THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ZIMBABWE

COVID-19 AND IMPLICATIONS ON IFRS9

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Accounting for expected credit losses applying IFRS 9 Financial Instruments in light of current uncertainty resulting from the covid-19 pandemic.

IFRS 9 sets out a framework for determining the amount of expected credit losses (ECL) that should be recognised. It requires that lifetime ECLs be recognised when there is a significant increase in credit risk (SICR) on a financial instrument. Lifetime ECLs are the expected credit losses that result from all possible default events over the expected life of a financial instrument. However, the standard does not set bright lines or a mechanistic approach to determining when lifetime losses are required to be recognised nor does it dictate the exact basis on which entities should determine forward-looking scenarios to consider when estimating ECLs.

IFRS 9 requires the application of judgement and both requires and allows entities to adjust their approach to determining ECLs in different circumstances. A number of assumptions and linkages underlying the way ECLs have been implemented to date may no longer hold in the current environment. Entities should not continue to apply their existing ECL methodology mechanically. For example, the extension of payment holidays to all borrowers in particular classes of financial instruments should not automatically result in all those instruments being considered to have suffered an SICR.

To assess SICR, IFRS 9 requires that entities assess changes in the risk of a default occurring over the expected life of a financial instrument. Both the assessment of SICRs and the measurement of ECLs are required to be based on reasonable and supportable information that is available to an entity without undue cost or effort. Entities are required to develop estimates based on the best available information about past events, current conditions and forecasts of economic conditions. In assessing forecast conditions, consideration should be given to the effects of covid-19.

One of the practical expedients given by IFRS 9 and often used by preparers is the use of a provision matrix in the calculation of ECL. The provision matrix is applied after classifying the receivables. This classification may be adjusted to factor for the customers' different degrees of exposure to impact by covid-19 hence susceptible to different risks of default.

In the Zimbabwean, the government has classified some lines of businesses as essential services which have mostly continued to provide goods and services with minimal restrictions on their economic activity and movement of employees. The degree of impact therefore on those operating in essential services and those in non-essential services will be different hence the classification and provision matrix ought to be modelled to reflect these circumstances.

Other factors that may also be considered include product type, geographical location of customer and whether the customer is retail or wholesale. Significant judgment will be involved in determining and understanding the drivers of credit risk for the receivable and how these have been impacted by covid-19. Additional adjustment to the ECL may also need to be made for customers that are known to already be in financial difficulty and those who have a history of making late payments. For those customers who may take longer than normal to pay, a determination and careful consideration will have to be made of whether this is due to operational issues related to COVID-19 restrictions or credit risk.

It is likely to be difficult at this time to incorporate the specific effects of covid-19 and government support measures on a reasonable and supportable basis. However, changes in economic conditions should be reflected in macroeconomic scenarios applied by entities and in their weightings. If the effects of covid-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered. The environment is subject to rapid change and updated facts and circumstances should continue to be monitored as new information becomes available.
Although current circumstances are difficult and create high levels of uncertainty, if ECL estimates are based on reasonable and supportable information and IFRS 9 is not applied mechanistically, useful information can be provided about ECLs. Indeed, in the current stressed environment, IFRS 9 and the associated disclosures can provide much needed transparency to users of financial statements.

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