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Mr Jaime Caruana  
Bank for International Settlements (BIS)  
Centralbahnplatz 2  
4051 Basel  
Switzerland

30 April 2015

Dear Mr Caruana,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the consultative document “Guidance on accounting for expected credit losses” (February 2015), hereafter called “the CD”.

Principal authors of this comment letter were Peter Bitzyk, Thomas Gaber, Michael Hammer, Herwig Hierzer, Gerhard Hoffmann, Friedrich Hief, Peter Häfliger, Wolfgang Reitgruber, Alexander Schiebel, Caroline Pranzl, Guido Sopp and Roland Nessmann. The professional background of these authors is varied (three preparers, two supervisors and six auditors) in order to assure a balanced Austrian view on the CD.

### **General comments**

While we acknowledge and welcome the role that BIS, and especially the Basel Committee on Banking Supervision (BCBS), plays in the international harmonisation of supervisory frameworks and rules, we believe it is up to the accounting standard setters to determine rules for financial statements within a given financial reporting framework. Preparers – in cooperation with their statutory auditors – have to ensure that financial statements are in line with the applicable financial reporting framework.

We note that BCBS attempts to harmonise the calculation of expected losses, which could be seen as one of the crucial elements for the financial stability of the financial sector, but point out that BIS (and BCBS) is an organisation charged with the harmonisation of the supervisory rules for international credit institutions, which is clearly different from setting accounting standards for preparers of financial statements.

We are afraid that the Basel Committee, by issuing guidance on accounting issues in financial reporting, could possibly come to be seen as an additional financial reporting standard setter.

IFRS 9 requires entities to account for and disclose financial instruments in the same way as they are treated in risk management. Our major concern is therefore about potential conflicts between IFRS 9 and the appendix of the CD. Any new, additional rules for the treatment of financial instruments in risk management will have to be reflected in the financial reports, thus leading to different application of IFRS 9: There will be one set of rules for those companies following IFRS 9 and a different for companies which have to follow the additional BCBS guidelines for the application of IFRS 9 set out in the appendix of the CD.

In our view, the international comparability of IFRSs, one of the key elements of the recent development of international accounting rules, could be jeopardised by the amendment of the standard (especially with regard to disclosure requirements) and/or the restriction of the applicability of existing options in IFRSs. We strongly believe that if BIS (BCBS) thinks IFRS 9 to be incomplete or misleading, BIS (BCBS) should request the relevant standard setters to change IFRS 9.

The CD states in its scope section (paragraph 13) that “this paper covers the credit risk practices for lending exposures that are subject of allowances under ECL accounting frameworks. While credit risk practices for other bank exposures, such as debt securities, are outside the scope of this paper, banks should ensure that sound credit practices are in place in these areas and that credit risk is properly considered in developing estimates for these other exposures.” IFRS 9 does not recognise a similar distinction between different classes of financial instruments, and the CD might bring confusion in this area of accounting by allowing the use of different rules for different classes.

Another debatable subject is the mandatory use of macroeconomic forecasts in the calculation of the expected loss. Who should be responsible for their preparation, and for the verification? Macroeconomic forecasts are highly subjective and will therefore be difficult to audit. We therefore do not see the need for such a widespread debate in the CD.

More generally, what is missing is a statement of the level at which the CD is to be applied: Should it in principle be applied to individual companies, or at the group level? From our point of view, it must be applied at the individual company level, but the method of calculation should be standardised at the group level as far as this is meaningful and possible.

The CD in its current form does not discuss materiality, which will play a key role when implementing IFRS 9 (e.g., IFRS 9 B5.5.15, regarding undue cost or effort, or that there is no need to undertake an exhaustive search for information). We think the guidance should also address the issue of materiality, especially when discussing implementation or new segmentation.

We note that BCBS uses the term “prudence” in the CD (e.g., paragraph 63). Prudence is not a term used in IFRS, as neutrality is a key characteristic of reporting under IFRS, as set out in the IASB’s Framework. Prudence in financial reporting is inconsistent with neutrality.

In principles 5 and 10 the BCBS acknowledges work performed by the external auditor. It is not clear in principle 5 whether this refers to the work performed by the auditor in forming his audit opinion or an additional review, implying a separate assignment.

### **Specific comments**

Apart from our general view that BIS (BCBS) should not amend IFRS 9 and/or restrict the application of options in IFRS 9, we have the following specific comments on the Appendix.

- A3. This paragraph appears to be unclear: a statistical validation of the specific interaction between positive and negative factors within a typical rating model, which is developed on the basis of multivariable factors, is not possible. What should such a validation look like? It might be possible if the wording were changed to “changes in macroeconomic risks”, but we think that regulation in accordance with IFRS 9 is not to be qualified or changed!
- A6. The principle of materiality applies to all IFRSs: this paragraph should therefore include the phrase “if possible without undue costs and efforts”. As IFRS 9 will have to be implemented by 2018, it will not be possible to develop new models based on material past experience by the time of first-time application. Models to score customer behaviour and to calculate point-in-time ECL will improve with long-term experience, but cannot be expected to include all factors mentioned by the CD when initially applied.
- A5. Default assessment should be fact-based and on an individual basis. Indications of unlikelihood of payment assessed on a collective base and/or adjusted for forward looking information should only be relevant for the significant increase in credit risk (bucket transitions) and calculation of any cash shortfalls.
- A8. The relationship of the information asked for in this paragraph to that stipulated in IFRS 7 seems unclear: If the BCBS thinks that the disclosures in IFRS 7 are not sufficient, the BCBS should either ask the IASB to amend IFRS 7 or require additional regulatory disclosures. Secondly, what should the documentation and disclosure of “rationale for extending these exposures and associated governance process” contain?
- A12. In our view, additional segmentation only seems appropriate if the segmentation is forced by a new, so far unrecognised significant risk or if risk factors or their correlation have changed.
- A20. For small exposures which are monitored and controlled on a portfolio basis (in particular in the retail segment) a past due indicator may be appropriate given cost-benefit considerations. Many banks have statistical models that capture the connection between

days past due and increased probability of default. For large exposures other factors will be considered, as these are monitored on an individual basis. However, this will usually not be possible for small loans, for which past due status may be an objective and comparable indicator.

- A26. This states that indicators as defined by IFRS 9.B5.5.17 (a)-(p) should each be considered when determining whether an exposure should move to bucket 2. IFRS 9 states that the factors mentioned “may be relevant”, but does not require entities to track all the factors for all loans.
- A27. A26 refers to IFRS 9.B5.5.17 and the 16 classes of possible factors to be monitored when assessing changes in credit risk. Then A27 picks out some and makes them more relevant than others. Also, the wording in A27 is inconsistent with IFRS 9.B5.5.17, which will lead to additional diversity in practice. It seems that factors listed in A27 generally lead to LEL. We do not see the need to establish these automatic moves to LEL as they might act as false incentives to banks (i.e., not to take additional collateral for an exposure when it would make economic sense, because it would lead to an automatic shift from bucket 1 to bucket 2). This paragraph should therefore either be rephrased or deleted.
- A29. This discusses the implications of notch downgrades. It could be read as saying that these downgrades are irrelevant for the assessment of credit risk. We do not understand the rationale of this paragraph and think that it – or at least the last sentence – should be deleted.
- A35. Even with reference to IFRS 9 IE39, it is not defined, what the word “group” means in this context. Thus, further clarification is needed. In our opinion a downgrading of a single counterparty within a group with shared credit risk characteristics should not automatically lead to transfer of the entire group to LEL.
- A46. Use of practical expedients (A46 *et seqq*; low credit risk / the 30-days-past-due rebuttable presumption): The IASB discussed the practical expedients to be allowed by IFRS 9 in detail with standard setters, regulators and users. As IFRS 9 was always expected to be particularly relevant for banks, the practical expedients were also intended to be available to banks in particular, to ease implementation of IFRS 9. Practical expedients for non-banks are also included, e.g., the possibility to use LELs for trade receivables and leasing exposures. A46 states that the cost of obtaining information is not considered by the Committee to be likely to involve “undue cost or effort”. The guidance emphasises the usage of extensive data, implementation of new systems and processes as well as a very limited use of practical expedients. IFRS 9 states several times that the increase in credit risk is to be determined on the basis of information that is available without undue cost and effort (e.g., IFRS 9.5.5.9 *et seqq*), which implies that IFRS 9 does not necessarily require that an entity develops new models but may make use of data already available. The CD goes against this principle by requiring implementation of new systems and collection of additional data. We note that the CD adds special rules additional to those in IFRS 9 for an unclearly defined group of companies (“internationally acting banks”). The differently applicable rules

for measurement and disclosures for financial instruments may reduce the comparability of financial statements, both overall and between sectors, in particular with respect to financial instruments.

- A48. Paragraph 46 imposes an additional burden of proof on the bank: the bank has to document and disclose why it has acted in a way that is permitted by IFRS 9, but is discouraged or forbidden by the CD.
- A49. Just as with any implementation of new systems or processes required by a new standard, the implementation of IFRS 9 should be subject to cost-benefit analysis, as generally stipulated in IFRS.
- A59. While we acknowledge that for risk monitoring and controlling purposes it may be better in the long run to accumulate and use long data series, there may be some legitimate situations where this is not possible. There can be a variety of valid reasons for using the low credit assumption without that implying low quality implementation – examples are the first-time application of IFRS 9, the acquisition of new segments/exposures, and exposures that are not material. For this reason, we object to this paragraph.
- A55. We do not understand what BIS (BCBS) intends with this paragraph, and request clarification. What is meant by assessment of a high risk exposure “on the basis of a global market perspective, which takes into account of all terms and conditions of the contractual relationship”?

Kind regards,

Romuald Bertl

Chairman