



Introduction of IFRS 9: Impact on statistical reporting

By Perry Francis and Dennis Jeevarajasingham

Tel: +44 (0)20 3461 5356

dsdp1team@bankofengland.co.uk

With the introduction of International Financial Reporting Standard 9 (IFRS 9) from January 2018 there will be changes to the way some institutions prepare their financial statements. This article outlines the main changes and the likely to affects on statistical data collected and published by the Bank. We would welcome any feedback or questions from those institutions transitioning to IFRS 9 or from users.

Background

In July 2014 the International Accounting Standards Board (IASB) published the final version of International Financial Reporting Standard 9 - Financial Instruments (IFRS 9). The final version brought together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 – Financial Instruments: Recognition and Measurement. One of the key objectives of the new standards is to address concerns that arose as a result of the financial crisis that the IAS 39 incurred loss model potentially contributed to the delayed recognition of credit losses.

IFRS 9 is effective for financial reporting periods beginning on or after 1 January 2018 for those institutions that are required to or choose to report in accordance with IFRS.

Credit loss data are published by the Bank in *Bankstats* Tables B3.2 (annual provisions and write-offs) and C2.1 (quarterly write-offs).

Classification and measurement

The measurement of financial assets and income streams for statistical data reporting remains unchanged and is determined by National Accounts requirements, so reporting institutions will have to adjust their financial valuations in the same way they do currently.

Impairment

One area where IFRS 9 changes will affect the reporting of statistical data is for impairments where statistical reporting will continue to mirror the impairments reported in accordance with the financial statements and will thus incorporate changes stemming from IFRS 9.

During the financial crisis, the delayed recognition of credit losses on loans (and other financial instruments) was considered to be a weakness in existing accounting standards. This was primarily due to the interpretation of the impairment requirements under IAS 39, which are based on an incurred loss model i.e. impairment losses are not recognised until after there is objective evidence of a loss event. As part of IFRS 9, the IASB has introduced a new, expected-loss impairment model that will require more timely recognition of expected credit losses (ECL). Specifically, the new standard requires entities to account for 12-month expected credit losses from when financial instruments are first recognised and to recognise full lifetime expected losses on a more timely basis, when there has been a significant increase in credit risk since origination.

Expected credit loss requirements apply to all debt instruments recorded at amortised cost and to most recorded at fair value through other comprehensive income as well as to certain loan commitments and financial guarantees ('relevant exposures').

The guiding principle of the expected credit loss model is to reflect the general pattern of deterioration or improvement in the credit quality of financial instruments. The expected credit loss

recognised as a loss allowance or provision depends on the extent of credit deterioration since initial recognition. Under the new standard, there are three key stages:

12-month ECLs (Stage 1 - Performing), applies to all relevant exposures (from initial recognition) as long as there is no significant deterioration in credit quality;

Lifetime ECLs (Stage 2 – Under-performing), applies when there is a significant deterioration in credit quality on an individual or collective basis but the relevant exposure is not credit impaired and

Lifetime ECLs (Stage 3 – Non-performing), applies when a significant increase in credit risk has occurred on an individual or collective basis and the relevant exposure is credit impaired.

Statistical reporting of provisions and releases

In terms of statistical reporting, the expectation is for an increase in the amount of new provisions for bad and doubtful debts as and when reporting institutions adopt IFRS 9. The anticipated increase in provisions will affect series *net new provisions charges* (GFAB5RO) in *Bankstats* Table B3.2. For statistical reporting we are content to have all new provisions (and associated releases) reported consistent with IFRS 9.

Statistical reporting of interest on impaired financial assets

Where IFRS 9 reporting will differ from that required for statistical reporting is in the estimation of accrued interest. Statistical reporting requires the recognition of interest accruals on the gross carrying value throughout the life of the instrument regardless of impairment whereas, for IFRS 9 Stage 3, interest is calculated on an amortised cost basis e.g. gross carrying amount less loss allowance. For IFRS 9 stages 1 and 2, interest is calculated on the gross carrying amount before loss allowances in line with statistical reporting. The reporting of interest statistical forms will remain on the current basis and will continue to include accrued interest based on the gross carrying amount for Stages 1, 2 and 3.

Hedging

New accounting models will align hedge accounting with risk management activities to assist users of financial statements to better understand these activities. It is the Bank's understanding that there will be no impact on statistical reporting for these changes.

Balance sheet reporting

Following a review of these changes, the reporting of balance sheet data (i.e. reporting of Form BT) is expected to be affected in the data items for retained earnings and provisions.

Further impact

Should reporting institutions or data users anticipate further aspects not mentioned above then please let us know using contact details shown at the start of this article.