The European regulator, ESMA\(^1\), has issued a statement to promote consistent application of IFRS\(^\circ\) Standards in reflecting governmental and related measures aimed at reducing the systemic impact of COVID-19 when measuring expected credit losses (ECLs) under IFRS 9 Financial Instruments. These measures include direct governmental support to borrowers as well as relief provided by lenders.

ESMA emphasises that the principles-based nature of IFRS 9 allows issuers to faithfully represent circumstances arising from COVID-19 and associated public policy measures.

**Accounting for modifications as a result of support measures**

Issuers need to assess whether economic support measures lead to a substantial modification of a financial asset that results in its derecognition.

The assessment may require significant judgement and should consider both quantitative and qualitative factors.

If the modification provides temporary relief to a debtor and the net economic value of the loan is not significantly affected, then it would be unlikely to be considered substantial.

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\(^1\) European Securities and Markets Authority.
Assessing significant increase in credit risk

IFRS 9 requires an issuer to assess whether there is a significant increase in credit risk (SICR) on an exposure at each reporting date. This is a holistic assessment that should capture the changes in the lifetime risk of default – i.e. over the entire expected life of the instrument.

Government programmes that provide support to borrowers should be considered in the assessment because they may reduce the lifetime risk of default.

Measures to allow suspension or delays in payments of a loan should not be regarded as automatically meaning the loan has suffered a SICR. Instead, the lender needs to analyse the conditions under which the measures are implemented and consider all facts and circumstances. A key issue is to distinguish temporary liquidity constraints on a borrower from a SICR over the life of the instrument.

IFRS 9 includes a rebuttable presumption that a loan that is more than 30 days past due has undergone a SICR. Issuers would need to consider whether economic support provided to a borrower might rebut this presumption.

If COVID-19 impacts on credit risk cannot be identified at an individual instrument level, then it may be necessary to assess SICR on a collective basis – e.g. for a group or part of a group of loans.

ECL estimation

ECLs are measured reflecting an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.

It takes into account reasonable and supportable information that is available without undue cost and effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Issuers need to consider how much the current uncertainty and changes in the short-term economic outlook are expected to result in impacts over the entire life of a financial instrument. Issuers will face challenges in developing reasonable and supportable forecasts. They need to consider how long the economic shock may persist before a reversion to long-term stable trends occurs and how government support might mitigate the shock.

Public guarantees on issuers’ exposures

Governments might provide guarantees over lending exposures.

A guarantee does not reduce the risk of default of an exposure but, if it is integral to the terms of a loan, it may reduce expected losses on default. Assessing whether a guarantee is integral may require judgement.

Transparency

ESMA stresses the importance of providing all relevant disclosures about actual and potential impacts of COVID-19 to comply with IFRS 7 Financial Instruments: Disclosures.

For interim financial statements, ESMA expects that sufficient disclosures will need to be provided to understand significant events and transactions since the last annual reporting date.

Additional information should be provided about significant judgements.

KPMG’s insights

We have spoken about the impacts of COVID-19 on ECL measurements and the need for transparent disclosures in our recently released article in our COVID-19 financial reporting resource centre.