or Originated Credit-Impaired Financial Assets

Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition (e.g. junk bonds).

A financial asset is credit-impaired when one or more events that have an unfavourable impact on its estimated future cash flows have occurred. When observable data about the following events exist, it supports the determination that a financial asset is credit-impaired:

- Borrower or issuer is experiencing significant financial difficulty;
- A breach of contract, such as a default or past due event;
- The granting of an uncustomary concession(s) by the lender(s) as a result of the borrower's financial difficulty;
- A high likelihood of bankruptcy or other financial reorganization by the borrower;
- The loss of an active market for that financial asset because of financial difficulties; or
- The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

Either a single discrete event or the combined effect of several events may result in financial assets becoming credit-impaired.

Note! The definition of credit-impaired is substantially the same as the IAS 39 “loss events”.

The impairment approach for these financial assets is as follows:

- No 12-month ECLs are recognized as these losses were previously reflected in the initial fair values of the purchased or originated credit-impaired financial assets.
- At each reporting date, the amount of the change in lifetime ECLs since initial recognition is recognized in profit or loss. This change is accumulated with the prior periods' changes in lifetime ECLs and presented as a loss allowance for such financial assets.
 - Favourable changes in lifetime ECLs are recognized even if they exceed the amount previously recognized as impairment losses. This could lead to the loss allowance increasing the amortized cost of the financial assets as a result of the ECLs in subsequent reporting periods being less than the amount of ECLs included in the estimated cash flows on initial recognition when calculating the credit-adjusted effective interest rate.
- A credit-adjusted effective interest rate is used to recognize interest on the amortized cost of the financial assets from initial recognition. Unlike the general approach, interest recognition does not change.

Note! It would be rare for an instrument to be originated credit-impaired because a “loss event” would have had to happen at origination. An example is the origination of an instrument as a result of a substantial modification of distressed debt which resulted in the derecognition of the original financial asset. In this situation, the modification could be seen as a “loss event” at initial recognition. Refer to the *Modifications* section of this guide for further detail.

Lenders may provide concessions to their members (e.g. interest only payments, granting an extension for payment, skipping a payment, etc.). By itself, such a concession does not necessarily indicate that the financial asset has become credit-impaired. However, it could be an indicator as mentioned in the definition above. An entity should consider the specific facts and circumstances of the situation, including the reasons for the concession, to determine if the financial asset is credit-impaired. A key consideration is whether the circumstances have a detrimental impact on the estimated future cash flows of that financial asset and whether the concession was provided because of the borrower's financial difficulty.

The following table summarizes the key differences between the general approach and the approach for purchased or originated credit-impaired financial assets.

	Exception 1: Purchased or Originated Credit-impaired Financial Assets	General Approach
Impact of Credit Deterioration Since Initial Recognition	No impact. Changes in lifetime ECLs are always recognized and interest is always calculated on a net basis.	Whether 12-month or lifetime ECLs are recognized and whether interest is recognized on a net or gross basis depends on the level of credit deterioration that has taken place since initial recognition.
Impairment Recognition	The purchase price/fair value at initial recognition includes an expectation for credit losses which was priced into the instrument. As a result, the loss allowance only consists of changes in lifetime ECLs since initial recognition, not the total ECLs (refer to example below).	The loss allowance is based on the total ECLs, which is calculated at each reporting date, rather than the changes in ECLs since initial recognition.
Interest Recognition	<p>Uses a credit-adjusted effective interest rate which is applied to the amortized cost (net amount after loss allowance).</p> <p>When calculating the credit-adjusted effective interest rate that discounts the expected future cash flows to the <u>amortized cost</u>, an entity estimates the expected cash flows by considering all contractual terms of the financial asset (e.g. prepayment, extension, call and similar options) including ECLs.</p>	<p>Uses the original effective interest rate which is applied to the gross carrying amount (gross basis) or amortized cost (net basis) depending on whether the instrument is credit-impaired or not.</p> <p>When calculating the original effective interest rate that discounts the expected future cash flows to the <u>gross carrying amount</u>, an entity estimates expected cash flows by considering all contractual terms of the financial asset (e.g. prepayment, extension, call and similar options) but shall not consider ECLs.</p>
Discount Rate Used When Calculating ECLs	ECLs are discounted using the credit-adjusted effective interest rate calculated on initial recognition.	ECLs are discounted using the original effective interest rate calculated on initial recognition.

Note! The accounting treatment for purchased or originated credit-impaired financial assets is similar to the accounting treatment for financial assets that become credit-impaired (i.e., Stage 3 of the general approach), except for:

- A special interest rate is calculated at initial recognition that takes into account ECLs.
- The loss allowance is only based on the changes in ECLs since initial recognition not a total estimate of ECLs.

Example of a Purchased or Credit-Impaired Financial Asset

An entity purchases a loan with a remaining term of 5 years for \$8,500,000. Transaction costs amount to \$200,000. The nominal amount of the loan was \$10,000,000 with interest payable at 10% per year. The loan is credit-impaired and, hence, the entity does not expect to recover all of the contractual cash flows. The entity expects to receive the following cash flows over the remaining term, which represents \$600,000 of the original \$1,000,000 interest owed annually and \$9,500,000 as the recoverable amount of the original \$10,000,000 loan principal at the end of the term.

End of Year	Expected Cash Flows
1	\$600,000
2	600,000
3	600,000
4	600,000
5	10,100,000*

*(\$9,500,000 + 600,000)

Because the loan is credit-impaired at the date of purchase, the credit-adjusted effective interest rate is calculated on initial recognition which is based on the amortized cost after taking into account ECLs. In this situation, the credit-adjusted effective interest rate is 8.45% (i.e., the rate that discounts the expected cash flows above to the amortized cost at initial recognition of \$8,700,000). If the loan was not credit-impaired, the effective interest rate would be based on the contractual cash flows. For example, if the nominal amount of the loan was \$10,000,000 with interest payable at 10% per year, the effective interest rate would be 13.77% (i.e., the rate that discounts the contractual cash flows of \$1,000,000 of interest per year and the \$10,000,000 nominal amount at the end of year 5 to the amortized cost at initial recognition of \$8,700,000).

On initial recognition, the entity records the following journal:

Dr Loan receivable – purchase amount plus transaction costs	\$8,700,000	
Cr Bank account		\$8,700,000

No impairment allowance is recognized at initial recognition. Instead, the ECLs are reflected in the fair value of the loan receivable recognized and taken into account when calculating the credit-adjusted effective interest rate, as described above.

Example of a Purchased or Credit-Impaired Financial Asset *(continued from previous page)*

At the end of year 1, assuming cash flows received match the entity's expectations, the entity records the following journal:

Dr Loan receivable (8.45% × \$8,700,000)	\$735,150	
Cr Interest income		\$735,150
Dr Bank account	\$600,000	
Cr Loan receivable		\$600,000

There have been no changes in the expected cash flows including ECLs. Therefore, no loss allowance is recognized. The amortized cost at the end of year 1, as indicated in the amortization table below, is \$8,835,150.

Amortized Cost Carrying Amount Net of Loss Allowance				
Year	Opening Balance	Interest Revenue @ 8.45%	Interest Received	Closing Balance
1	\$8,700,000	\$735,150	\$600,000	\$8,835,150
2	8,835,150	746,570	600,000	8,981,720
3	8,981,720	758,955	600,000	9,140,676
4	9,140,676	772,387	600,000	9,313,063
5	9,313,063	786,954	600,000	9,500,016*

* rounding error

Now assume that at the end of year 2, the entity expects that it will recover the full \$10,000,000 at the end of the term. Accordingly, the expected cash flows including ECLs are as follows for the remaining term of the loan:

End of Year	Expected Cash Flows
3	\$600,000
4	600,000
5	10,600,000

The entity records the following journal entries for the interest recognized and paid in year 2 (based on the amortization table above):

Dr Loan receivable (8.45% × \$8,835,150)	\$746,570	
Cr Interest income		\$746,570
Dr Bank account	\$600,000	
Cr Loan receivable		\$600,000

Example of a Purchased or Credit-Impaired Financial Asset *(continued from previous page)*

The present value of the revised expected cash flows (i.e., \$600,000 annual interest and \$10,000,000 at end of the term) over the remaining term (i.e., 3 years) discounted using the original credit-adjusted effective interest rate of 8.45% is \$9,373,703. Accordingly, at the end of year 2, the entity recognizes the favourable change in the ECLs of \$391,983 (\$9,373,703 - 8,981,720 which is the carrying amount at the end of year 2 per the amortization table above) as follows:

Dr Loan receivable - expected credit loss allowance	\$391,983	
Cr Impairment gain (profit or loss)		\$391,983

The revised amortization table is as follows:

Amortized Cost Carrying Amount Net of Loss Allowance				
Year	Opening Balance	Interest Revenue @ 8.45%*	Interest Received	Closing Balance
3	\$9,373,703	\$792,078	\$600,000	\$9,565,781
4	9,565,781	808,308	600,000	9,774,089
5	9,774,089	825,911	600,000	10,000,000

** At acquisition of the loan, the entity expected to only receive \$9,500,000 million of the \$10,000,000 principal. Since the loan was a purchased credit-impaired financial asset, the \$500,000 ECLs were reflected in the fair value of the loan receivable at initial recognition. At the end of year 2, the entity expected that the full \$10,000,000 loan principal would be recovered at the end of the term resulting in an ECL allowance with a debit balance of 391,983. Therefore, a portion of the net interest over the remaining period would be adjusted against the loan receivable – ECL allowance account to bring the balance to \$500,000 (debit) at the end of year 5 which reflects the full reversal of the original ECLs recognized in the fair value of the loan receivable at initial recognition. The adjustment for the other portion of the net interest would go to the loan receivable account each year to bring the balance to \$10,000,000 at the end of year 5.*

Now assume that at the end of year 5, the amount received from the borrower is \$9,000,000. The difference of \$1,000,000 is an unfavourable change in the lifetime ECLs on settlement. Thus, the entity records the following closing journal entry:

Dr Bank account	\$9,000,000	
Dr Impairment loss (profit or loss)	\$1,000,000	
Cr Loan receivable (\$9,500,000 original expectation + \$500,000 change in loss allowance)		\$10,000,000

Note! Lenders may acquire a portfolio of credit-impaired financial assets through mergers or other business acquisitions. However, per IFRS 3.B41 *Business Combinations*, an allowance is not recognized as of the acquisition date because the uncertainty over the collectability of future cash flows is incorporated in the financial assets' acquisition-date fair values. That is, the acquisition method of accounting for business combinations considers the collectability when determining the financial assets' acquisition-date fair values.

Accordingly, goodwill should not be impacted by recognizing lifetime ECLs for purchased or originated credit-impaired financial assets. Calculating the credit-adjusted effective interest rate will be done after the business combination accounting and the expected cash flows used in this calculation will include ECLs. This is in contrast to other financial instruments acquired for which the effective interest rate will be calculated but the expected cash flows exclude ECLs.

Exception 2: Simplified Approach for Trade and Lease Receivables and Contract Assets

As explained earlier, one of the exceptions to the general impairment approach is a simplified approach that may apply to certain trade receivables, contract assets and lease receivables. Depending on the type of item, the simplified approach is either required or the entity has an accounting policy choice. Therefore, the simplified approach is represented by two questions in Diagram 2, as follows:

Exception 2a: <i>Is the instrument a trade receivable/contract asset <u>without</u> a significant financing component (see IFRS 15) or does the entity apply the IFRS 15 practical expedient for contracts finalized within one year?</i>	Exception 2b: <i>Is the instrument a lease receivable (see IAS 17) or trade receivable/contract asset <u>with</u> a significant financing component and the entity elected to always recognize lifetime ECLs?</i>
<p>If yes, an allowance for lifetime ECLs is always recognized for:</p> <ul style="list-style-type: none"> ▪ Receivables and contract assets <u>without</u> a significant financing component; or ▪ When the entity applies the practical expedient (for contracts that are one year or less) in accordance with IFRS 15*. 	<p>If yes, the entity elected to recognize an allowance for lifetime ECLs for:</p> <ul style="list-style-type: none"> ▪ Trade receivables and contract assets <u>with</u> a significant financing component; and ▪ Lease receivables. <p>If no election was made, the entity continues to apply the general impairment approach.</p>

** Contracts with a significant financing component are those for which the agreed timing of payment provides the customer or the entity with a significant benefit of financing on the transfer of goods or services. In determining the transaction price in such situations, an entity is required to adjust the promised amount of consideration for the effects of the time value of money. However, if at contract inception, the entity anticipates that only a year or less will pass between when the entity transfers a promised good or service to a customer and when payment is received from the customer, as a practical expedient, an entity is not required to adjust the promised amount of consideration for the effects of a significant financing component.*

Note! Under the simplified approach, lifetime ECLs are always recognized. Accordingly, the simplified approach eliminates the need for an entity to calculate the 12-month ECLs and the instrument can only fall in Stage 2 or 3. In addition, there is no need to evaluate whether the credit quality has deteriorated significantly since initial recognition to determine whether a change between Stage 1 and 2 took place.

a) *How consistent should the policy election be applied? Can an entity apply it to some trade receivables, contract assets or lease receivables but not others?*

An entity may select its accounting policy choice for trade receivables, lease receivables and contract assets independently of each other. However, the policy must be applied consistently within each category. For example, an entity can apply the accounting policy for its trade receivables, and must do so for all trade receivables, but can choose not to apply the accounting policy for its lease receivables and contract assets.

b) *Can an entity use other practical expedients to measure ECLs?*

IFRS 9 allows the use of practical expedients in the measurement of ECLs so long as the measurement reflects:

- A range of unbiased and probability-weighted outcomes.
- The discounted present value of the ECLs.
- The consideration of historical events, current conditions and forecasts of future economic conditions if the information is available without undue cost or effort.

A common practical expedient applied to measure ECLs for trade receivables is the use of a provision matrix. A provision matrix could be as simple as assigning default rates to different time periods reflecting aging of the trade receivables. In contrast, a provision matrix could be more multifaceted if the entity experiences significantly different loss patterns for different customer segments. In such situations, the trade receivables would be categorized based on relevant criteria (e.g. geographical region, product type, customer rating, collateral or trade credit insurance and type of customer) with different default rates assigned to each grouping. Nevertheless, the provision matrix would be developed based on the entity's historical credit loss experience and adjusted for current conditions and future forecasts.

The example below demonstrates the use of a provision matrix which is expected to be used frequently in practice. The example also contrasts the accounting treatment under IFRS 9 versus IAS 39.

Note! IAS 39 allows a practical expedient whereby a creditor may measure the impairment of a financial asset carried at amortized cost on the basis of the instrument's fair value using an observable market price. Such a practical expedient is not available under IFRS 9.

Example of Determining a Loss Allowance for Trade Receivables Using a Provision Matrix

This example illustrates the mechanics of the impairment calculation applicable to trade receivables when using a provision matrix. The situation is assessed under both the IAS 39 and IFRS 9 standards below.

A Ltd., a trading company, has trade receivables with a gross carrying amount of \$1,000,000 at the end of 2018. Careful analysis of the trade receivables showed the following:

- A Ltd. serves a wide customer base of small clients and groups its trade receivables based on common credit risk characteristics that are representative of the customers' ability to pay all amounts due according to the contractual terms.
- The simplified approach under IFRS 9 applies to these trade receivables because they do not have a significant financing component. The receivables are all short-term in nature and the effect of discounting is immaterial.
- One of A Ltd.'s customers, debtor Z, filed for bankruptcy proceedings during 2018. A Ltd.'s receivable from debtor Z amounts to \$40,400 and A Ltd. expects to recover close to nil based on the limited information currently available regarding the value of the collateral held.
- Aging structure of the trade receivables is as follows (A Ltd. calculated historical loss rates for each past due category percentages):

Aging	Trade Receivables Balance (\$)	Historical Loss Rate (%)
Not past due	\$748,400	-%
1-30 days	104,600	0.22
31-90 days	55,200	4.30
91-180 days	26,400	7.00
181-365 days	15,000	14.00
365+ days	10,000	63.5
Debtor Z	40,400	N/A
Total	\$1,000,000	n/a

Example of Determining a Loss Allowance for Trade Receivables Using a Provision Matrix *(continued from previous page)*

Impairment per IAS 39

IAS 39 requires recognizing the impairment loss to the extent it has already been incurred. Future expectations are not considered; thus, A Ltd. needs to only examine the events leading to impairment loss that have already occurred. In the trade receivables portfolio, there is only one receivable with an incurred impairment loss, as the bankruptcy proceedings against debtor Z would represent a default event causing A Ltd. to likely not recover its trade receivable. This is often referred to as a specific provision.

As A Ltd. assumes the recovery on the one receivable will be close to nil, it will recognize a provision for credit losses (i.e., an allowance for doubtful accounts) amounting to 100% of the receivable's gross carrying amount of \$40,400. Additionally, a provision is recognized for losses that management estimates to have occurred in the remainder of the trade receivables portfolio. The provision is calculated by allocating the trade receivables into different groups based on common credit risk characteristics and estimating each group's future cash flows. The future cash flows are determined by applying the historical loss rates for assets with similar characteristics as those in the groups, adjusted for the effects of current conditions. This is often referred to as a collective provision.

Therefore, based on the adjusted historical loss rate, the total provision for credit losses under IAS 39 would be as follows:

Aging	Trade Receivables Balance (\$)	Historical Loss Rates Adjusted for Current Conditions (%)	Provision for Credit Losses (\$ x %)
Not past due	\$748,400	-%	\$-
1-30 days	104,600	0.25	262
31-90 days	55,200	4.50	2,484
91-180 days	26,400	8.00	2,112
181-365 days	15,000	15.00	2,250
365+ days	10,000	62.25	6,225
Debtor Z	40,400	100.00	40,400
Total	\$1,000,000	n/a	\$53,733

Impairment per IFRS 9

The provision for credit losses on debtor Z's receivable of \$40,400 will not be any different under IFRS 9. This receivable is credit-impaired and full lifetime ECLs is simply 100% of this receivable.

A Ltd. has reasonably supportable information that indicates that economic conditions will deteriorate over the next year. Therefore, the historical loss rates were adjusted to reflect this forward-looking information. To determine the ECLs for the other receivables, A Ltd. uses a provision matrix. As previously discussed, the provision matrix uses historically observed default rates over the expected life of the trade receivables, adjusted for current conditions and forward-looking estimates. At every reporting date, A Ltd. reviews and adjusts its historically observed default rates based on current conditions and changes in the future forecasts.

Example of Determining a Loss Allowance for Trade Receivables Using a Provision Matrix *(continued from previous page)*

Therefore, based on the historical loss rate adjusted for forward-looking information, the total provision for ECLs under IFRS 9 would be as follows:

Aging	Trade Receivables Balance (\$)	Historical Loss Rates Adjusted for Current Conditions and Forward-Looking Information (%)	Provision for ECLs (\$ × %)
Not past due	\$748,400	0.50%	\$3,742
1-30 days	104,600	0.80	837
31-90 days	55,200	5.60	3,091
91-180 days	26,400	8.90	2,350
181-365 days	15,000	20.30	3,045
365+ days	10,000	63.90	6,390
Debtor Z	40,400	100.00	40,400
Total	\$1,000,000	n/a	\$59,855

The calculations assume that the ECLs represented by the historical loss rates adjusted for forward-looking information has a 100% probability of occurring. Hence, there is an implied probability of 0% that no loss will occur. In addition, the receivables are short-term and hence no discounting of the impairment allowance is necessary.

Note! The impairment testing of trade receivables, lease receivables and contract assets under the new model could be similar to IAS 39. Specific and collective allowances could still be made with the exception that forward-looking information about credit loss events must be considered in the assessment and any practical expedients applied must be consistent with the principles discussed in IFRS 9.5.5.17.

Financial Instruments with Low Credit Risk at the Reporting Date

The standard offers a practical expedient for financial assets with low credit risk at the reporting date. IFRS 9 allows an entity to assume that there has not been a significant increase in credit risk for these instruments since their initial recognition. Therefore, with limited analysis, instruments with low credit risk may remain in Stage 1 and 12-month ECLs recognized if the entity so chooses.

A financial instrument has low credit risk, and the simplification can be applied, when all of the following exist:

- The financial instrument has a low risk of default – this is assessed by looking at the risk of default of the instrument itself without comparison to the risk of default of other instruments or other considerations, such as the credit risk of the geographic region within which the business operates.
- The borrower has a strong ability to meet its contractual cash flow obligations in the near term.
- It is not evident that adverse changes in future economic and business conditions will reduce the ability of the borrower to fulfil its contractual cash flow obligations.

Note! This is an optional simplification which allows increases in credit risk on high quality instruments to be monitored less closely. The simplification will be easier to apply to externally rated debt investments than other instruments subject to impairment.

a) *How does an entity determine whether a financial instrument has low credit risk?*

There are multiple approaches an entity may use to determine whether a financial instrument has low credit risk. Internal or external credit risk ratings, or other methodologies, may be used. However, the approach applied should be consistent with a globally understood definition of low credit risk and consider the risks and the type of financial instruments being assessed. For example, a financial instrument with an external rating of 'investment grade' may be considered to have low credit risk.

b) *Is a financial instrument required to be externally rated to be considered to have low credit risk?*

No. The use of external credit ratings is merely one approach and such ratings are not to be used blindly. Credit ratings or default rates published by external rating agencies may not always be updated in a timely manner. Therefore, when assessing credit risk, an entity should consider expected changes in ratings and changes needed to reflect entity and financial instrument specific conditions, current economic and business conditions, and forward-looking information.

Note! Even if an instrument is considered to have low credit risk (e.g. AAA-rated bonds), IFRS 9 requires that 12-month ECLs still be recognized.

c) *Does the fact that an instrument is collateralized automatically mean it has low credit risk?*

No. The fact that a financial instrument has collateral impacts the amount of ECLs recognized; however, it does not indicate that the instrument's credit risk is low. Furthermore, the assessment of the level of credit risk is not performed by comparing the credit risk of financial instruments with collateral against those without.

d) *Is a financial instrument considered to have low credit risk simply because it has a lower risk of default than the entity's other financial instruments or relative to the credit risk of the jurisdiction within which an entity operates?*

No. Whether a financial instrument has a low risk of default is assessed without comparison to the risk of default of other instruments or the jurisdiction.

e) *If an instrument has low credit risk in the previous reporting period and not the current reporting period, does it automatically mean lifetime ECLs should be recognized?*

No. In such a case, an entity determines whether there has been a significant increase in credit risk since initial recognition. This is the key question that determines whether 12-month or lifetime credit losses are recognized. This is discussed further in the following section of this guide.

Significant Increase in Credit Risk Since Initial Recognition

Recap! Once a financial asset experiences a significant increase in credit risk, lifetime ECLs are recognized instead of 12-month ECLs. Interest recognition remains on a gross basis (refer to *Diagram 1* and *Diagram 2*).

An entity is required to assess at each reporting date whether the credit risk on a financial instrument has increased significantly since initial recognition. Making this assessment, will likely require significant judgment because IFRS 9 does not have a specific definition or rule to apply.

As indicated in the diagram below, an entity compares the risk/probability of a default occurring on the financial instrument as at the reporting date with the risk/probability of a default occurring on the financial instrument as at the date of initial recognition.



The relevant factors to consider in making this assessment are discussed in more detail below.

a) *Why does an entity use the change in probability of default for this assessment and not the change in ECLs?*

An entity uses the change in the risk/probability of a default occurring over the expected life of the financial instrument because it is considered the most relevant factor in assessing credit risk. Furthermore, the process of tracking the risk/probability of default is consistent with an entity's credit risk management practices. Waiting for a change in the amount of ECLs would likely have a similar effect to the incurred loss model in IAS 39.

b) *How should an entity define a default which is to be used in this assessment?*

Interpretations of the term default may vary from broader judgmental definitions that consider qualitative indicators (e.g. covenants) to narrower, non-judgmental definitions focusing only on the failure to make a contractual payment. Therefore, there may be diversity in the definition of default applied by one entity as compared to another entity. However, the definition of default applied by a specific entity must be consistent with that used for its internal credit risk management purposes.

The definition of default should be applied consistently to all financial instruments. However, information may become available that demonstrates another default definition is more appropriate for a particular financial instrument. Nevertheless, there is a rebuttable presumption that a financial instrument cannot be in default later than 90 days past due unless reasonable evidence exists that supports a more lagging default criterion.

Note! It is expected that many less sophisticated entities will use the rebuttable presumption and, accordingly, assess at the reporting date whether the risk/probability of the loan becoming 90 days past due has increased significantly since initial recognition. The definition that the entity chooses will particularly impact the amount of 12-month ECLs recognized as a more lagging criterion will cause there to be a lower probability of default within the next 12 months.

c) *Can an entity compare the absolute risk of default occurring over time when making this assessment?*

Not necessarily. Comparing changes in the absolute risk of a default occurring over time is not sufficient for assessing changes in credit risk. There is a relationship between the expected life of a financial instrument and its risk of default – i.e., the risk of default typically decreases as the financial instrument’s maturity date approaches. However, while the risk of default may decrease or remain the same as time passes, there may be an increase in credit risk since initial recognition. For example, a financial instrument that has the same risk of a default occurring at initial recognition when it has an expected life of ten years than in a subsequent period when its remaining expected life is only five years may be indicative of an increase in credit risk.

Consideration of payment terms (e.g. payments are due throughout the term vs. at the end of the term) and other qualitative factors may influence the conclusion of whether credit risk has increased significantly since initial recognition despite the length of time to the maturity date.

d) *Can changes in the risk of a default occurring over the next 12 months be a reasonable approximation of the changes in the lifetime risk of a default occurring?*

Yes, if the probability of default is not expected to significantly differ at specific points during the expected life of the financial instrument based on the default patterns of comparable past financial instruments. In other cases, the 12 months risk of default may not be a suitable basis for determining whether credit risk has increased significantly since initial recognition (e.g. the majority of payments occur beyond the next 12 months; changes in credit-related factors are expected to impact a financial instrument’s credit risk beyond the next 12 months; etc.).

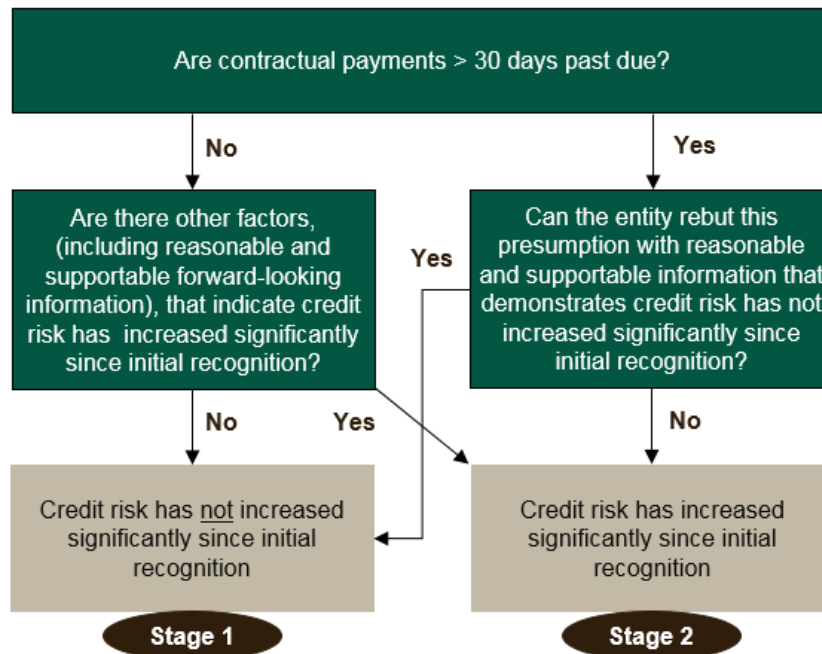
e) *To what extent can past due information be used to make this assessment?*

Past due information is commonly utilized in determining whether there has been a significant increase in credit risk since initial recognition. Moreover, IFRS 9 sets out a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. However, this presumption may be refuted by reasonable and supportable information (including macroeconomic factors on a portfolio level) when available without undue cost or effort.

Note! Past due information is considered to be a lagging indicator. An entity cannot rely solely on past due or historical information if reasonable and supportable forward-looking information is available without undue cost or effort. The requirement to consider forward-looking information prevents an entity from automatically reverting to the incurred loss model under IAS 39.

The rebuttable presumption does not represent conclusive evidence that lifetime ECLs should be recognized. Regardless, it is presumed that lifetime ECLs would not be recognized later than the point at which a financial asset is 30 days past due. The diagram below sets out this thought process which may be helpful in practice to ensure that past due and forward-looking information is considered appropriately.

Note! The rebuttable presumption is based on information that an entity typically has readily available. It may provide a quick way of identifying financial instruments for which credit risk has significantly increased. Therefore, in practice, it may be helpful to consider it first. Additional analysis can then be performed for instruments where contractual payments are less than 30 days past due, if applicable, or to assess whether the presumption should be rebutted.



Examples of Rebutting the Presumption that Credit Risk Has Significantly Increased if 30 Days Past Due
(Adapted from IFRS 9.B5.5.20)

An administrative error resulted in the non-payment rather than financial difficulty of the borrower.

An entity’s historical information reveals a link between significant increases in the risk of a default occurring and financial assets on which payments are more than 60 days past due.

f) *What information should be used for the assessment?*

As previously noted, an entity should use historical information, adjusted for current conditions and forward-looking information, if available without undue cost or effort, when assessing the level of credit risk of a financial asset. An extensive search for information is not necessary but an entity is required to consider all reasonable and supportable information, including forward-looking information that is available without undue cost or effort and is indicative of significant increases in credit risk. This information should include actual and expected changes in external market indicators, internal factors and borrower-specific information. The characteristics of the financial instrument (or group of financial instruments) and the default patterns also need to be considered. Appendix A of this guide contains a list of information that may be relevant to this assessment.

g) Is the assessment made on an instrument or aggregated level?

Impairment must first be assessed at an individual financial instrument level. However, in some instances, the assessment will need to be made at a more aggregated level (i.e., portfolios, groups of portfolios or portions of a portfolio of financial instruments) because certain factors or indicators may not be identifiable on an individual financial instrument level.

Credit risk analysis entails a complete assessment of multiple factors. The relevance of a specific factor, and its significance compared to other factors, will depend on the type of product, characteristics of the financial instruments and the borrower as well as the geographical region.

h) Is statistical quantitative information or a credit ratings process required?

No. Sometimes, an entity may be able to complete its assessment based on qualitative and non-statistical quantitative information only. In other cases, a more detailed assessment may be required that includes information from an entity's statistical models or credit ratings processes. Alternatively, an entity may incorporate both types of information in its assessment (i.e., qualitative factors that are not captured through the internal ratings process and a specific internal rating category at the reporting date compared to credit risk characteristics at initial recognition).

i) Can an entity align the timing of significant increases in credit risk and the recognition of lifetime ECLs to when a financial asset is regarded as credit-impaired or to an entity's internal definition of default?

No. Significant increases in credit risk are normally identified, and lifetime ECLs recognized, before a default occurs or the financial asset becomes credit-impaired, either on an individual or collective basis.

Example of Information to Consider in Determining a Significant Increase in Credit Risk

Prairie Credit Union (the "Credit Union") provides mortgages and personal loans to residents of a small town. As part of its loan application process, the Credit Union requests specific information about the borrower and the property to be mortgaged such as employment/business details, the location of the residence and the appraised value of the property. The Credit Union monitors the change in the risk of default of individual mortgages based on the length of time the contractual payments are past due. For the Credit Union's mortgages, the ratio of its first mortgage lien value as a percentage of the total appraised value of real property is 80%.

An oil production plant is the largest employer in town. The Credit Union anticipates that due to the declining oil prices there may be reduced operations resulting in layoffs. This will negatively impact a large number of the Credit Union's members.

Assessment: The Credit Union is required to consider both past due and forward-looking information that is available without undue cost or effort when assessing whether there has been a significant increase in credit risk for their mortgages portfolio. Within its loan system, the Credit Union can categorize its mortgages to identify those members who are employed by the oil production plant. The Credit Union groups the mortgages further based on their past due status. The value of the collateral (i.e., the property) attached to the individual mortgages is reflected in the estimate of lifetime ECLs. Depending on the value of the collateral compared to the outstanding balance on the mortgages, the amount of lifetime ECLs recognized may be immaterial.

Note! The security on a loan affects the amount of the loss that would be realized if a default occurs but does not affect the risk of a default occurring. Therefore, it is not considered when determining whether there has been a significant increase in credit risk since initial recognition.

Example of Evaluating a Significant Increase in Credit Risk (Adapted from IFRS 9.IE7-IE11 Example 1)

Lender X has made a loan to Company Y. The loan had a high credit risk upon issuance because Company Y already held a significant amount of debt resulting in a high debt-to-asset ratio. Company Y has positive revenue and cash flow forecasts, which make it likely that Company Y will meet the loan covenants over the life of the instrument.

At initial recognition, because of the factors outlined above, Lender X considers that, despite the level of credit risk at initial recognition, the loan is not an originated credit-impaired loan because it does not meet the definition of a credit-impaired financial asset in IFRS 9 Appendix A.

The following reasonable and supportable information is available to Lender X, without undue cost or effort, at the subsequent reporting period with respect to its loan to Company Y:

- A downturn in the economy resulted in anticipated sales not materializing despite Company Y's additional investment in inventory.
- A new competitor for Company Y's product has emerged and is gaining momentum. The competitor's product uses a new technology that customers claim gives superior results.
- Company Y has some traded bonds and the credit risk on those bonds have increased during the last year.
- Lender X expects that the economy could go into a recession and Company Y's results may further deteriorate.
- Company Y's debt-to-asset ratio has further increased because it needed to draw on additional credit facilities and is now close to breaching its covenants on the loan to Lender X. The loan may need to be restructured and covenants renegotiated.
- An increase in the internal credit risk grading is expected although not yet confirmed by the department within Lender X responsible for setting the internal risk rating grades.

Assessment: Lender X determines that the credit risk on the loan to Company Y has significantly increased since initial recognition. Internal credit ratings are only one factor that may be used to assess an increase in credit risk. Therefore, the fact that Lender X has not yet downgraded its credit rating of the loan doesn't preclude it from concluding that there has been a significant increase in credit risk based on the consideration of other factors. Accordingly, Lender X recognizes lifetime ECLs on the loan.

Note! A loan can have a very high credit risk at initial recognition and not be considered purchased or originated credit-impaired. It will only move to Stage 2 once there has been a significant increase in credit risk since initial recognition. However, the probability of default used in the 12-month calculations and expectations of credit losses may be higher for such loans than for loans with lower credit risk who are also in Stage 1.

Credit-Impaired Financial Assets

Recap! Once a financial asset has become credit-impaired, interest is recognized on a net basis instead of a gross basis. Lifetime ECLs continue to be recognized (refer to *Diagram 1* and *Diagram 2*).

A financial asset is credit-impaired when one or more events that have an unfavourable impact on its estimated future cash flows have occurred. When observable data about the following events exist, this supports the determination that a financial asset is credit-impaired:

- Borrower or issuer is experiencing significant financial difficulty;
- A breach of contract, such as a default or past due event;
- The granting of an uncustomary concession(s) by the lender(s) as a result of the borrower's financial difficulty;
- A high likelihood of bankruptcy or other financial reorganization by the borrower;
- The loss of an active market for that financial asset because of financial difficulties; or
- The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

Either a single discrete event or the combined effect of several events may result in financial assets becoming credit-impaired.

Note!

- Forward-looking information is less relevant in the assessment of whether a financial asset is credit-impaired because these "events" have actually occurred.
- IAS 39 referred to objective evidence of impairment and listed certain examples in IAS 39.59. Most of these examples are now included in the definition of credit-impaired financial assets as noted above.
- Under IAS 39, many entities regarded financial assets as having objective evidence of impairment when payments were 90 days past due. It may still be appropriate to apply the 90 days past due criterion under IFRS 9 to determine when a financial instrument has moved into Stage 3 and lifetime ECLs should be recognized.

Measurement of ECLs

In summary, the measurement of ECLs reflects:

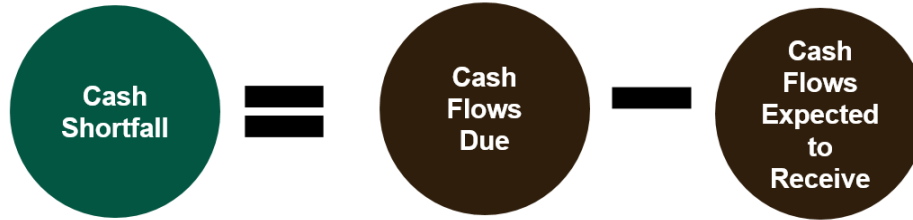
- A range of unbiased and probability-weighted outcomes.
- The discounted present value of the ECLs.
- The consideration of historical events, current conditions and forecasts of future economic conditions if the information is available without undue cost or effort.

ECLs are a probability-weighted estimate of credit losses (i.e., the present value of all cash shortfalls) over the expected life of the financial instrument. This can be described in the following steps:

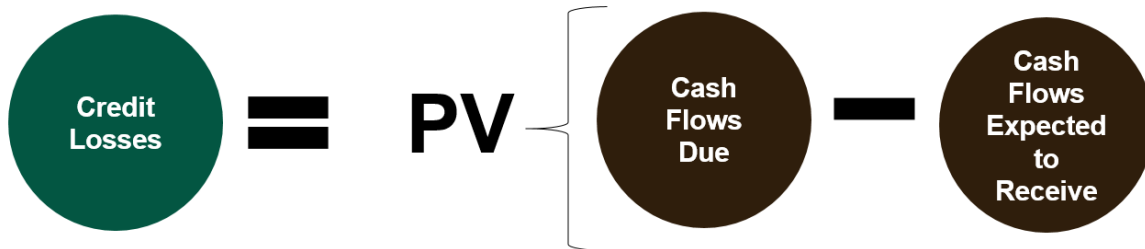
a) Step 1: Determine Credit Losses as the Present Value of Cash Shortfalls

A cash shortfall is the difference between:

- The contractual cash flows that are due to an entity; and
- The cash flows that the entity expects to receive.



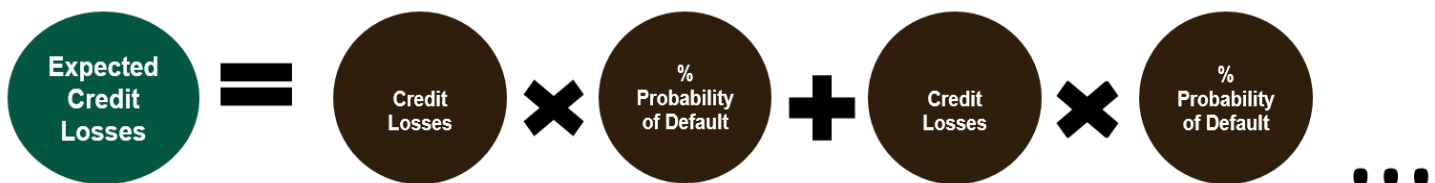
For financial assets, a credit loss is the present value of the cash shortfall.



ECLs are still recognized whether the entity expects to be paid in full but at a later date than contractually agreed to. This is due to the fact that both the amount and timing of payments are included in the calculation of ECLs.

b) Step 2: Apply a Probability Weighting to Calculated ECLs

ECLs = credit losses multiplied by the probability of default occurring.



Recap! Although every possible scenario is not required to be identified, the estimate should always reflect at least two scenarios:

- The probability that a credit loss occurs, even if this probability is very low; and
- The probability that no credit loss occurs.

ECLs are not meant to represent the worst or best-case scenarios.

a) What is the period over which ECLs are estimated?

An entity should calculate ECLs for the maximum expected life of the financial asset (i.e., both the original term of the financial asset plus any extension options available). There may be circumstances where a longer period may be consistent with business practice; however, ECLs should not be measured based on this period as it does not reflect the period over which the entity is exposed to credit risk.

b) *How does collateral impact the measurement of ECLs?*

As previously noted, ECLs represent the weighted-average of the probable discounted cash shortfalls. Therefore, collateral and other credit enhancements are incorporated into the measurement of ECLs in the following manner:

- Cash shortfalls – the value of the collateral, net of costs to obtain and sell it, is reflected in the cash flows expected to be received balance when calculating cash shortfalls. The value of the collateral would be discounted based on the expected timing of these cash flows even if beyond the contractual maturity of the financial asset.
- Probability of default – The probability of foreclosure is reflected in the probability of default percentages used as weights in the calculation of ECLs.

Note! Collateral is considered in the calculation of cash shortfalls despite whether it is probable that foreclosure will occur. This is because the probability of foreclosure is already reflected within the probability of default percentages applied as weights in the ECLs calculation.

If the collateral meets the relevant criteria to be recognized as a separate asset from the collateralized financial instrument, the collateral is not reflected in the measurement of ECLs.

ECLs could be small or nil for collateralized financial assets. For example, for a commercial or mortgage loan issued by a lender, an increase in credit risk may have occurred on the loan since initial recognition because of an economic recession and the borrower missing a contractual payment. It is also expected that the borrower may not be able to repay further monthly instalments. However, if the expected proceeds from the collateral (i.e., the secured tangible asset) exceed the loan amount, then the entity may have an ECL allowance of zero.

c) *How does the reclassification of financial assets impact the measurement of ECLs?*

There is no impact on the measurement of ECLs when reclassifying a financial asset between the amortized cost and FVOCI measurement categories. This is because both measurement categories apply the same impairment approach. However, as at the reclassification date, there is a change in the presentation of the impairment loss in the statement of financial position.

If the financial asset is reclassified from the FVOCI to the amortized cost category, the accumulated impairment loss is removed from OCI and reflected as an impairment loss allowance, adjusted against the gross carrying amount of the financial asset. Conversely, if the financial asset is reclassified from the amortized cost to the FVOCI category, the impairment loss allowance recorded against the gross carrying amount of the financial asset is derecognized and recorded as an accumulated impairment loss in OCI.

If the financial asset is reclassified out of the FVTPL category to any other category, there is no existing impairment loss to reclassify as an impairment assessment is not required for financial assets measured as at FVTPL. However, an impairment assessment would be performed as at the reclassification date. If the financial asset is reclassified into the FVTPL category from the amortized cost category, any difference between the previous amortized cost balance and the asset's fair value is recognized in profit or loss. Thus, all or a portion of any previous impairment loss allowance may be reflected in the asset's fair value as at the reclassification date and/or as an impairment loss in profit or loss. Lastly, if the financial asset is reclassified into the FVTPL category from the FVOCI category, the asset continues to be recognized at fair value and any accumulated gain or loss in OCI, which would include any impairment loss, would be reclassified to profit or loss.

Measurement Approaches

There are a variety of measurement approaches that an entity may use to calculate ECLs. Furthermore, an entity need not apply the same approach for all financial instruments. As mentioned earlier, practical expedients which are consistent with the measurement principles can be used to measure ECLs. A provision matrix approach, as discussed under *Exception 2: Simplified Approach for Trade and Leases Receivables and Contract Assets*, may be an appropriate approach.

One measurement approach is the probability of default approach, as presented in the example below.

Example of Probability of Default Approach (Adapted from IFRS 9.IE49-IE50 Example 8: Scenario 1)

Mortgage Investment Company Y (MICY) provided a 10-year residential mortgage for \$2,000,000.

At initial recognition of the mortgage, MICY determines the following on the basis of the most relevant and supportable information available:

- A 12-month probability of default (PD) of 0.75% when considering historical results and current expectations of similar financial instruments, the borrower's financial condition and economic forecasts for the next 12 months.
- It has been determined that the changes in the 12-month PD reasonably approximate the lifetime PD when assessing if there has been significant increase in credit risk.
- The Loan Given Default (LGD) is 25% - i.e., the estimated loss amount of the gross carrying amount of the loan if it were to default.

Assessment: There has been no change in the 12-month PD nor a significant increase in credit risk since initial recognition. Therefore, the mortgage falls in Stage 1. MICY calculates the 12-month ECL allowance as \$3,750 ($\$2,000,000 \times 0.75\% \text{ PD} \times 25\% \text{ LGD}$).

Another example of a measurement approach is a loss rate approach. The loss rate approach may only be used if the entity can separately identify the changes in the various inputs driving the ECLs (e.g. probability of default, collateral, etc.).

The following factors should also be considered when making the impairment assessment:

- The change in the probability of default since initial recognition;
- The expected life of the financial instrument;
- Reasonable and supportable information that is available without undue cost or effort.

Example of Loss Rate Approach (Adapted from IFRS 9.IE53-IE57 Example 9)

Lender X has a portfolio of 200 loans with a total gross carrying amount of \$250,000. At initial recognition, the portfolio is separated into two borrower groups (Group A and B) on the basis of shared credit characteristics.

- Group A has 100 loans at \$1,000 per client for a total gross carrying amount of \$100,000.
- Group B has 100 loans of \$1,500 per client for a total gross carrying amount of \$150,000.
- For simplicity, the loans have no transaction costs and include no options, premiums or discounts, points paid, or other fees associated.
- Historical loss rates for Group A loans are 4.5% based on 5 past defaults and Group B loans are 2% based on 3 past defaults.

Example of Loss Rate Approach (continued from previous page)

ECLs are measured using the loss rate approach for Groups A and B based on Lender X's historical default and loss experience.

	Number of Clients in Sample	Estimated per Client Gross Carrying Amount at Default	Total Estimated Gross Carrying Amount at Default	Historical Defaults	Total Estimated Gross Carrying Amount of Expected Defaulted Loans	Present Value of Observed Loss	Loss Rate
Group	A	B	C = A x B	D	E = B x D	F	G = F ÷ C x 100
A	100	\$1,000	\$100,000	5	\$5,000	\$4,500	4.5%
B	100	\$1,500	\$150,000	3	\$4,500	\$3,000	2.0%

Based on current and forecast economic conditions, Lender X expects an increase in defaults over the next 12 months compared to the historical rate at the reporting date. Lender X estimates 6 defaults in Group A and 4 defaults in Group B in the next 12 months. It estimates the present value of the observed credit loss per client will remain the same as the historical loss per client (i.e., \$900 for Group A and \$1,000 for Group B). Lender X determines that the expected increase in defaults does not represent a significant increase in credit risk since initial recognition for the portfolios based on the expected life of the loans.

Assessment: As the expected increase in defaults does not represent a significant increase in credit risk since initial recognition, the loss allowance is measured at an amount equal to the 12-month ECLs on the 100 loans in Group A and B at \$5,400 and \$4,000, respectively. This represents a loss rate in the first year of 5.4% for Group A and 2.67% for Group B.

	Number of Clients in Sample	Estimated per Client Gross Carrying Amount at Default	Total Estimated Gross Carrying Amount at Default	Expected Defaults	Total Estimated Gross Carrying Amount of Expected Defaulted Loans	Present Value of Observed Loss	Loss Rate
Group	A	B	C = A x B	D	E = B x D	F	G = F ÷ C x 100
A	100	\$1,000	\$100,000	6	\$6,000	\$5,400	5.4%
B	100	\$1,500	\$150,000	4	\$6,000	\$4,000	2.67%

Lender X uses the loss rates of 5.4% and 2.67% to estimate 12-month ECLs on new loans originated during the year in Group A and B, respectively, and for which credit risk has not increased significantly since initial recognition.

Therefore, if \$100,000 new loans were originated during the year in each group the 12-month ECLs allowance for these new loans would be $\$100,000 \times 5.4\% + \$100,000 \times 2.67\% = \$5,400 + \$2,670 = \$8,070$.

Time Value of Money

As previously noted, the estimate for ECLs should reflect the time value of money, discounted to the reporting date.

The standard provides guidance on the discount rates used to calculate the present value of the ECLs or cash shortfalls which are summarized in the table below:

Instrument	Time Value of Money – ECLs Shall be Discounted Using...
Purchased or originated credit-impaired financial assets	Credit-adjusted effective interest rate determined at initial recognition.
Lease receivables	Same discount rate used in the measurement of the lease receivable in accordance with IAS 17/IFRS 16*.
Loan commitments	The effective interest rate, or an approximation thereof, that will be applied when recognizing the financial asset resulting from the loan commitment**.
Loan commitments for which the effective interest rate cannot be determined	A discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.
Financial guarantee contracts	
Other financial assets subject to impairment	The effective interest rate calculated at initial recognition or an approximation thereof.
Financial instruments with variable interest rates	The current effective interest rate, if applicable***.

* IAS 17 requires a lessor to present finance lease receivables at an amount equal to the net investment in the lease, which uses a discount rate equivalent to the interest rate implicit in the lease. This is the same under IFRS 16 which replaces IAS 17 effective for annual periods on or after January 1, 2019.

** Use of the effective interest rate of the asset that is recognized once the commitment is drawn down gives rise to a consistent rate for a credit facility that includes both a loan (i.e., a financial asset) and an undrawn commitment (i.e., a loan commitment). If such an effective interest rate is not determinable, entities are required to use the current risk-free rate (i.e., the discount rate that reflects the current market assessment of the time value of money).

*** For floating-rate financial assets, the calculation of cash flows must be periodically re-estimated to reflect current market rates of interest. The change in cash flows modifies the effective interest rate. If a floating-rate financial asset is recognized initially at an amount equal to the principal receivable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset.

Reasonable and Supportable Information

ECLs are estimated using reasonable and supportable information that is available without undue cost or effort. It is not expected that an extensive search be performed nor that the information cover the entire expected life of the financial asset. However, an entity must consider all information that is reasonably attainable pertaining to the borrower, past events, and general current and future economic conditions. Any projections regarding future economic conditions may be extrapolated when detailed information is not available for the entire expected life of the instrument. Information available for financial reporting purposes must be analyzed when calculating ECLs for a financial asset.

Reasonable and supportable information may be obtained from a variety of internal (entity-specific) and external sources, including:

- Historical credit loss experience of the entity and/or its peers;
- Internal credit risk ratings or forecasts;
- External ratings, reports and statistics (e.g. interest rate and unemployment forecasts from Chartered Banks or Statistics Canada and credit score information); and
- Peer group experience for comparable financial instruments (or groups of financial instruments) where insufficient sources of entity-specific data exist.

Note! Historical information, such as credit loss experience, is an important starting point to which an entity makes adjustments on the basis of reasonable and supportable information that incorporates both current conditions and its forecasts of future conditions. In some cases, adjustments are made to remove the effects of conditions in the historical period that are not relevant to future contractual cash flows. In other cases, unadjusted historical information may be the best reasonable and supportable information.

Individual vs. Collective Assessments

The objective of an impairment assessment is to recognize ECLs based on a financial asset's level of credit risk. An entity would first attempt to determine whether there has been a significant increase in credit risk since initial recognition for each individual financial asset. However, in some instances, a significant increase in credit risk may not be evident on an individual instrument basis before the financial instrument becomes past due. For example, a lender may not monitor the credit risk on its individual commercial mortgages until a customer actually misses a payment. Therefore, performing an impairment assessment on an individual basis would not faithfully represent changes in credit risk since initial recognition.

When an individual assessment is not possible, an entity must consider all reasonable and supportable information available without undue cost or effort to determine whether there has been a significant increase in credit risk on a collective basis (i.e., at a group or sub-group level). To do so, an entity can group financial instruments on the basis of shared credit risk characteristics. This grouping could be similar to that previously established under IAS 39.

The standard provides the following examples of shared credit risk characteristics:

- Instrument type;
- Credit risk ratings;
- Collateral type;
- Date of origination;
- Remaining term to maturity;
- Industry;
- Geographical location of the borrower; and
- The value of collateral relative to the financial asset if it has an impact on the probability of default occurring (e.g. loan-to-value ratios for non-recourse loans in some jurisdictions).

The aggregation of financial instruments may change over time as new information becomes available.

Examples of Collective Assessment *(Adapted from IFRS 9.IE38-IE39 Example 5)*

Example 1:

Mortgage Investment Company Y (MICY) has a mortgage portfolio comprised of residential mortgages on real estate in Calgary where the real estate values are largely dependent on the production and export of natural gas and related products. Recently, there was a significant decrease in the price of natural gas and exports have declined. MICY expects that unemployment rates will increase and the risk of default on mortgages to borrowers employed in the natural gas industry has increased significantly, even if those borrowers are not past due at the reporting date. Reasonable and supportable information is not yet available to assess whether there has been a significant increase in credit risk since initial recognition of specific individual mortgages.

Assessment: Since there is insufficient evidence to assess the credit risk of individual mortgages, MICY performs an impairment assessment on a collective basis. MICY segments its mortgage portfolio based on industries (i.e., a shared credit risk characteristic) to identify borrowers that rely on natural gas whether for employment or their main business. As there has been a significant increase in credit risk on this segment of the portfolio, a loss allowance equal to lifetime ECLs is recognized.

However, MICY continues to recognize a loss allowance equal to 12-month ECLs for newly originated loans to borrowers who rely on natural gas because these have not experienced a significant increase in credit risk since initial recognition.

Example 2:

Credit Union Z has a homogeneous portfolio of variable interest rate mortgages in a specific region. Based on the Credit Union's historical information, it established that an increase in interest rates is a major indicator of future defaults on similar mortgages in the region. Specifically, Credit Union Z estimates that an anticipated increase in interest rates of 1.5% will result in a significant increase in credit risk on 15% of the variable interest rate portfolio. Credit Union Z cannot identify sub-segments within the portfolio on the basis of shared risk characteristics that represent mortgages expected to have increased significantly in credit risk.

Assessment: Credit Union Z assesses if there is a significant increase in credit risk since initial recognition on the overall variable interest rate mortgage portfolio using information on expected increases in interest rates during the expected life of the mortgages. Since it is anticipated that an increase in interest rates will significantly increase the credit risk in 15% of the variable interest rate portfolio, Credit Union Z recognizes lifetime ECLs on 15% of the portfolio and 12-month ECLs on 85% of the portfolio.

Note! Example 2 above specifically applies to variable interest rate loans where increases in interest rates have a significant impact on the credit quality of these loans compared to fixed rate loans. In Canada, we are currently in a very low interest rate environment so there is an expectation that interest rates will increase at some point. Actual, and anticipated, increases in interest rates since initial recognition should be considered when evaluating whether there has been a significant increase in credit risk for variable interest rate loans. Reasonable supportable forward-looking information on expected interest rate increases are published by the Chartered Banks and economists. Treasury departments typically forecast interest rates when setting their fixed rates and establishing their budgets. Actual interest rate increases are announced by the Bank of Canada.

Furthermore, the fact that we are in a low interest rate environment may also influence other calculations and assumptions relating to impairment (e.g. the probabilities of defaults used in the measurement of ECLs).

Impairment of Loan Commitments

Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. Examples of loan commitments are revolving facilities such as credit cards, overdraft facilities and credit lines.

As mentioned earlier, for undrawn loan commitments the ECL allowance is recognized as a provision in the statement of financial position because undrawn loan commitments are not recognized until drawn.

a) *What if an entity estimates ECLs on an instrument (facility) level and are therefore not able to distinguish the ECLs related to the drawn component (the financial asset) and the undrawn component (the loan commitment)?*

This is often the case for partly used credit lines, credit card limits, etc. In such a situation, the ECLs on a loan commitment should be presented together with the loss allowance for ECLs on the associated financial asset. To the extent that the total ECLs exceed the gross carrying amount of the associated financial asset recognized in the statement of financial position, the remaining balance of ECLs should be presented as a provision.

b) *Would an entity recognize a loss allowance for revocable loan commitments?*

This depends on whether the issuer of the revocable loan commitment has exposure to credit risk as demonstrated in the table below.

Instrument	Exposure to Credit Risk?
Irrevocable loan commitments	Yes. The issuer has a present legal obligation to extend credit as a result of a past event. The issuer has no discretion to avoid having to advance the loan. Therefore, by entering into the loan commitment, the issuer is exposed to credit risk.
Revocable commitments with notice period	The issuer has a present obligation to extend credit until the notice period lapses. While the issuer has discretion to cancel the facility by giving notice, it cannot prevent the drawdown of credit before the notice period lapses. Given that the entity has no discretion to avoid the draw down, it is exposed to credit risk.
Revocable loan commitment that can be cancelled immediately without a notice period (e.g. a credit card product in which each transaction is specifically reviewed and approved at the point of sale and the cardholder's ability to spend can be cancelled immediately at the credit card company's discretion at any time).	<p>The issuer does not have a present legal obligation to extend credit. In other words, those facilities are non-binding agreements.</p> <p>The credit card company has no legal obligation to extend credit at any time and is not exposed to ECLs that are the result of an existing credit exposure until the funds are advanced.</p>

c) *Over what period should an entity estimate ECLs for loan commitments?*

An entity should calculate ECLs for the maximum expected life of the financial asset; for loan commitments, this would be the maximum contractual period over which an entity has a present contractual obligation to extend credit. However, a longer period may be appropriate when the financial instrument includes both a drawn and undrawn component. Because there is a drawn component, an entity is exposed to credit risk beyond the contractual notice period for cancellation of the loan commitment.

For example, revolving credit facilities, such as credit cards and overdraft facilities, can be contractually cancelled by the lender with as little as one day's notice. However, in practice, lenders do not monitor and assess the credit risk of each individual credit facility on a daily basis. Rather, lenders manage these credit facilities on a collective basis and only cancel a specific credit facility when the borrower's credit risk has increased. Therefore, this approach exposes the lender to credit risk beyond the contractual cancellation period.

Note! The IASB noted that most loan commitments will expire at a specified date, and if an entity decided to renew or extend its commitments, it will be a new instrument for which the entity has the opportunity to revise the terms and conditions. Consequently, the IASB confirmed that the period over which ECLs are estimated is the contractual term over which the entity is committed to provide credit. This is the case even if an entity has a past practice of renewing the instrument and renewals are likely.

d) How does an issuer of loan commitments with both drawn and undrawn components estimate the period over which it is exposed to credit risk but for which ECLs would not be mitigated by the entity's normal credit risk management actions?

Consider factors such as historical information and experience about:

- The period over which the entity was exposed to credit risk on similar financial instruments;
- The length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and
- The credit risk management actions that the entity expects to take once the credit risk on the financial instrument has increased (e.g. the reduction or removal of undrawn limits).

Example of Revolving Facilities with Drawn and Undrawn Components *(Adapted from IFRS 9.IE58-65 Example 10)*

Bank H provides credit cards to its members. The credit card contract terms state that the Bank is able to cancel the credit card (both the drawn and undrawn components) with one day's notice. Bank H assesses impairment on its credit card commitments on a collective basis and does not monitor an individual customer's credit risk until that customer has missed a payment. It also monitors the credit risk on a facility level rather than on the drawn and undrawn components separately.

At year-end, the credit card portfolio has an outstanding balance of \$70,000 and the available undrawn balance is \$30,000. Based on relevant historical and forward-looking information, Bank H determines that the expected life of the credit card portfolio (i.e., the period over which it expects to be exposed to credit risk on the facilities) is 24 months. Furthermore, Bank H determines that 30% of the portfolio (based on outstanding balances) experienced a significant increase in credit risk since initial recognition. The outstanding balance on these credit facilities for which lifetime ECLs (i.e., those in Stage 2) should be recognized is \$21,000 (30% x \$70,000). The undrawn portion for these cards are \$9,000 (30% x \$30,000). The outstanding balance on these credit facilities for which 12-month ECLs (i.e., those in Stage 1) should be recognized is \$49,000 (70% x \$70,000). The undrawn portion for these cards are \$21,000 (70% x \$30,000).

Bank H also considers expected future draw-downs over the expected life of the portfolio (i.e., 24 months) and estimates what the outstanding balance (i.e., exposure at default or "EAD") on the portfolio would be if customers were to default. It determines that the expected draw-downs until default for the credit card facilities in Stage 1 and 2 are \$6,000 and \$4,000, respectively.

Assessment: The EAD on the credit card facilities in Stage 2 is \$25,000 (i.e., the drawn balance of \$21,000 plus further draw-downs of \$4,000 from the available undrawn commitment).

The EAD on the credit card facilities in Stage 1 is \$55,000 (i.e., the drawn balance of \$49,000 plus further draw-downs of \$6,000 over the next 12 months from the available undrawn commitment).

The EAD and expected life determined by Bank H are used to measure the lifetime ECLs and 12-month ECLs on its credit card portfolio.

e) IFRS 9 requires that an entity determine whether a significant increase in credit risk has taken place since initial recognition. What is the date of initial recognition for the purposes of applying the impairment requirements to loan commitments?

The date of initial recognition is the date that the entity becomes a party to the irrevocable commitment.

For loan commitments, an entity considers changes in the risk of default occurring on the loan to which a loan commitment relates to assess whether there has been a significant increase in credit risk since initial recognition.

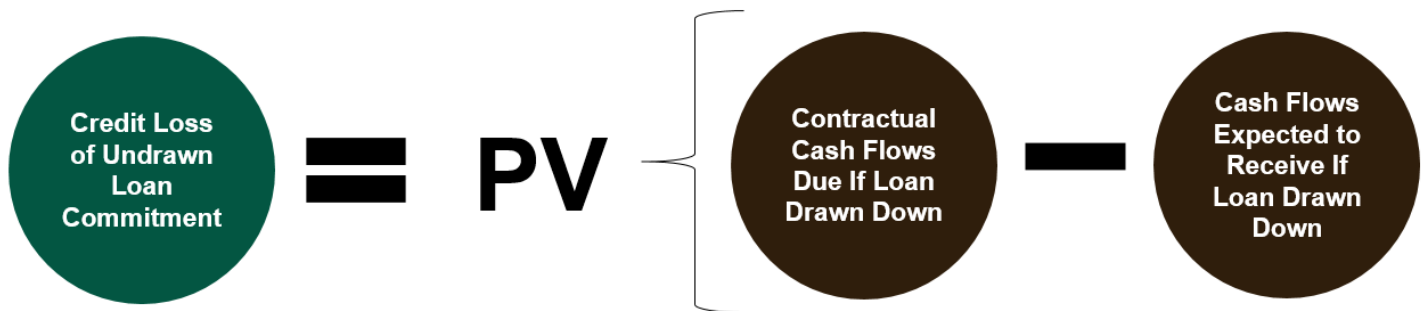


Note! To make the assessment of whether a significant increase in credit risk has taken place for loan commitments, an entity would need to assess credit risk at the origination of the loan commitments rather than when each loan amount is drawn down. This will require maintaining and storing such information over the period of the loan commitments which may be a fairly long period in the case of credit card and revolving loan facilities.

f) How are ECLs determined?

For undrawn loan commitments, a credit loss is the present value of the difference between:

- The contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and
- The cash flows that the entity expects to receive if the loan is drawn down.



An entity's estimate of ECLs on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment as follows:

ECLs Based on...	Then Consider Expected Portion of the Loan Commitments that will be Drawn Down
12-month ECLs	Within 12 months of the reporting date
Lifetime ECLs	Over the expected life of the loan commitment

Note! Measuring ECLs for loan commitments is complex and may involve significant judgments. When measuring ECLs of loan commitments, additional uncertainty arises in respect of one of the input factors, namely, the exposure at default. To measure the exposure at default of the loan commitments, the issuer needs to estimate the amount that a borrower will have drawn down at the time of default. That is, the issuer needs to estimate the part of the undrawn facility that the borrower will convert into a funded amount, typically referred to as a credit conversion factor or an utilization rate. Some financial institutions are required to make similar assessments for regulatory capital purposes.

Example of Determination of ECL

On December 31, 2018, Lender ABC granted a total of \$10 million overdraft facilities, which remained undrawn as of that date. Lender ABC considers that \$8 million is in Stage 1 (i.e., there is no significant increase in credit risk of these facilities since initial recognition). Of the \$8 million in Stage 1, \$4 million is expected to be drawn down within the next 12 months, with a 10% probability of default over the next 12 months and 100% loss given default. Assume the present value of the expected withdrawals are also \$4 million given the one-year timeframe. Lender ABC considers that \$2 million is in Stage 2 (i.e., there is a significant increase in credit risk of these facilities since initial recognition) and \$2 million is expected to be drawn down over the remaining life of the facilities with a 25% probability of default and 100% loss given default. The present value of the \$2 million included in Stage 2 is \$1.5 million at December 31, 2018.

The ECLs will be determined as:

Stage 1: \$4 million × 10%	\$400,000
Stage 2: \$1.5 million × 25%	375,000
Total	\$775,000

The ECLs against the undrawn facilities of \$775,000 would be recognized as a provision in the statement of financial position, and as an impairment loss in the income statement.

g) Which discount rate should be used to discount ECLs for loan commitments?

As previous discussed, the discount rate used to discount ECLs is as follows:

Instrument	Time Value of Money – ECLs Shall be Discounted Using...
Loan commitments	The effective interest rate, or an approximation thereof, that will be applied when recognizing the financial asset resulting from the loan commitment*.
Loan commitments for which the effective interest rate cannot be determined	A discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.

* Use of the effective interest rate of the asset that is recognized once the commitment is drawn down gives rise to a consistent rate for a credit facility that includes both a loan (i.e., a financial asset) and an undrawn commitment (i.e., a loan commitment). If such effective interest rate is not determinable, entities are required to use the current risk-free rate (i.e., the discount rate that reflects the current market assessment of the time value of money).

Impairment of Financial Guarantee Contracts

Under a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor.

As with loan commitments, the ECL allowance for financial guarantee contracts is recognized as a provision as there is no amount on the statement of financial position to offset the allowance against.

a) IFRS 9 requires that an entity determine whether a significant increase in credit risk has taken place since initial recognition. What is the date of initial recognition for the purposes of applying the impairment requirements to financial guarantee contracts?

For financial guarantee contracts, the date of initial recognition is the date that the entity enters into the binding agreement.

An entity compares the change in the default risk that a borrower will fail to honour its obligations under a financial guarantee contract as at initial recognition and the reporting date.



b) *What is the period that the ECLs should be estimated for?*

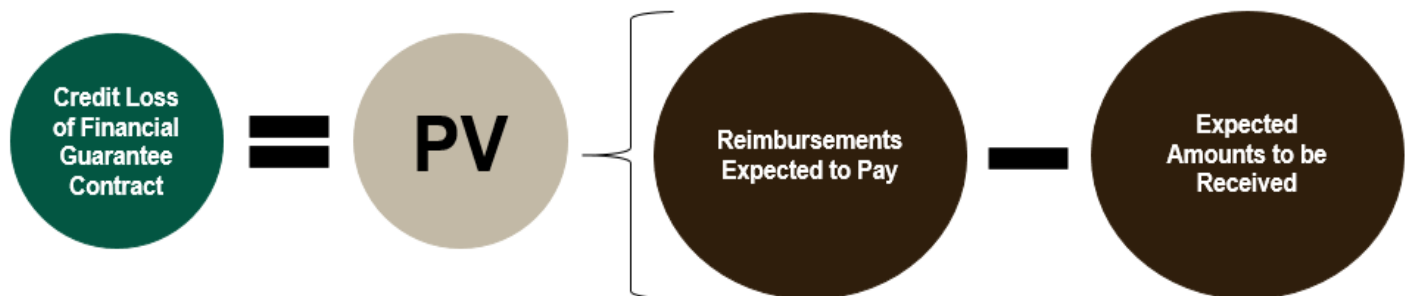
The period over which the ECLs would be estimated would be the maximum contractual period over which an entity has a present contractual obligation to extend credit.

Note! The IASB noted that most financial guarantee contracts will expire at a specified date, and if an entity decided to renew or extend its commitments, it will be a new instrument for which the entity has the opportunity to revise the terms and conditions. Consequently, the IASB confirmed that the period over which ECLs are estimated is the contractual term over which the entity is committed to provide credit. This is the case even if an entity has a past practice of renewing the instrument and renewals are likely.

c) *How are ECLs determined?*

For financial guarantee contracts, a credit loss is the present value of the difference between:

- The expected payments to reimburse the holder for a credit loss that it incurs; and
- Any amounts that the entity expects to receive from the holder, the debtor or any other party.



If an asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be the same as the estimation of cash shortfalls for the related asset. In other words, the loss allowance for the financial guarantee contract would be the same as for the asset subject to the guarantee because the entity will be responsible for paying the shortfalls relating to the guaranteed asset.

d) *Which discount rate should be used to discount ECLs for financial guarantee contracts?*

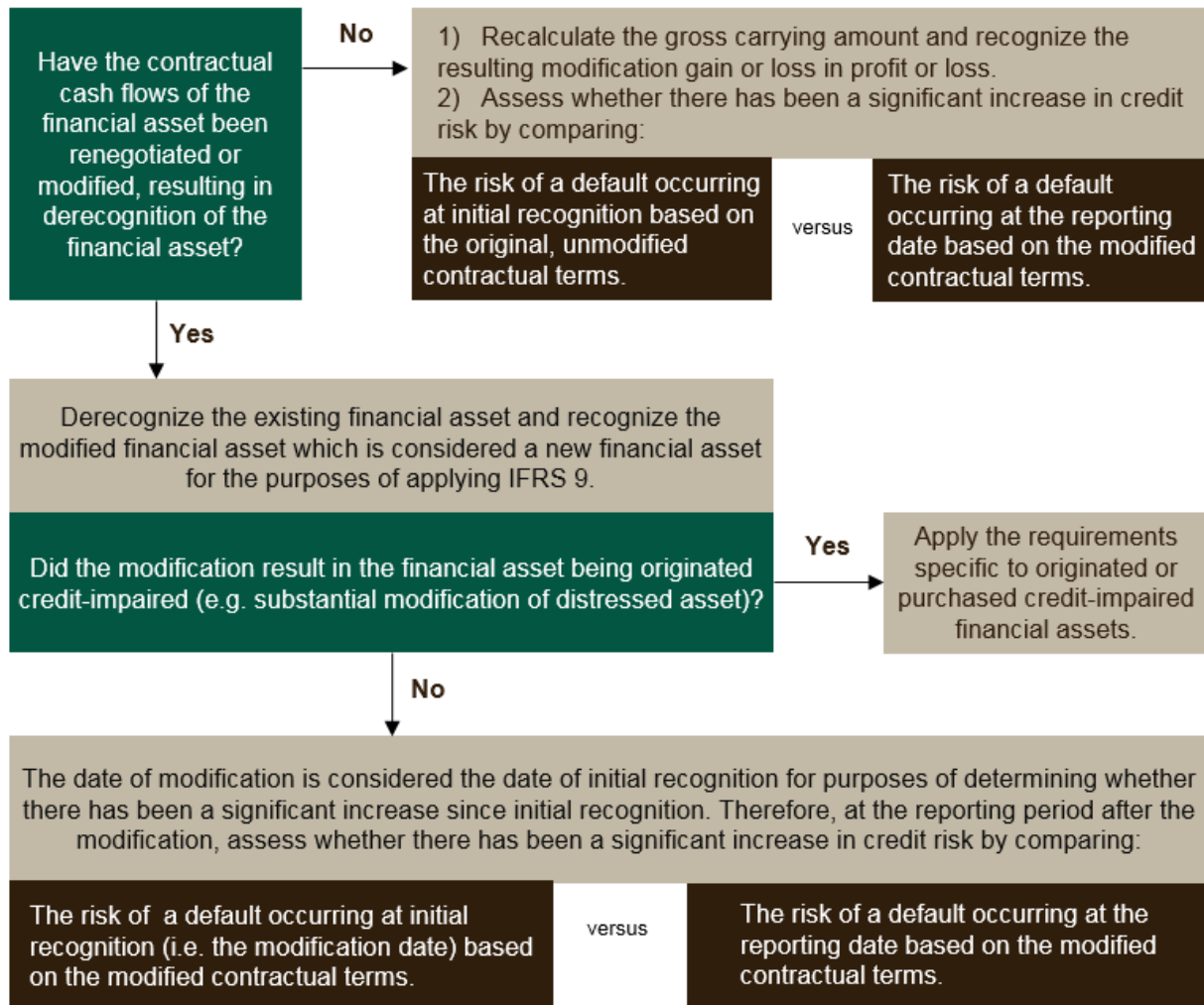
As previously discussed, the discount rate used to discount ECLs for financial guarantee contracts is as follows:

Instrument	Time Value of Money – ECLs Shall be Discounted Using...
Financial guarantee contracts	A discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.

Modifications

If the contractual cash flows on a financial asset have been renegotiated or modified, an entity shall assess whether the financial asset should be derecognized in accordance with IFRS 9³.

The following diagram summarizes the requirements depending on this assessment.



If the original financial asset is derecognized, the difference between the carrying amount of the original financial asset, net of any loss allowance, and the fair value of the new financial asset is recognized in profit or loss at the date of recognition.

³ The derecognition requirements for financial assets and liabilities have not changed between IAS 39 and IFRS 9.

- a) How is the gross carrying amount of the financial asset recalculated, and what is the impact on credit risk, if the modification did not result in derecognition?

It is the present value of the modified contractual cash flows, discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). Any costs or fees incurred are adjusted against the carrying amount of the modified financial asset and amortized over its remaining term.

A modified financial asset that continues to be recognized is not automatically considered to have lower credit risk. Whether there has been a significant increase in credit risk since initial recognition is assessed on the basis of all reasonable and supportable information that is available without undue cost or effort, comprising historical and forward-looking information. The entity should also consider the facts that caused the modification in assessing the financial asset's credit risk. Evidence that 12-month ECLs can be recognized after a period of recognizing lifetime ECLs may include a history of up-to-date and timely payment performance against the modified contractual terms. In other words, one payment received on time may not be sufficient rationale for moving the asset from Stage 2 to Stage 1.

- b) If the financial asset was derecognized as a result of the modification, what is the typical impact on the measurement of the loss allowance?

The date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements. Typically, this means measuring the loss allowance at an amount equal to 12-month ECLs until the requirements for the recognition of lifetime ECLs are met, unless the modified financial asset is credit-impaired.

Example of Modifications *(Adapted from IFRS 9.IE66-IE73 Example 11)*

Credit Union A granted a \$10,000 loan with a five-year term and a 5% interest rate payable annually. The principal amount must be repaid in full at maturity. The effective interest rate is 5%.

Period 1: Loss allowance of \$250 is recognized based on 12-month ECLs because there was no significant increase in credit risk since initial recognition.

Period 2: Credit risk on the loan has increased significantly since initial recognition; therefore, the loss allowance is measured based on lifetime ECLs. The updated loss allowance is \$500 resulting in a \$250 loss being recognized in profit or loss.

Period 3: The borrower experienced significant financial difficulty and Credit Union A modifies the contractual cash flows by extending the term of the loan by one year and waiving all interest. This results in 3 years remaining in the term at the date of modification. The modification did not result in derecognition of the loan in accordance with IFRS 9. Credit Union A compares the credit risk of the modified loan to the credit risk of the original loan at initial recognition. It determines that the loan is not credit-impaired but its credit risk has increased significantly since initial recognition. Therefore, the loss allowance continues to be measured based on lifetime ECLs. The updated loss allowance is \$600 resulting in a \$100 loss being recognized in profit or loss.

Assessment: The modification resulted in the following actions:

- Credit Union A recalculates the gross carrying amount of the loan as \$8,638 which is the present value of the modified contractual cash flows (\$10,000 loan due in 3 years time) using the loan's original 5% effective interest rate.
- The difference between the recalculated gross carrying amount after the modification and the loan's original gross carrying amount ($\$10,000 - \$8,638 = \$1,362$) is recognized as a modification loss. The modification loss is offset against the original gross carrying amount.

Example of Modifications *(continued from previous page)*

The following table and journal entries present the impact of the impairment assessments and contract modification:

Period	Beginning Gross Carrying Amount	Impairment Loss	Modification Loss	Interest Revenue	Cash Flows	Ending Gross Carrying Amount	Loss Allowance	Ending Amortized Cost Amount
	A	B	C	D = A × 5%	E	F = A + C + D - E	G	H = F - G
1	\$10,000	(\$250)	\$-	\$500	\$500	\$10,000	\$250	\$9,750
2	10,000	(250)	-	500	500	10,000	500	9,500
3	10,000	(100)	(1,362)	500	500	7,000	600	8,038

At initial recognition, the entity records the following journal entry:

Dr Loan receivable	\$10,000	
Cr Bank account		\$10,000

At end of period 1, the entity records the following journal entries:

Dr Bank account	\$500	
Cr Interest income		\$500
Dr Impairment loss (profit or loss)	\$250	
Cr Expected credit loss allowance		\$250

At end of period 2, the entity records the following journal entries:

Dr Bank account	\$500	
Cr Interest income		\$500
Dr Impairment loss (profit or loss)	\$250	
Cr Expected credit loss allowance		\$250

At end of period 3, the entity records the following journal entries:

Dr Bank account	\$500	
Cr Interest income		\$500
Dr Impairment loss (profit or loss)	\$100	
Cr Expected credit loss allowance		\$100
Dr Modification loss (profit or loss)	\$1,362	
Cr Loan receivable		\$1,362

An assessment of whether a significant increase in credit risk has occurred since initial recognition will be performed at each subsequent reporting date by comparing the current credit risk (based on the modified cash flows) with the credit risk at initial recognition (based on the original unmodified cash flows).

Assume that in Period 4 the borrower has performed better than forecasted, the future outlook has improved, and all reasonable and supportable information that is available without undue cost or effort supports a decrease in overall credit risk. Credit Union A determines that there has been no significant increase in credit risk since initial recognition and the loss allowance should again be based on 12-month ECLs of \$300.

Example of Modifications *(continued from previous page)*

At that time, the following journal entry is recognized:

Dr Expected credit loss allowance	\$300	
Cr Impairment loss (profit or loss)		\$300

The amount represents the difference between the actual loss allowance in the prior year, which was based on lifetime ECLs of \$600, and the updated loss allowance based on 12-month ECLs of \$300.

Interest income in period 4 and beyond will be recognized by applying the effective interest rate of 5% to the new gross carrying amount so that the gross carrying amount at the end of the term will be \$10,000.

Write-offs

Under IAS 39, the loss allowance reduces the carrying amount of an asset directly or through the use of an allowance account. IFRS 9 requires that a loss allowance account be maintained. The gross carrying amount of a financial asset is reduced directly (i.e., written off) under IFRS 9 when the entity has no reasonable expectations of recovering the financial asset in its entirety, or a portion thereof.

Note! What constitutes “no reasonable expectation of recovery” is a matter of judgment that will depend on the particular facts and circumstances. Information considered may include:

- Expected and actual proceeds (to be) received from realization of security/collateral.
- Whether efforts to collect the debt has stopped.
- Whether there is a range of possible outcomes. It may be harder to justify a write-off when an entity has such a range of expected outcomes.
- The particular situation of the debtor (e.g. whether the debtor is in bankruptcy or liquidation).
- The status of the debt (e.g. days overdue or when the last payment was made).

A write-off is a derecognition event. This is in contrast to an allowance for ECLs which is maintained and may be offset against the carrying amount of the financial asset.

Disclosure

IFRS 7, paragraphs 35A – 38, contain the disclosure requirements relating to the credit risk exposure of an entity's financial instruments.

Note! Judgment is required to determine: the level of detail and aggregation provided; how much emphasis to place on each requirement; and whether to include additional information to help users evaluate the quantitative information.

Examples of disclosures required are:

1. An entity's credit risk management practices and how they relate to the recognition and measurement of ECLs. The standard contains detailed requirements for meeting this objective.
2. Inputs, assumptions and estimation techniques used in calculating ECLs and determining whether credit risk has significantly increased since initial recognition.
3. Quantitative and qualitative information about amounts arising from ECLs. This includes reconciliations of opening to closing balances of loss allowances, showing separately changes for:
 - a. 12-month ECLs.
 - b. Lifetime ECLs for those that:
 - i. are credit-impaired at the reporting date;
 - ii. experienced a significant increase in credit risk since initial recognition; and
 - iii. trade receivables, lease receivables and contract assets subject to the simplified approach.
 - c. Financial assets that are purchased or originated credit-impaired. For these financial assets, an entity also needs to disclose the total amount of undiscounted ECLs at initial recognition for those recognized during the reporting period.
4. Gross carrying amounts per credit risk rating grades and the exposure to credit risk on loan commitments and financial guarantee contracts. This information shall also be provided separately for the categories mentioned in 3 above.
5. Information on the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of ECLs.
6. The entity's write-offs policy.
7. Information on collateral or other credit enhancements.

IFRS 7 also contains disclosures that are required on initial application of IFRS 9. These are discussed in more detail in our 'An Overview of the Transition Requirements of IFRS 9 *Financial Instruments* guide.

Note! Careful and detailed analysis is needed to identify and determine the adequacy and appropriateness of an entity's disclosure requirements. In planning the IFRS 9 implementation, entities should consider the systems, data, processes and policies necessary to comply with and ensure the completeness of the disclosure requirements. It may also be helpful to include some of these disclosure requirements in investor communications.

Additional Resources

External Resources

- IFRS 9 can be found in Part I of the CPA Canada Handbook - Accounting.
- More information about IFRS 9 and background to the updates can be found in the [press release](#) for the standard.
- The IASB's [Project Summary](#) provides an overview of the new standard.

IFRS 9 has several Illustrative Examples that accompany, but are not part of, the standard. These examples illustrate the underlying concepts, methodology and computations of the impairment model.

Other MNP Technical Guidance

- IFRS 9 Snapshot
- An Overview of IFRS 9 *Financial Instruments* versus IAS 39 *Financial Instruments: Recognition and Measurement*
- An Overview of the New Financial Asset Classification and Measurement Requirements of IFRS 9 *Financial Instruments*
- An Overview of the Transition Requirements of IFRS 9 *Financial Instruments*
- An Overview of the Hedging Requirements of IFRS 9 *Financial Instruments* (coming soon)

Appendix A: Information That May be Relevant in Assessing Changes in Credit Risk

Per IFRS 9 B5.5.17 the following non-exhaustive list of information may be relevant in assessing changes in credit risk:

- a) Significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.
- b) 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.
- c) Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:
 - i. The credit spread;
 - ii. The credit default swap prices for the borrower;
 - iii. The length of time or the extent to which the fair value of a financial asset has been less than its amortized cost; and
 - iv. Other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.
- d) An actual or expected significant change in the financial instrument's external credit rating.
- e) An actual or expected internal credit rating downgrade for the borrower or decrease in behavioral scoring used to assess credit risk internally. Internal credit ratings and internal behavioral scoring are more reliable when they are mapped to external ratings or supported by default studies.
- f) Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the 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.
- g) An actual or expected significant change in the 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 organizational structure (such as the discontinuance of a segment of the business) that results in a significant change in the borrower's ability to meet its debt obligations.
- h) Significant increases in credit risk on other financial instruments of the same borrower.
- i) 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.

- j) Significant changes in the value of the collateral supporting the obligation or in 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.
- k) 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.
- l) 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, that 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 securitizations, whether subordinated interests are expected to be capable of absorbing ECLs (for example, on the loans underlying the security).
- m) 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.
- n) Significant changes in the expected performance and behavior 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 significant increases 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).
- o) Changes in the entity's credit management approach in relation to the financial instrument; i.e., based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.
- p) Past due information, including the rebuttable presumption that assumes credit risk has increased significantly if more than 30 days past due.

Appendix B: Impairment Comprehensive Example

Lender A is applying IFRS 9 for the first time in its December 31, 2018 financial statements. The following is information about its member loan portfolio at December 31, 2018:

- Loans 1-4, as well as all of the loans in Group A1 and A2, share similar risk characteristics. They are mortgage loans in the same geographical area which are all secured by collateral.
- All of the loans were originated at a market rate of interest.
- Lender A is unable to rebut the presumption that its loans have experienced a significant increase in credit risk when more than 30 days past due.
- Lender A considers all loans over 90 days to be credit-impaired based on historical experience with recovering the associated debt.
- The aging of Lender A's loans and the split between fixed and variable rates mortgages are as follows on December 31, 2018:

Loan #	Total	Current	More than 30 Days Past Due	More than 60 Days Past Due	More than 90 Days Past Due
Group A1 – fixed rate mortgages	\$1,700,000	\$1,400,000	\$75,000	\$100,000	\$125,000
Group A2 – variable rate mortgages	\$600,000	\$500,000	\$20,000	\$30,000	\$50,000
Total	\$2,300,000	\$1,900,000	\$95,000	\$130,000	\$175,000

- The Lender A's treasury department forecasts that interest rates will increase by 1% over the next 2 years. Based on historical data, Lender A knows that a 1% increase in market interest rates usually results in a significant increase in credit risk for 10% of the variable rate mortgages that would otherwise be in Stage 1.
- Lender A monitors certain loans more closely on an individual basis given their significance and unique characteristics. The following information is available without undue cost or effort on an individual loan basis:

Loan #	Amount	Past Due Status	Other Information	PV of Expected Future Cash Flows, Including ECLs and the Expected Recoveries from Collateral
1 (fixed rate)	\$200,000	90 days	The borrower has filed for bankruptcy.	\$180,000 (100% probability of default)
2 (fixed rate)	\$150,000	Current	None	Not calculated
3 (fixed rate)	\$120,000	Current	The borrower has breached several other covenants within the loan agreement and was recently arrested for embezzling money from his employer.	\$120,000
4 (fixed rate)	\$50,000	60 days	The borrower recently lost his job due to an economic recession and was granted a concession to skip payments.	\$37,000 (100% probability of default)

- Additional information for Group A1 and A2 taking into account historical information, current conditions and forward-looking information, including actual loss experience and recoveries from the sale of collateral, is as follows:

Probability of Default in the Next 12 months	Lifetime Probability of Default	Loss Given Default
Fixed rate loans = 2%	Credit-impaired loans = 100%	All loans = 25%
Variable interest rate loans = 1%	Not credit-impaired loans = 5%	

Analysis:

The following table explains how the impairment allowance for Lender A is calculated at December 31, 2018.

Loan	Amount	Stage	Rationale	Action Required Under IFRS 9	ECL Allowance
1	\$200,000	3	Credit-impaired because 90 days past due and borrower bankruptcy	Recognize lifetime ECLs	$(\$200,000 - \$180,000) \times 100\% = \$20,000$
2	\$150,000	1	No significant increase in credit risk	Move to Group A1 (fixed rate loans)	Included in Group A1
3	\$120,000	2	Significant increase in credit risk	Recognize lifetime ECLs	$\$120,000 - \$120,000 = \$0$
4	\$50,000	3	Credit-impaired because of past due status and other events that have a detrimental effect on future cash flows	Recognize lifetime ECLs	$(\$50,000 - \$37,000) \times 100\% = \$13,000$
Group A1	\$1,400,000 (current) + \$150,000 (loan 2) = \$1,550,000	1	Not past due and no other information that indicates a significant increase in credit risk	Recognize 12-month ECLs	$\$1,550,000 \times 25\% \times 2\% = \$7,750$
Group A1	\$75,000 (30 days past due) + \$100,000 (60 days past due) = \$175,000	2	More than 30 days past due; therefore, presumed to have experienced a significant increase in credit risk	Recognize lifetime ECLs	$\$175,000 \times 25\% \times 5\% = \$2,188$
Group A1	\$125,000 (90 days past due)	3	90 days overdue and based on past experience these are considered credit-impaired	Recognize lifetime ECLs	$\$125,000 \times 25\% \times 100\% = \$31,250$
Group A2	\$500,000 (current) $\times 90\%$ (not affected by interest rate increase) = \$450,000	1	Not past due and no other information that indicates a significant increase in credit risk	Recognize 12-month ECLs	$\$450,000 \times 25\% \times 1\% = \$1,125$
Group A2	\$20,000 (30 days past due) + \$30,000 (60 days past due) + $10\% \times \$500,000$ (current but affected by interest rate increase) = \$100,000	2	More than 30 days past due; therefore, presumed to have experienced a significant increase in credit risk and a portion experienced an increase in credit risk due to announced interest rate increase	Recognize lifetime ECLs	$\$100,000 \times 25\% \times 5\% = \$1,250$
Group A2	\$50,000 (90 days past due)	3	Credit-impaired because 90 days past due*	Recognize lifetime ECLs	$\$50,000 \times 25\% \times 100\% = \$12,500$

* In this situation, reasonable and supportable information on credit losses and collateral was not reasonably available without undue cost or effort on all individual credit-impaired loans because it comprised a large number of small loans. Therefore, ECLs are measured on a collective basis. In other situations, it may be possible to estimate ECLs for individual credit-impaired loans. The same applies to estimating whether there has been a significant increase in credit risk.

Total impairment loss under IFRS 9 = \$89,063 (\$20,000 + \$13,000 + \$7,750 + \$2,188 + \$31,250 + \$1,125 + \$1,250 + \$12,500)

Appendix C: Application of the Impairment Requirements for Loan Commitments and Financial Guarantees Compared to Other Financial Assets

	Date of Initial Recognition	Period Over Which to Estimate ECLs	Cash Shortfalls	Interest Rate Used in Discounting ECLs	Assessment of Significant Increases in Credit Risk
Loan Commitments	Date the entity became a party to the irrevocable commitment.	The maximum contractual period over which an entity has a present contractual obligation to extend credit. For instruments that include a loan and an undrawn commitment, the entity shall measure ECLs over the period that the entity is exposed to credit risk and ECLs would not be mitigated by credit risk management actions.	The difference between the contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan and the cash flows that the entity expects to receive if the loan is drawn down.	Effective interest rate, or an approximation thereof, that will be applied when recognizing the financial asset resulting from the loan commitment.	Compare the risk of a default occurring on the loan to which a loan commitment relates as at the reporting date with the risk of default occurring as at initial recognition.
Financial Guarantee Contracts	Date the entity became a party to the irrevocable commitment.	The maximum contractual period over which an entity has a present contractual obligation to extend credit.	The expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party.	A discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.	Compare the risk that the specified debtor will default on the contract as at the reporting date with the risk the debtor will default as at initial recognition.
Other Financial Assets / Contracts Subject to Impairment	Trade date	The maximum contractual period over which the entity is exposed to credit risk. This period includes extension options.	The difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.	Effective interest rate determined at initial recognition or an approximation thereof.	Compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of default occurring as at initial recognition.



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