COMITÊ DE PRONUNCIAMENTOS CONTÁBEIS
SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
http://www.cpc.org.br

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commentletters@ifrs.org

IFRS Foundation
7 Westfery Circus – Canary Wharf
London E14 4HD
United Kingdom

Reference: Request for Information – Post-implementation Review – IFRS 9 *Financial Instruments* – Impairment

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)[1] welcomes the opportunity to respond to the Request for Information – Post-implementation Review – IFRS 9 Financial Instruments – Impairment.

We are a standard-setting body engaged in studying, developing, and issuing accounting standards, interpretations, and guidance for Brazilian companies.

If you have any questions about our comments, please do not hesitate to contact us at operacoes@cpc.org.br.

Yours sincerely,

Rogério Lopes Mota
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)

[1]The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC Brasil (National Association of Capital Market Investment Professionals and Analysts), B3 (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Audit).

Addressing the questions

Question 1—Impairment

Do the impairment requirements in IFRS 9 result in:

(a) more timely recognition of credit losses compared to IAS 39 and address the complexity caused by having multiple impairment models for financial instruments? Why or why not?

(b) an entity providing useful information to users of financial statements about the effect of credit risk on the amount, timing and uncertainty of future cash flows? Why or why not?

Please provide information about the effects of the changes to the impairment requirements introduced by IFRS 9, including the ongoing costs and benefits of preparing, auditing, enforcing or using information about financial instruments.

This question aims to help the IASB understand respondents' overall views and experiences relating to the IFRS 9 impairment requirements. Sections 2–9 seek more detailed information on specific requirements.

Response 1 (a) and (b): Yes, IFRS 9 was successful in addressing the timing of recognition of credit losses compared to IAS 39. It was noted that application of ECL during COVID-19 pandemic resulted in increasing impairment allowances due to uncertainties in global economy during the peak of pandemic and after that, releases of impairment allowances according to the recovery period. The COVID-19 pandemic was also a show case of how important is IFRS 9 ECL in providing more useful information to users about the credit risk amount, timing and specially uncertainty of future cash flows compared to IAS 39 incurred loss provision. Although complexity of impairment models is still a challenge, due to multiple portfolios, how they are aggregated in homogeneous groups and how they respond to forward looking information, expected credit losses provides better information to users of financial statements.

Question 2—The general approach to recognising expected credit losses

(a) Are there fundamental questions (fatal flaws) about the general approach? If yes, what are those fundamental questions?

Please explain whether requiring entities to recognise at least 12-month expected credit losses throughout the life of the instrument and lifetime expected credit losses if there has been a significant increase in credit risk achieves the IASB's objective of entities providing useful information about changes in credit risk and resulting economic losses. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the general approach.

(b) Are the costs of applying the general approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

If, in your view, the ongoing costs of applying the general approach to particular financial instruments are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those instruments.

Response 2 (a): In general, IFRS 9 general approach is working well. However, there are some aspects that could be enhanced to better respond to changes in credit risk that could result in economic losses. For example, assessing the significant increase in credit risk (SICR) requires a significant level of judgment and the outcome may not be necessarily consistent with management's view of credit risk management, resulting in lack of comparability or volatility.

Response 2 (b): The adoption of IFRS 9 ECL resulted in significant costs and efforts as the requirements are considerably more complex than IAS 39, and ongoing costs and efforts incurred to apply the requirements of IFRS 9 are significantly higher than expected. For example, costs and efforts are required to maintain the ECL models, data storage, production of the ECL estimates and its governance processes, internal control environment and audit. Besides, models require to be continuously refined, adding variations to be explained, report to management and disclosure to the market, that has increased relative to IAS 39. Although IFRS 9 results in substantial ongoing costs and efforts, it provides better information to users of financial statements and benefits outcome cost in this aspect.

Question 3—Determining significant increases in credit risk

(a) Are there fundamental questions (fatal flaws) about the assessment of significant increases in credit risk? If yes, what are those fundamental questions?

Please explain whether the principle-based approach of assessing significant increases in credit risk achieves the IASB's objective of recognising lifetime expected credit losses on all financial instruments for which there has been a significant increase in credit risk since initial recognition.

If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the assessment of significant increases in credit risk.

(b) Can the assessment of significant increases in credit risk be applied consistently? Why or why not?

Please explain whether the requirements provide an adequate basis for entities to apply the assessment consistently to all financial instruments within the scope of impairment requirements in IFRS 9.

If diversity in application exists for particular financial instruments or fact patterns, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements.

If you have identified diversity in application of the assessment, please provide your suggestions for resolving that diversity.

In responding to (a) and (b), please include information about applying judgement in determining significant increases in credit risk (see Spotlight 3).

Response 3 (a): No.

Response 3 (b): the assessment of significant increase in credit risk needs to respect the characteristics of the financial instruments' population. It requires a high level of judgement, giving rise to different estimation approaches across financial instruments of the same entity. These differences could be, for instance, related to the PD models (application, behavior, internal or external rating, credit scores), historical data availability and level of disaggregation (retail or wholesale, product, geography).

However, in order to achieve the principle-based approach of assessing significant increases in credit risk, we consider important to maintain the use management's judgement and we expect the application of these factors to differ across entities.

Question 4—Measuring expected credit losses

(a) Are there fundamental questions (fatal flaws) about requirements for measuring expected credit losses? If yes, what are those fundamental questions?

Please explain whether the requirements for measuring expected credit losses achieve the IASB's objective of providing users of financial statements with useful information about the amount, timing and uncertainty of an entity's future cash flows. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the measurement requirements.

(b) Can the measurement requirements be applied consistently? Why or why not?

Please explain whether the requirements provide an adequate basis for entities to measure expected credit losses consistently for all financial instruments within the scope of impairment requirements in IFRS 9.

If diversity in application exists for particular financial instruments or fact patterns, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements.

If you have identified diversity in application of the requirements, please provide your suggestions for resolving that diversity.

In responding to (a) and (b), please include information about forward-looking scenarios (see Spotlight 4.1), post-model adjustments or management overlays (see Spotlight 4.2) and off-balance-sheet exposures (see Spotlight 4.3), as relevant.

Response 4 (a) and (b): In the estimation of expected credit losses to reflect probability-weighted amount that is determined by evaluating a range of possible outcomes, it is not clear how the entities should approach. It is expected that in less instable economies, forward-looking information and use of scenarios should be monitored and updated more frequently. It would be helpful if IASB could give additional guidance on how forward-looking information should be applied as well as the use of scenarios. Perhaps this would increase the understanding of what organizations should achieve with such estimation and what users should expect from this information.

Question 5—Simplified approach for trade receivables, contract assets and lease receivables

(a) Are there fundamental questions (fatal flaws) about the simplified approach? If yes, what are those fundamental questions?

Does applying the simplified approach achieve the IASB's objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables?

If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the simplified approach.

(b) Are the costs of applying the simplified approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

If, in your view, the ongoing costs of applying the simplified approach are significantly greater than expected, or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment.

Response 5 (a) and (b): The simplified approach is working well and we acknowledge that cost and complexities are significant lower than the requirements for measuring expected credit losses.

Question 6—Purchased or originated credit-impaired financial assets

Can the requirements in IFRS 9 for purchased or originated credit-impaired financial assets be applied consistently? Why or why not?

Please explain whether the requirements can be applied consistently to these types of financial assets and lead to accounting outcomes that faithfully reflect the underlying economic substance of these transactions.

If there are specific application questions about these requirements, please describe the fact pattern and:

(a) explain how the IFRS 9 requirements are applied;

(b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect);

(c) explain how pervasive the fact pattern is; and

(d) support your feedback with evidence.

Response 6: We noted that the identification of POCI instruments may diverge across companies (i.e. new credit to a client already in default, restructuring of credit already written off or purchase of non-performing loan portfolio). It would be helpful to clarify the scope or types of financial instruments that should be classified as POCI and provide more guidance about measurement and favorable changes in cash flow expectation. Additionally, the disclosure of POCI is diverse, some entities disclosure POCI and Stage 3 altogether, some do it separately.

Question 7—Application of the impairment requirements in IFRS 9 with other requirements

Is it clear how to apply the impairment requirements in IFRS 9 with other requirements in IFRS 9 or with the requirements in other IFRS Accounting Standards? If not, why not?

If there are specific questions about how to apply the impairment requirements alongside other requirements, please explain what causes the ambiguity and how that ambiguity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. Please describe the fact pattern and:

(a) indicate the requirements in IFRS 9 or in other IFRS Accounting Standards to which your comments relate;

(b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect);

(c) explain how pervasive the fact pattern is; and

(d) support your feedback with evidence.

In responding to this question, please include information about matters described in this section of the document.

Response 7: Yes, we believe that the current guidance is clear.

Question 8—Transition

Were the costs of applying the transition requirements and auditing and enforcing their application significantly greater than expected? Were the benefits to users significantly lower than expected?

Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Please explain any unexpected effects or challenges preparers of financial statements faced applying the impairment requirements retrospectively. How were those challenges overcome?

Response 8: We acknowledge that the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Question 9—Credit risk disclosures

(a) Are there fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk? If yes, what are those fundamental questions?

Please explain whether the combination of disclosure objectives and minimum disclosure requirements for credit risk achieves an appropriate balance between users of financial statements receiving:

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

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

If an appropriate balance is not achieved, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the disclosure requirements.

(b) Are the costs of applying these disclosure requirements and auditing and enforcing their application significantly greater than expected? Are the benefits to users significantly lower than expected?

If, in your view, the ongoing costs of providing specific credit risk disclosures are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those disclosures. Please provide your suggestions for resolving the matter you have identified.

If, in your view, the IASB should add specific disclosure requirements for credit risk, please describe those requirements and explain how they will provide useful information to users of financial statements.

Please also explain whether entities' credit risk disclosures are compatible with digital reporting, specifically whether users of financial statements can effectively extract, compare and analyse credit risk information digitally.

Response 9 (a): We believe that disclosure requirements in IFRS 7 for credit risk are generally working well. Comparable information works well for entities that are similar in terms of business model and not necessarily for entities just because they are in the same economic segment. We note that there is comparability between minimum requirements. However, we consider that there is an opportunity to reduce disclosure in financial statements identifying disclosure requirements that are also required for Basel purposes and that are used broadly. This could help to enhance relevant information in the financial statements.

Response 9 (b): The costs of producing and auditing the current minimum disclosure requirements are significantly higher than expected given the large number of requirements. In addition, due to the complex use of different sources of systemic information, the use of digital reporting requires investments and allocation of resources on an ongoing basis, whenever new models are created or changed. On the other hand, the benefits for users outcome the costs.

Question 10—Other matters

(a) Are there any further matters that you think the IASB should examine as part of the post-implementation review of the impairment requirements in IFRS 9? If yes, what are those matters and why should they be examined?

Please explain why those matters should be considered in the context of this post-implementation review and the pervasiveness of any matter raised.

Please provide examples and supporting evidence.

(b) Do you have any feedback on the understandability and accessibility of the impairment requirements in IFRS 9 that the IASB could consider in developing its future IFRS Accounting Standards?

Response 10 (a) and (b): Yes. IFRS 9 requires that financial instruments in stage 3 have interest revenue recognized according to effective interest on amortised cost. However, when a financial instrument is non-performing or impaired, there should be an assessment of whether the interest revenue is probably to be collected. The reason behind is that being the financial instrument in default and correctly measuring its expected credit loss, it means that any increase in the exposure should be compensated by an increase in impairment allowance. Therefore, it would be simpler to allow "stop accrual" at stage 3 recognition of interest revenue or, at least, to give the option to an entity to make an accounting choice.