A Review of the Expected Credit Loss Model of IFRS 9$_{(2014)}$ *Financial Instruments*

By Tan Liong Tong

1. Introduction

In July 2014, the IASB issued a new version of IFRS 9 *Financial Instruments* that marked the completion of its project to replace IAS 39 *Financial Instruments: Recognition and Measurement* in its entirety. This final version, apart from prescribing the classification and measurement of financial assets and financial liabilities, also includes a new impairment methodology and a new hedge accounting model (the new hedge accounting model was first introduced in the November 2013 Amendments to IAS 39 and IFRS 9$_{(2010)}$). However, the effective date of IFRS 9$_{(2014)}$ is for financial statements beginning on or after 1 January 2018, with earlier application permitted.

The revised IFRS 9 introduces an expected credit loss model for recognition and measurement of impairment losses of financial assets measured at amortised cost or at fair value through other comprehensive income, loan commitments, certain financial guarantee contracts, lease receivables and contract assets. This Article examines the reasons for the change in the impairment methodology and explains the detailed requirements in the new impairment model. As the new impairment requirements would affect almost all entities, it is important that users and preparers of financial statements prepare in advance for the application of the new impairment model when it becomes effective in the foreseeable near future.

2. Rationale for Change

The current IAS 39 uses an incurred loss model to recognise impairment loss of a financial asset only after a trigger loss event has occurred. In this model, an entity initially recognises a financial asset (for example, a trade receivable or an investment) in its entirety without factoring in the credit risk. Subsequently, when a "trigger" loss event occurs, the entity performs the impairment test and recognises an impairment loss when incurred, such as when there is a default in payment. During the global financial crisis which started in 2007, many constituents and users of financial statements have expressed concern that this incurred loss model reports loan losses "too little too late" because the model delays the recognition of a credit loss event until there is objective evidence of an impairment. They have urged the IASB to explore alternatives to the incurred loss model that would use more forward-looking information.

The complexity of the current accounting which uses different impairment methods for different financial assets was also identified as a concern. For example, in testing impairment for a financial asset carried at amortised cost (debt instruments), the revised estimated cash flows must be discounted at the *original effective interest rate* whereas for a financial asset carried at cost (unquoted equity instruments), the discount rate applied is the *current market rate of return*. The use of a current market rate of return to discount the revised cash flows of a financial asset carried at cost is similar to a fair value measurement, which is inconsistent with the cost measurement model applied for that asset. For quoted equity investments classified as available-for-sale assets, any impairment loss is recognised in profit or loss but any subsequent recovery of the market prices cannot be reversed in profit or loss, a treatment that has been argued by many as too rule-based.

Furthermore, in applying the current IAS 39 in measuring credit losses, an entity may only consider those losses that arise from past events and current conditions. The effects of future credit loss events cannot be considered, even when they are expected. The concern then, when developing the incurred loss impairment model, was the possible creation of "secret or hidden reserve" if future loss events were allowed in the impairment measurement. It was designed to limit an entity's ability to create hidden reserves that can be used to boost earnings during bad times. However, the IASB

observed that as the global financial crisis unfolded, it became clear that the incurred loss model gave room to a different kind of earnings management, namely to postpone losses. Even though IAS 39 does not require waiting for actual default before impairment is recognised, in practice, this is often the case. Thus, the financial crisis had shown that the concern about hidden reserves is no longer supportable because future loss events when expected must be considered to prevent reporting loan losses too little too late.

3. Recognition of Expected Credit Losses

IFRS 9 uses an "expected loss model" for all financial instruments that are subject to impairment accounting. It requires that an entity shall recognise a loss allowance for *expected credit losses* on a financial asset measured at amortised cost or at fair value through other comprehensive income, a lease receivable (in accordance with the draft Standard on *Leases*), a contract asset (in accordance with IFRS 15 *Revenue from Contracts with Customers*) or a loan commitment and a financial guarantee contract to which the impairment requirements of the Standard apply [IFRS 9.5.5.1].

Expected credit losses are an estimate of losses that an entity expects will result from a credit event, such as a payment default. Expected credit losses are costs of a lending activity. These costs are reflected through:

(a) the pricing (yield) of financial instruments, which compensates the lender for the creditworthiness of the borrower at the time of lending or commitment to lend; and

(b) changes in the creditworthiness of the borrower after lending or committing to lend (i.e. changes in expected credit losses). These changes in expected credit losses are not priced into the financial instruments, so give rise to an economic loss.

3.1 When to Recognise Expected Credit Losses

Under this new model, expected credit losses would be recognised from the point at which financial instruments are originated or purchased. There would no longer be a threshold (such as a trigger loss event of default) before expected credit losses would start to be recognised. With limited exceptions, a *12-month expected credit losses* must be recognised initially for all assets subject to impairment. For example, an entity recognises a loss allowance at the initial recognition of a purchased debt instrument rather than when an event of default by the issuer occurs.

The amount of expected credit losses that are recognised would depend on the change in the credit quality since initial recognition to reflect the link between expected credit losses and the pricing of the financial instrument. With limited exceptions, IFRS 9 requires that at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the *lifetime expected credit losses* if the credit risk on that financial instrument has increased significantly since initial recognition [IFRS 9.5.5.3]. *Lifetime expected credit losses* are defined as the expected credit losses that result from all possible default events over the life of the financial instrument.

The requirements in IFRS 9 would result in *lifetime expected credit losses* being recognised only when the credit risk of a financial instrument is worse than that anticipated when the financial instrument was first originated or purchased. If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to *12-month expected credit losses* [IFRS 9.5.5]. *12-month expected credit losses* are defined as the expected credit losses that result from those default events on the financial instrument that are possible within the 12 months after the reporting date.

A portion of lifetime expected credit losses is recognised when financial instruments are first originated or purchased. This is a way to reflect that the yield on the instrument includes a return to

cover those credit losses expected from when a financial instrument is first recognised. If this amount was not recognised the full yield would be recognised as interest revenue with no adjustment for credit losses that were always expected.

Example 1

Entity B generates a five-year term loan of RM1,000,000 at the beginning of Year 1. If there were no possibility of credit losses, the coupon rate that Entity B would charge the borrower is 5% per annum. However, because of the borrower's credit rating, Entity B estimates that there is a possibility the borrower might default on the payments and the expected credit losses are estimated at RM10,000 per year over the five-year term. Accordingly, Entity B charges the borrower 6% coupon rate to reflect the yield on the instrument to include a return to cover those credit losses expected when the loan is first recognised. The present value of the lifetime expected credit losses of RM10,000 per year for five years discounted at 6% is RM42,124. The present value of the 12-month expected credit losses of RM10,000 for the first year discounted at 6% is RM9,434.

Thus, on initial recognition, Entity B records the following journal entries:

	RM	RM
Dr Loan receivable	1,000,000	
Cr Cash		1,000,000
- to recognise loan asset at gross amount.		
Dr Impairment loss in profit or loss	9,434	
Cr Loss allowance in financial position		9,434
- to recognise 12-month expected credit losses.		

If, at the end of Year 1, there is no significant deterioration of the credit quality, there would be no change to the recognition of the 12-month expected credit losses. Suppose, at the end of year 1, there is a significant deterioration of the credit quality and Entity B re-estimates that the present value of the lifetime expected credit losses is RM34,651. It recognises the lifetime expected credit losses, as follows:

	RM	RM
Dr Impairment loss in profit or loss (34,651 – 9,434)	25,217	
Cr Loss allowance in financial position		25,217
- to recognise lifetime expected credit losses.		

The loss allowance in the statement of financial position would have a balance of RM34,651 and that is equal to the lifetime expected credit losses at the end of Year 1.

3.2 Assessing Significant Increases in Credit Risk

Unlike the proposals in the original 2009 ED on this topic, which gradually build up the expected credit losses to a point when an actual default occurs, IFRS 9$_{(2014)}$ takes a two-step approach; the first is to recognise a 12-month expected credit loss on initial recognition of a financial asset, and then, when there has been a significant increase in credit risk after the initial recognition, a lifetime expected credit loss is recognised. Other than trade receivables, contract assets and lease receivables, the Standard does not provide for an exception to the 12-month expected credit losses on initial recognition. This means that a 12-month expected credit loss must be considered on initial recognition for a financial asset carried at amortised cost, even if the instrument is of a high quality, for example, *AAA-rated* bonds. It applies equally for all short-term debt securities measured at amortised cost, including placements of fixed deposits with banks and financial institutions, even if the likelihood of default by issuers or bankers is highly remote. The rationale for this requirement is based on the principle that credit risk is a cost of a lending or an investing activity, and that cost is included in the pricing or yield of a financial instrument. Thus, as long as a credit risk exists and no matter how low that risk may be, the 12-month expected credit losses requirement applies. The only notable exception may be investments in government bonds and government securities, which in

principle, are risk-free (although the global financial crisis had shown that not all sovereign debts are risk-free, they can be rated and priced accordingly, although the probability of default may be close to zero).

If a financial instrument is determined to have low credit risk at the reporting date an entity may assume that the credit risk of the financial instrument has not increased significantly since initial recognition. Credit risk is considered to be low if the financial instrument has a low risk of default, the issuer or borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in conditions in the longer term may, but will not necessarily reduce the ability of the issuer or borrower to fulfill its obligations. An example of a low credit risk instrument is one that has an investment grade rating (although an external rating grade is not a prerequisite for a financial instrument to be considered low credit risk).

An entity shall consider reasonable and supportable information that is available without undue cost or effort when determining whether the recognition of lifetime expected credit losses is required. The new model acknowledges that credit risk analysis is a multifactor and holistic analysis, whether a specific factor is relevant, and its weights compared to other factors will depend on the particular circumstances, such as the types of product, characteristics of the financial instruments and the borrower. Typically, credit risk increases significantly before a financial instrument becomes delinquent (i.e. past due or other lagging borrower-specific factors, such as modification or restructuring, are observed). Assessment of significant increases in credit risk may be done on a collective basis, for example, on a group or sub-group of financial instruments. This is to ensure that lifetime expected credit losses are recognised on a timely basis when there is a significant increase in credit risk even if evidence of that increase is not yet available on an individual instrument level.

In assessing whether lifetime expected credit losses should be recognised, an entity must compare the initial credit risk of a financial instrument with the credit risk at the reporting date, taking into consideration its remaining life and initial credit risk. The entity shall also consider whether there is a significant increase in the credit risk rather than in the expected credit losses (i.e. the assessment is based on changes in the probability of a default occurring), whether assessed on an individual or collective basis, and considering all reasonable and supportable information, including that which is forward-looking.

If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument by comparing: (a) the risk of a default occurring at the reporting date (based on the modified contractual terms), and (b) the risk of a default occurring at initial recognition (based on the original unmodified contractual terms).

The Standard allows the following operational simplifications for evaluating whether lifetime expected credit losses should be recognised:

(a) If the entity estimates that the financial instrument has a low credit risk at the reporting date (for example, it is "investment grade"), then the loss allowance (or provision) is measured at an amount equal to 12-month expected credit losses regardless of whether there has been a significant increase in credit risk; and

(b) A rebuttable presumption that a significant increase in credit risk has occurred when payments are more than *30 days past due* if no other borrower-specific information is available, without undue cost or effort, to decide whether a loss allowance (or a provision) at an amount equal to lifetime expected credit losses shall be recognised. The rebuttable presumption is not an absolute indicator, but is presumed to be the latest point at which lifetime expected credit losses should be recognised even when using forward-looking information.

3.3 Reversals and Re-establishment of 12-month Expected Credit Losses

IFRS 9 requires that a loss allowance (or a provision) measured at an amount equal to 12-month expected credit losses shall be re-established for financial instruments if there is no longer a significant increase in credit risk since initial recognition. In other words, if an entity has measured the loss allowance for a financial instrument at an amount equal to lifetime expected credit losses in the previous reporting period, but determines at the current reporting date that the conditions are no longer met, the entity shall measure the loss allowance at an amount equal to 12-month expected credit losses at the current reporting date [IFRS 9.5.5.7]. In this later case, there may be a reversal of the loss allowance for that financial instrument.

3.4 Financial Asset that is considered Credit-Impaired

IFRS 9 clarifies that a financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidences that a financial asset is credit-impaired are similar to the "trigger loss events" in the current IAS 39 and they include observable data about the following events:

(a) significant financial difficulty of the issuer or the borrower;

(b) a breach of contract, such as a default or past due event;

(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;

(d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisations;

(e) the disappearance of an active market for that financial asset because of financial difficulties; or

(f) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

However, it may not be possible to identify a single discrete event that caused credit-impairment of financial assets. Instead, the combined effect of several events may have caused financial assets to become credit-impaired.

3.5 Purchased or Originated Credit-Impaired Financial Assets

A purchased or originated credit-impaired financial asset is a financial asset that is credit-impaired on initial recognition. At the reporting date, an entity shall only recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets. The lifetime expected credit loss is recognised by determining the credit-adjusted effective interest rate of the instrument at initial recognition and over the expected life of the instrument through the amortisation process. An entity recognises in profit or loss the amount of the any change in lifetime expected credit losses as an impairment gain or loss. This means that an entity must recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of the expected credit losses that were included in the estimated cash flows on initial recognition.

4. Measurement of Expected Credit Losses

4.1 Basis for an Estimate of Expected Credit Losses

IFRS 9 requires that an estimate of expected credit losses shall reflect:

(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

(b) the time value of money; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions [IFRS 9.5.5.17].

The use of an outcome based on a best or worst-case scenario is not permitted. IFRS 9 does not prescribe particular measurement methods. An entity would need to consider a broader range of information when assessing and measuring expected credit losses. The measurement should be based on the relevant information that is available without undue cost or effort, including information about:

(a) past events, such as the historical loss experience for similar financial instruments;

(b) current conditions; and

(c) reasonable and supportable forecasts that affect the expected collectability of future cash flows on the instrument.

For this requirement, an entity would need to consider both quantitative and qualitative factors that are specific to the borrower, including the entity's current evaluation of the borrower's creditworthiness, general economic conditions and an evaluation of both the current point in, and the forecast direction of, the economic cycle. Although the model is forward-looking, historical information is always considered to be an important anchor or base from which to measure expected credit losses. However, historical data should be adjusted on the basis of current observable data to reflect the effects of current conditions and forecasts of future conditions.

An estimate of expected credit losses would always reflect the probability that a credit loss might occur and, implicitly, that it might not occur. Thus, an entity is not permitted to estimate expected credit losses solely on the basis of the most likely outcome (i.e. use of the statistical mode is prohibited).

Example 2: 12-month expected credit loss measurement using an explicit probability of default occurring (PD) approach

Entity L originates a single loan for RM1,000,000. Using the most recent information available, such as holder-specific data, industry data, the credit quality of the borrower and the economic outlook for the next 12 months, Entity L estimates that the instrument has a 1% probability of a default occurring in the next 12 months. It further estimates that 25% of the gross carrying amount will be lost if the loan defaults. Entity L recognises a loss allowance at an amount equal to 12-month expected credit losses using the 1% 12-month probability of default. Implicit in the calculation is the 99% probability that there is no default. The loss allowance for the 12-month expected credit losses is computed as follows:

= 1% x 25% x RM1,000,000 = RM2,500.

Example 3: 12-month expected credit loss measurement based on loss rate (LR) approach.

Bank X segments its housing loan portfolio into borrower groups P and Q on the basis of common risk characteristics that are indicative of the borrower's ability to pay all amounts that are contractually due. Groups P and Q make up RM200 million and RM300 million of the carrying amount respectively. The principal per client is RM200,000 for Group P and RM600,000 for Group Q.

Historically, for a sample of 50 loans in each group, Group P's per annum average was four defaults in the first year, and Group Q's per annum average was two defaults in the first year. Over the entire contractual term of those loans that defaulted in the first year after origination, the

present value of the observed credit loss was RM750,000 for Group P and RM1,130,000 for Group Q. The historical loss rates for the first year are determined as follows:

Housing loan portfolio							
Group	Number of client in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per annum average default	Estimated total gross carrying amount at default	Present value of observed loss	Loss rate
	(a)	(b)	(c) = (a) x (b)	(d)	(e) = (b) x (d)	(f)	(g) = (f)/(c)
		RM'000	RM'000		RM'000	RM'000	
P	50	200	10,000	4	800	750	7.50%
Q	50	600	30,000	2	1,200	1,130	3.77%

At the end of the current year Bank X expects an increase in defaults over the next 12 months compared to the historical rate. As a result, Bank X estimates five defaults in the next 12 months for 50 loans in Group P and three for 50 loans in Group Q. It estimates that the present value of observed credit loss per client will remain consistent with the historical loss per client. Bank X revises the historical loss rates as follows:

Housing loan portfolio							
Group	Number of client in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Expected defaults over next 12 months	Estimated total gross carrying amount at default	Present value of observed loss	Loss rate
	(a)	(b)	(c) = (a) x (b)	(d)	(e) = (b) x (d)	(f)	(g) = (f)/(c)
		RM'000	RM'000		RM'000	RM'000	
P	50	200	10,000	5	1,000	938	9.38%
Q	50	600	30,000	3	1,800	1,695	5.65%

Bank X uses the revised expected loss rates of 9.38% and 5.56% to estimate 12-month expected credit losses on other loans in Group P and Group Q respectively, which the Bank originated during the year.

4.2 Components in the Measurement of Expected Credit Losses

Expected credit losses are an estimate of the present value of all cash shortfalls over the remaining life of the financial instrument. A cash shortfall is 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. For a financial asset, a cash shortfall is the difference between:

(a) the present value of the principal and interest cash flows due to the entity under the contract; and

(b) the present value of the cash flows that the entity expects to receive.

The Standard requires an entity to estimate the expected credit losses to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. This need not be a complex analysis. In some cases, relatively simple modelling may be sufficient,

without the need for a large number of detailed simulations or scenarios. For example, the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount. In other situations, the identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probabilities of those outcomes are likely to be needed. In those situations, the Standard requires that the expected credit losses shall reflect *at least two outcomes.*

When determining the discount rate to be used to reflect the time value of money and credit risk for the calculation of expected credit losses, the 2013 Impairment Exposure Draft proposed to allow an entity to discount expected credit losses using a risk-free rate, the effective interest rate on the related financial asset or any rate in between these two rates. Many respondents to the 2013 Impairment Exposure Draft did not agree with this flexibility, the main reason being that the effective interest rate is the only conceptually correct rate and is consistent with amortised cost measurement. Thus the final Standard requires that an entity shall use the original effective interest rate to discount expected credit losses. For purchased or originated credit-impaired financial assets, the discount rate is the credit-adjusted effective interest rate, and for loan commitments and financial guarantee contracts, an approximation of the effective interest rate may be applied.. The expected credit losses are discounted to the reporting date, not to the expected default or some other dates.

The estimate of expected cash flows in a collaterised financial instrument reflects the amount and timing of cash flows that are expected from foreclosure less costs for obtaining and selling the collateral, irrespective of whether foreclosure is probable (i.e. the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it).

When measuring a loss allowance for a lease receivable, the cash flows used for the measurement should be consistent with the cash flows used in measuring the lease receivable in accordance with IAS 17 *Leases*. This means that when selecting the discount rate to be used for measuring expected credit losses of lease receivables, the rate the lessor charges the lessee or the effective interest rate implicit in the lease shall be applied, depending on which rate is used in measuring the lease receivable.

Example 4

Entity Q generates a loan of RM10 million. The loan is repayable by the borrower on equal annual instalments of RM2.40 million over a five-year term. The effective interest rate that Entity Q charges the borrower is 6.4% per annum comprising 4% risk-free rate and 2.4% for credit risk.

Entity Q estimates that there is a 75% chance that there loan will not default; a 15% chance that the loan defaults and the expected cash flow in each year is RM1.80 million; and a 10% chance that the loan defaults and the expected cash flow in each year is RM1.20 million.

At initial recognition, Entity Q estimates the following:

Year	Asset's contractual cash flows	Scenarios of expected cash flows and probabilities						Probability-weighted cash shortfall
		No default cash flows	Cash shortfall 75%	Default 1 cash flows	Cash shortfall 15%	Default 2 cash flows	Cash shortfall 10%	
	RM'm	RM'm	RM'm	RM'm	RM'm	RM'm	RM'm	RM'm
0	(10.00)							
1	2.40	2.40	-	1.80	0.60	1.20	1.20	0.21
2	2.40	2.40	-	1.80	0.60	1.20	1.20	0.21
3	2.40	2.40	-	1.80	0.60	1.20	1.20	0.21
4	2.40	2.40	-	1.80	0.60	1.20	1.20	0.21
5	2.40	2.40	-	1.80	0.60	1.20	1.20	0.21
IRR	6.40%						NPV(6.4%,y1-y5)	0.88
							Lifetime expected credit losses	

The lifetime expected credit losses, measured at present value are RM0.88 million. The 12-month expected credit losses measured at present value [RM.21m/(1.064)] = RM0.197 million. Hence, on initial recognition, Entity Q records the following:

	RM'm	RM'm
Dr Loan receivable	10.00	
Cr Cash		10.00

- *to record loan receivable at gross amount.*

	RM'm	RM'm
Dr Impairment loss in profit or loss	0.197	
Cr Loss allowance in financial position		0.197

- *to recognise 12-month expected credit losses.*

An entity may use practical expedients when estimating expected credit losses if they are consistent with the impairment principles of the IFRS. An example of practical expedient is the calculation of the expected credit losses on trade receivables using a provision matrix.

For a financial asset that has objective evidence of impairment at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's amortised cost and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The adjustment is recognised in profit or loss as an impairment reversal or impairment expense.

5. Stages in the Expected Credit Loss Model

There are three stages in the new impairment model to reflect the general pattern of the deterioration of a financial instrument that ultimate defaults. The differences in accounting relate to the recognition of expected credit losses and, for financial assets, the calculation and presentation of interest revenue.

Stage 1: As soon as a financial instrument is originated or purchased, 12-month expected credit losses are recognised in profit or loss and a loss allowance is established. This serves as a proxy for the initial expectations of credit losses. For financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk at the reporting date, the loss allowance for 12-month expected credit losses is maintained but updated for changes in amount. For financial assets, interest revenue is calculated on the gross carrying amount of the asset (i.e. without reduction for expected credit losses);

Stage 2: If the credit risk increases significantly and the resulting credit quality is not considered to be low credit risk, full lifetime expected losses are recognised. Lifetime expected credit losses are

only recognised if the credit risk increases significantly from when the entity originates or purchases the financial instruments but that do not have objective evidence of a credit loss event. Expected credit losses may be individually and/or collectively assessed. For a financial asset, interest revenue is still calculated on the gross carrying amount of the asset (same as for Stage 1).

Stage 3: If the credit risk of a financial asset increases to the point that it is considered credit-impaired (that have objective evidence of impairment at the reporting date), lifetime expected credit losses continue to be recognised. For financial assets in this stage, lifetime expected credit losses will generally be individually assessed. However, interest revenue is calculated on the amortised cost net carrying amount (i.e. reduced for expected credit losses).

Example 5

An entity generates a loan receivable of RM1,000,000 at beginning of Year 1. The loan is fully repayable at the end of Year 10. The effective interest rate is 6% per year payable at the end of each year. Assume that the loan eventually defaults at the end of Year 5 and the actual loss amounts to RM250,000.

Under the current IAS 39, if there were no earlier evidence of loss event, the impairment loss of RM250,000 (lifetime credit losses) would be recognised only when the loss event occurred, in this case probably towards or at the end of Year 5.

Under the new impairment model, if on initial recognition this loan has a low credit risk, 12-month expected credit losses are recognised. If the probability of default within the next 12-month period is 1%, a loss allowance is recognised as follows:

	RM	RM
Dr Loan receivable – amortised cost asset	1,000,000	
Cr Cash		1,000,000
Dr Impairment loss in profit or loss (1% x 250,000)	2,500	
Cr Loss allowance in financial position		2,500

If, at the end of Year 1, there has been no significant deterioration in the credit quality or the loan is still considered to be of low credit risk, the entity would continue to recognise 12-month expected credit losses. Suppose the probability of default increases slightly to 1.5% due to the marginal increase in credit risk of the borrower, the 12-month expected credit losses is re-estimated at 1.5% x 250,000 = RM3,750. The entity records the following journal entry:

	RM	RM
Dr Impairment loss in profit or loss (3,750 – 2,500)	1,250	
Cr Loss allowance in financial position		1,250

Interest income for the first year will be calculated at 6% x 1,000,000 = RM60,000.

If, at the end of the second year, there has been a significant deterioration of the credit quality but there is no objective evidence of an impairment loss, the lifetime expected credit losses are recognised. If the expected credit losses over the remaining period of the loan is estimated at RM100,000, the entity recognises the lifetime expected credit losses, as follows:

	RM	RM
Dr Impairment loss in profit or loss (100,000 – 3,750)	96,250	
Cr Loss allowance in financial position		96,250

Interest income for the second year will continue to be calculated on the gross amount i.e. 6% x 1,000,000 = RM60,000.

Suppose in Year 3 and Year 4, the credit quality of the loan continues to deteriorate but there is no objective evidence of impairment. Assume that in those two years, the amount recognised as impairment losses are as follows:

	RM	RM
Dr Impairment loss in profit or loss	100,000	
Cr Loss allowance in financial position		100,000

Interest income in each year continues to be recognised on the gross loan receivable.

Assume that the loan defaults at end of Year 5 and the actual impairment loss is estimated at RM250,000, the entity records a further impairment loss as follows:

	RM	RM
Dr Impairment loss in profit or loss	50,000	
Cr Loss allowance in profit or loss		50,000

The net carrying amount of the loan at the end of Year 5 will be RM750,000. Subsequently from Year 6 onward, interest income would be calculated at 6% on the net carrying amount of the loan. If at the beginning of Year 6, the loan is sold to a third party for RM740,000, the journal entry would be as follows:

	RM	RM
Dr Cash	740,000	
Dr Loss allowance in financial position – derecognised	250,000	
Dr Loss on disposal in profit or loss	10,000	
Cr Gross loan receivable – derecognised		1,000,000

6. Debt Instruments Mandatorily Measured at Fair Value through OCI

In the original IFRS 9$_{(2009)}$, financial assets are classified into one of two measurement categories: namely (i) at amortised cost, and (ii) at fair value through profit or loss, which an option for equity investments to be designated (optional) as measured at fair value through other comprehensive income. The classification is based on an entity's business model objective for managing financial assets. A financial asset (debt instrument) must be measured at amortised cost model if it is held within the business model objective of collecting contractual cash flows and the instrument has contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on principal amount outstanding.

For a financial asset measured at fair value through profit of loss (for all equity instruments, whether quoted or unquoted, and debt instruments measured at fair value), impairment test is redundant because the fair value measurement automatically recognises any decrease in fair value through profit or loss. This current requirement in IAS 39 on impairment of unquoted equity investments measured at cost is no longer applicable in IFRS 9 because the cost measurement model for such investments has been removed. It also implies that the fair value measurement of unquoted equity investments may be measured using any reasonable and supportable method in accordance with IFRS 13 *Fair Value Measurement*, including asset-based measurement methods, such as the adjusted net asset valuation method. The current IAS 39 requires that in testing for impairment of an unquoted equity investment, an entity must use the revised cash flows (the discounted cash flows method), which has been argued as not practicable in many circumstances because information about the cash flows of a private investee is not readily available to the investor. Similarly, for equity investments optionally designated as measured at fair value through other comprehensive income, any decline in fair value, including those that may be considered as impairment, is also recognised in other comprehensive income without any option of a subsequent reclassification to profit or loss.

IFRS 9$_{(2014)}$ introduces a third measurement category for a financial asset mandatorily measured at fair value through other comprehensive income (FVOCI) if: (i) the financial asset is held within a business model whose objective is achieved by collecting contractual cash flows and selling financial assets, and (ii) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding [IFRS

9.4.1.2A]. This third category has a hybrid treatment for fair value changes whereby interest income (calculated using the effective interest method), impairment losses and exchange gains or losses and any gain or loss on derecognition are recognised in profit or loss. All other gains or losses shall be recognised in other comprehensive income. These treatments are similar to debt instruments classified as available-for-sale investments under the current IAS 39. Some entities, such as insurers and banks, may have such a business model of holding debt instruments for collecting contractual cash flows and for sale. The IASB believes that this hybrid treatment results in the amortised cost information being provided in profit or loss and the fair value information provided in the statement of financial position.

For this third category, an entity shall apply the requirements for the measurement of a loss allowance in IFRS 9 to the measurement of the accumulated impairment amount for financial assets that are mandatorily measured at FVOCI. The accumulated impairment amount is not separately presented in the statement of financial position, however, the measurement of this amount is required to calculate the impairment gains or losses to be recognised in profit or loss in accordance with Section 5.5 *Impairment* of IFRS 9 and it is a loss allowance for the purposes of the disclosure requirements of this IFRS.

Example 6

On 1 January 20x1, Entity P purchases a quoted company bond with a fair value of RM95,000 (nominal value is RM100,000). Entity P classifies the debt instrument as mandatorily measured at FVOCI. The debt instrument carries a market-related interest rate of 6.1932% (consisting of Klibor of 4% plus credit spread of 2.1932%). The contractual terms of debt instrument are for 5% coupon interest payable at the end of each year over five years and redeemable at the nominal value of RM100,000. At initial recognition, Entity P determines that the asset is not credit-impaired. Based on the credit rating, Entity P recognises an impairment loss in profit or loss at an amount equal to 12-month expected credit losses of RM500. Thus, on 1 January 20x1, Entity P recognises the following journal entries:

	RM	RM
Dr Financial asset – FVOCI	95,000	
Cr Cash		95,000
Dr Impairment loss in profit or loss	500	
Cr Other comprehensive income		500

Suppose at the end of year 1 (i.e. on 31 December 20x1, the benchmark Klibor increases by 25 basis point to 4.25% and the credit spread of the issuer increases to 2.6932%. The market interest rate of the issuer at the end of year 1 is 6.9432% and the market value of the debt instrument declines to RM93,410. The analysis of the change in value, under various scenarios of market interest rate, K_d, is as follows:

Year	If Kd had not changed	If only Klibor changed by .25%	If both Klibor and credit risk changed
	RM	RM	RM
2	5,000	5,000	5,000
3	5,000	5,000	5,000
4	5,000	5,000	5,000
5	105,000	105,000	105,000
NPV	95,884	95,049	93,410
Discounted at	6.1932%	6.4432%	6.9432%

Total change in fair value (95,000 - 93,410)	(1,590)
Accretion due to time factor as interest income	884
Decrease due to Klibor change	(835)
Decrease due to credit risk	(1,639)
	(1,590)

Suppose Entity P determines that there has not been a significant increase in credit risk since initial recognition and that it is still appropriate to measure expected credit losses at an amount equal to 12-month expected credit losses. However, the expected credit losses have increased by RM1,139 (i.e. from RM500 to RM1,639). Thus, the journal entries at the end of year 1 would be as follows:

	RM	RM
Dr Cash	5,000	
Dr Financial asset – FVOCI	884	
Cr Interest income		5,884

- *to recognise interest income at effective interest rate based on gross carrying amount of asset.*

	RM	RM
Dr Impairment loss in profit or loss (1,639 – 500)	1,139	
Dr Other comprehensive income (835 + 500)	1,335	
Cr Financial asset – FVOCI		2,474

- *to recognise decrease in fair value of asset and impairment loss in profit or loss.*

Entity P provides the disclosure of the accumulated impairment amount (the loss allowance) of RM1,639. The accumulated OCI has a debit balance of RM835.

Suppose, on 1 January 20x2, Entity P sells the debt instrument for RM93,410 which is the fair value at that date, the journal entries to derecognise the debt instrument and reclassify the gains or losses that have been accumulated in other comprehensive income would be as follows:

	RM	RM
Dr Cash	93,410	
Cr Financial asset – FVOCI		93,410
Dr Loss on sale in profit or loss	835	
Cr Other comprehensive income		835

7. Simplified Approach for Trade Receivables, Contract Assets and Lease Receivables

The IASB noted that the cost of determining whether to recognise 12-month or lifetime expected credit losses may not be justified for trade receivables, contract assets and lease receivables. Thus, IFRS 9 allows a simplified approach for the impairment accounting of such financial and non-financial assets.

The Standard requires that an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:

(a) trade receivables or contract assets that result from transactions that are within the scope of IFRS 15 *Revenue from Contracts with Customers*, and that:

   (i) do not contain 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; or

   (ii) contain a significant financing component in accordance with IFRS 15, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to the lifetime expected credit losses. That accounting policy shall be applied to all such trade receivables or contract assets but may be applied separately to trade receivables and contract assets.

(b) lease receivables that result from transactions that are within the scope of IAS 17 *Leases*, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables [IFRS 9.5.5.15].

When a trade receivable that does not contain a financing component or the accounting policy option is availed for a trade receivable that is a financing transaction or a lease receivable, a loss allowance at an amount equal to lifetime expected credit losses is recognised. This would remove the need for an entity to calculate the 12-month expected credit losses and the need to consider whether the credit quality of these financial assets has deteriorated significantly since initial recognition.

Example 6

Bam Soon Bhd, a manufacturer of palm oil related consumer products, has trade receivables of RM20,600,000 at its financial year end of 31 December 20x4. The entity operates only in Malaysia. The trade receivables are categorised by common risk characteristics that are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms. All the trade receivables have a maturity of less than one year and do not have a significant financing component in accordance with IFRS 15 *Revenue from Contracts with Customers*. The customer base consists of two groups, classified by credit risk characteristics.

Of the balance in the trade receivables, RM600,000 has been specifically identified as unrecoverable and individual loss allowances have been provided. For the balance and to determine the expected credit losses for the two groups of trade receivables, Bam Soon uses a provision matrix. The provision matrix is based on the company's historical observed default rates over the lives of the trade receivables and is additionally adjusted by a forward-looking estimate that includes the probability of a worsening economic environment within the next year. At every reporting date, the historical observed default rates are updated and changes of forward-looking estimates are analysed.

At 31 December20x4, Bam Soon estimates the following updated provision matrix:					
Customer group	Not past due	1-30 days past due	31-60 days past due	61-90 days past due	>90 days past due
Group A					
Lifetime expected credit loss rate	0.5%	1.5%	3.5%	7.0%	10.5%
Group B					
Lifetime expected credit loss rate	0.6%	1.8%	3.8%	8.2%	11.3%

For each customer group, the trade receivables and the lifetime expected credit losses are measured and recognised as follows:

	Gross carrying amount RM	Expected credit loss rate %	Lifetime expected credit losses RM
Group A:			
Not past due	6,700,000	0.5%	33,500
1-30 days past due	2,000,000	1.5%	30,000
31-60 days past due	1,600,000	3.5%	56,000
61-90 days past due	1,200,000	7.0%	84,000
>90 days past due	500,000	10.5%	52,500
	--------------		------------
Total for Group A	12,000,000		256,000
	--------------		------------
Group B			
Not past due	4,700,000	0.6%	28,200
1-30 days past due	1,600,000	1.8%	28,800
31-60 days past due	500,000	3.8%	19,000
61-90 days past due	400,000	8.2%	32,800
>90 days past due	800,000	11.3%	90,400
	--------------		-----------
Total for Group B	8,000,000		199,200
	--------------		-----------
Total trade receivables	20,000,000	AR=2.28%	455,200
	========	=======	======

With this simplified approach, the impairment testing of trade receivables, lease receivables and contract assets under the new model would be about the same as the current practice (under IAS 39) of recognising individual and collective loss allowances, with an exception that forward-looking information about credit loss events must be considered in the assessment. It is unclear why this simplified approach is not extended to other short-term debt instruments, such as investments in marketable securities and placements of fixed deposits with banks, which have low or little credit risk.

8. Other Requirements in IFRS 9

8.1 Write-off

In the current IAS 39, an impairment loss may be written off directly against the gross carrying amount of the related financial asset. There is no requirement that a loss allowance account must be maintained. IFRS 9 requires a loss allowance account to be maintained for expected credit losses, which means that a direct write-off is not permitted. An entity shall directly reduce the gross

carrying amount of a financial asset only when the entity has no reasonable expectations of recovery. A write-off constitutes a derecognition event as contrast to an allowance for expected credit losses, which is presented as an offset against the gross carrying amount of the financial asset [IFRS 9.5.4.4].

8.2 Interest Revenue and Effective Interest Rate

Interest revenue shall be calculated by using the effective interest method and applying the effective interest rate to the gross carrying amount of a financial asset except for:

(a) Purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the *credit-adjusted effective interest rate* to the amortised cost of the financial asset from initial recognition.

(b) Financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. For those assets, the entity shall apply the effective interest rate to the amortised cost amount after adjustment for any credit loss allowance of the financial asset in the *subsequent reporting periods* [IFRS 9.5.4.1].

Example 7

An entity originates a 5-year loan of RM10,000,000 that pays fixed interest of 8% per year and is repayable at the nominal amount at the end of Year 5. Transaction costs amount to RM200,000. If the borrower defaults at the end of Year 5, the entity expects to recover only RM7,500,000 of the principal amount. Based on the credit risk of the borrower, there is a 1% chance that the borrower will default at the end of Year 5. Using a discount rate of 4% risk-free rate, the probability-weighted lifetime expected credit losses is estimated at RM20,548. An initial 12-month expected credit losses of RM4,110 is recognised as a loss allowance on the origination date of the loan. The effective interest rate is calculated on the gross carrying amount as follows:

$$RM10,200,000 = \sum_{t=1}^{5} \frac{RM800,000}{(1 + r)^t} + \frac{RM10,000,000}{(1 + r)^5}$$

Where: "r", the effective interest rate, is determined at 7.51%.

The interest revenue is recognised at the effective interest rate of 7.51% on the gross carrying amount over the five-year term and the loss allowance is adjusted for the 12-month expected credit losses at the end of each year as follows:

Amortised Cost Carrying Amount				Loss Allowance	
Year	Opening balance	Interest revenue at 7.51%	Coupon interest	Closing balance	12-month expected loss allowance	Impairment loss in P&L
	RM	RM	RM	RM	RM	RM
0	-	-	-	10,200,000	4,110	4,110
1	10,200,000	765,571	(800,000)	10,165,571	4,274	164
2	10,165,571	762,987	(800,000)	10,128,558	4,445	171
3	10,128,558	760,209	(800,000)	10,088,766	4,623	178
4	10,088,766	757,222	(800,000)	10,045,989	4,808	185
5	10,045,989	754,011	(800,000)	10,000,000	5,000	192
		3,800,000	(4,000,000)			5,000

At the end of Year 5 and if there is no default, the entity records the following journals:

RM   RM

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

- to record receipt on repayment of loan receivable.

Dr Loss allowance in financial position	5,000	
Cr Impairment gain in profit or loss		5,000

- to recognise reversal of 12-month expected credit losses.

When the Loan becomes Credit-Impaired

If, in the above example, the loan receivable subsequently becomes credit-impaired at the end of Year 2, and the entity revises the estimated future cash flows to consist of RM600,000 interest per year for the remaining three years and the recoverable amount of RM9,000,000 of the principal at the end of Year 5. Using the original effective interest rate of 7.51%, the present value of the revised future cash flows is calculated at RM8,803,671. The lifetime expected credit losses are calculated at the present value of the shortfall in the future cash flows and the amount of lifetime expected credit losses required is RM1,324,887. The entity recognises the impairment loss as follows:

	RM	RM
Dr Impairment loss in profit or loss (1,324,887 – 4,274)	1,320,613	
Cr Loss allowance account – lifetime expected credit losses		1,320,613

The entity subsequently applies the original effective interest rate to the revised amortised cost amount in the subsequent periods, as follows:

Revised Amortised Cost Carrying Amount			
Year	Opening balance	Interest revenue at 7.51%	Coupon interest	Closing balance
	RM	RM	RM	RM
3	8,803,671	660,768	(600,000)	8,864,439
4	8,864,439	665,329	(600,000)	8,929,768
5	8,929,768	670,232	(600,000)	9,000,000
		1,996,329	(1,800,000)	

For a Purchased or Originated Credit-Impaired Loan

If the entity in the above example purchases an equivalent 5-year loan that is credit-impaired and it pays RM8,500,000 for the gross amount of RM10,000,000. Because the loan is credit-impaired at the date of purchase, a loss allowance of RM1,500,000 is simultaneously recognised at the date of purchase. The entity estimates that the expected future cash flows of the loan are RM600,000 per year for interest payment and RM8,500,000 for the principal amount at the end of Year 5. The credit-adjusted effective interest rate of this purchased credit-impaired loan is calculated on the amortised cost amount net of initial loss allowance as follows:

$$RM8,700,000 = \sum_{t=1}^{5} \frac{RM600,000}{(1+r)^t} + \frac{RM8,500,000}{(1+r)^5}$$

Where: "r", the credit-adjusted effective interest rate, is determined at 6.49%.

On initial recognition the entity records the following journal:

	RM	RM
Dr Loan receivable – gross amount	10,200,000	
Cr Loss allowance account (lifetime expected credit losses)		1,500,000

Cr Bank account 8,700,000

If there is no further deterioration in the credit risk of the borrower i.e. no subsequent changes to the lifetime expected credit losses, the entity recognises interest revenue at 6.49% per year on the net amortised cost carrying amount at the end of each year as follows:

Amortised Cost Carrying Amount Net of Loss Allowance			
Year	Opening balance	Interest revenue at 6.49%	Interest received	Closing balance
	RM	RM	RM	RM
1	8,700,000	564,868	(600,000)	8,664,868
2	8,664,868	562,587	(600,000)	8,627,455
3	8,627,455	560,158	(600,000)	8,587,613
4	8,587,613	557,571	(600,000)	8,545,184
5	8,545,184	554,816	(600,000)	8,500,000
		2,800,000	(3,000,000)	

If, at the end of year 5, the amount received from the borrower is RM9,000,000 the additional RM500,000 received is attributable to a favourable change in the lifetime expected credit losses on settlement [see IFRS 9.5.5.14]. Thus, the entity records the following closing journal:

	RM	RM
Dr Bank account	9,000,000	
Dr Loss allowance account	1,500,000	
Cr Loan receivable account		10,000,000
Cr Impairment gain in profit or loss		500,000

9. Disclosures about Impairment Losses

The new impairment model in IFRS 9 is accompanied by improved disclosures about expected credit losses and credit risk. Entities are required to provide information that explains the basis for their expected credit loss calculations and how they measure credit losses and assess changes in credit risk.

Also, entities are required to provide a reconciliation from the opening to the closing loss allowance balances for 12-month expected credit losses separately from lifetime expected credit losses. This should be provided along with a reconciliation from the opening to the closing balances of the related carrying amounts of financial assets subject to impairment. The reconciliations are required to be provided in a way that enables users of financial statements to understand the reason for changes in the loss allowance balances, such as whether it is caused by changes in credit risk or increased lending. In addition, in response to requests from users of financial statements, information is required to be provided about the credit risk of financial assets by rating grades and about financial assets on which contractual cash flows have been modified.

10. Transitions

With limited exceptions, IFRS 9 requires an entity to apply the impairment requirements in Section 5.5 retrospectively in accordance with IAS 8. At the date of initial application, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that a financial instrument was initially recognised (or for loan commitments or financial guarantee contracts at the date that the entity became a party to the irrevocable commitment) and compare that to the credit risk at the date of initial application of the Standard.

If, at the date of initial application, determining whether there has been a significant increase in credit risk since initial recognition would require undue cost or effort, an entity shall recognise loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognised (unless that financial instrument is low credit risk at a reporting date).

An entity that applies the amortised cost measurement for financial assets shall provide the new enhanced disclosures in IFRS 7 *Financial Instruments: Disclosures* but need not restate prior periods. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application.

If an entity prepares interim financial reports in accordance with IAS 34 *Interim Financial Reporting* the entity need not apply the requirements in this Standard to interim periods prior to the date of initial application if it is impracticable to do so (as defined in IAS 8).

11. Implications and Conclusions

The new impairment model would resolve many of the concerns raised by constituents and users of financial statements about the complexity, inconsistency and rule-based treatments in the current IAS 39 on impairment accounting. Instead of applying multiple impairment models for different financial assets, IFRS 9 uses a single forward-looking impairment model that eliminates the threshold for the recognition of expected credit losses, so that it is no longer necessary for a trigger loss event to have occurred before credit losses are recognised. IFRS 9 requires an entity to base its measurement of expected credit losses on reasonable and supportable information that is available without undue cost or effort and that includes not just historical loss experience and current conditions, but also forecast of future economic conditions. Consequently, more timely information about expected credit losses is provided and this would address the concern of reporting credit losses too little too late.

The requirement to recognise 12-month expected credit losses on the origination or purchase of a financial asset subject to impairment is conceptually sound as it is based on the notion that the losses are included in the pricing (yield) of financial instruments, which compensates the investor or lender for the creditworthiness of the issuer or borrower at the time of investing or lending or commitment to lend. This requirement may work fine with banks, insurance entities and other financial institutions, who would typically have detailed credit risk management. A forward-looking impairment model would supplement prudency in the management of banks and insurance entities.

But for many other entities not in these two industries, there may be practical difficulties in measuring the 12-month expected credit losses on the initial recognition of a financial asset subject to impairment. For example, if a non-bank entity purchases a high-qualify corporate bond, it would need to recognise 12-month expected credit losses (which should be measured as a portion of the lifetime expected credit losses) on the purchase date even if the probability of default is highly remote. The entity is unlikely to have similar past loss experience of such investments and any estimation about possible outcomes and probability-weighted loss amount is highly subjective. It would have been easier if the new model had allowed an option for non-bank entities to recognise lifetime expected credit losses at all times for investments in debt instruments (similar to the practical expedient allowed for trade receivables, contract assets and lease receivables).

The 12-month expected credit loss requirement is debatable for investments in short-term debt securities, including placements of fixed deposits with banks and financial institutions. For an entity who wishes to earn a stable interest income over a period of time with relatively little risk, the recognition of an impairment loss upfront may be argued as counter-intuitive. It is unclear in such

cases whether an entity may assume a zero rate of default in the measurement of the loss allowance and thus avoid the need to recognise the 12-month expected losses upfront. The standard setters should consider making an exception to investments in such low-risk financial instruments for non-bank entities. Also, the condition of "without undue cost or effort" for the impairment measurement needs to be clarified further, such as whether there are circumstances in which undue cost or effort may be availed to over-ride the recognition and measurement of impairment losses. It would appear that an entity may be able to apply the costs-benefits consideration of the *Conceptual Framework* on the ground of undue cost or effort for an exception to the 12-month expected credit losses for short-term debt securities with relatively little credit risk. A reporting entity may want to consider whether classifying all such short-term debt securities as measured at fair value through profit or loss would be an easier and less costly option if it is within its business model objective.

With the new impairment model, the likely changes in the accounting and the effects to reporting entities would be in the following areas:

(a) 12-month expected credit losses must be recognised on origination or purchase of a financial asset subject to impairment (except for trade receivables, contract assets and lease receivables if the simplified approach is applied, and originated or purchased credit-impaired assets). Loss allowance is likely to increase for banks, insurance entities and entities with significant investments in debt instruments;

(b) Probability-weighted estimates of lifetime expected credit losses using reasonable and supportable information, including forecast of future economic conditions. In worsening economic conditions and future outlook, loan losses are likely to increase, particularly for banks, insurance entities and entities with significant investments in debt instruments; and

(c) Enhanced disclosures about expected credit losses.

References:

1. IAS 39 *Financial Instruments: Recognition and Measurement*, 1997, IASC.
2. IFRS 9$_{(2009)}$ *Financial Instruments*, October 2009, IASB.
3. IFRS 9$_{(2010)}$ *Financial Instruments*, November 2010, IASB.
4. IFRS 9$_{(2014)}$ *Financial Instruments*, July 2014, IASB.
5. *Implementation Guidance: IFRS 9 Financial Instruments*, July 2014, IASB.
6. *Project Summary: IFRS 9 Financial Instruments*, July 2014, IASB.

Tan Liong Tong is the Project Manager of the MASB Working Group (WG 63) on Consolidation. The views expressed in this article are those of the author and not the official views of the MASB.