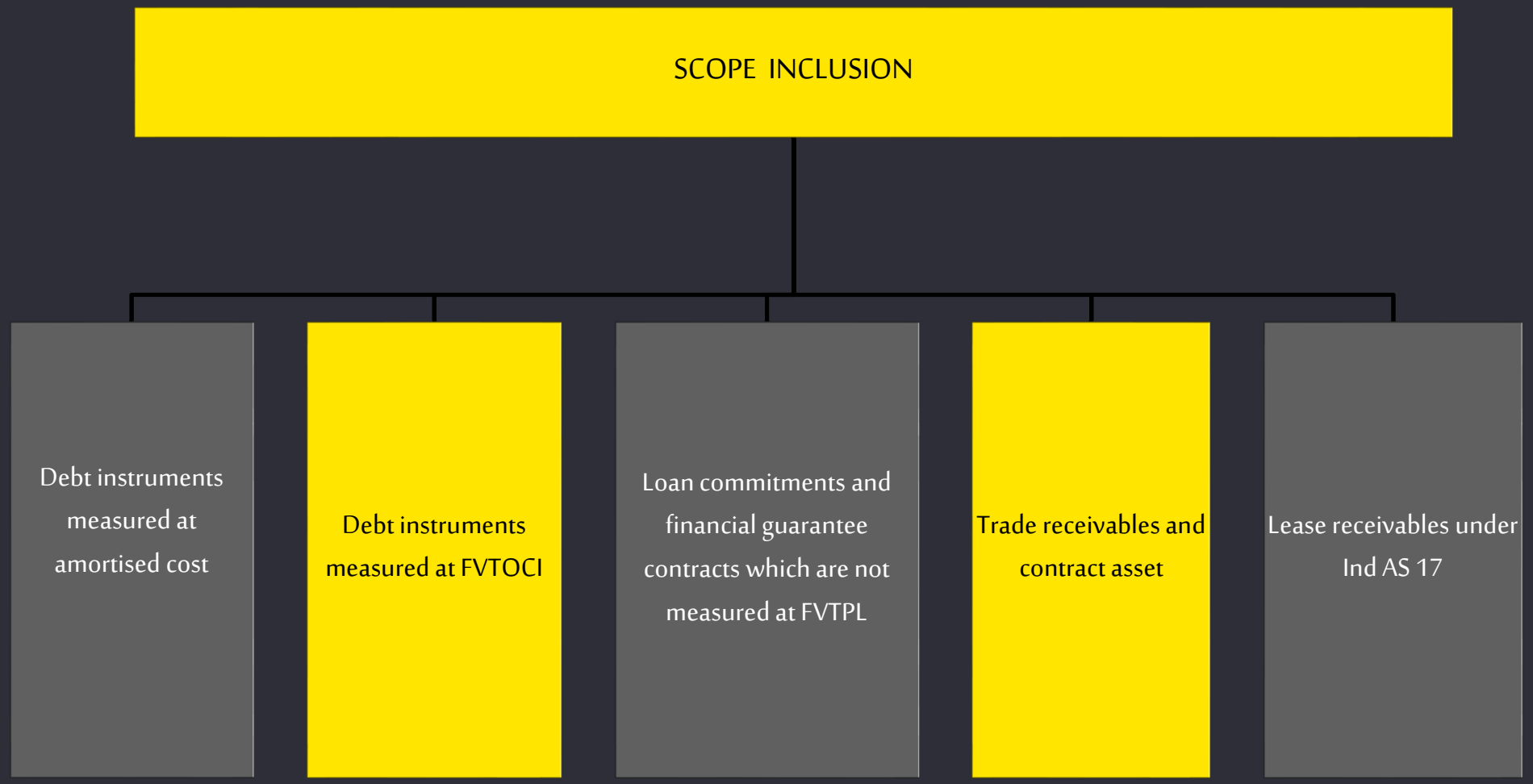
Ind AS Master Class
(Expected Credit Loss)

July 31, 2020

Expected Credit Loss Model

Scope


SCOPE INCLUSION
Debt instruments measured at amortised cost
Debt instruments measured at FVTOCI
Loan commitments and financial guarantee contracts which are not measured at FVTPL
Trade receivables and contract asset
Lease receivables under Ind AS 17

General Approach Vs. Simplified Approach

APPROACH FOR COMPUTATION OF ECL

General Approach

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.

Simplified Approach

an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses.

Variation of ECL Model

Scope of ECL requirements	General approach	Simplified approach
Ind AS 109 Financial Instruments		
Trade receivables that do not contain a significant financing component		✓
Trade receivables that contain a significant financing component	Policy election at entity level	
Other debt financial assets measured at Amortised Cost or at FVOCI	✓	
Loan commitments and financial guarantee contracts not accounted for at FVTPL	✓	
Ind AS 115 Revenue from Contracts with Customers		
Contract assets that do not contain a significant financing component		✓
Contract assets that contain a significant financing component	Policy election at entity level	
Ind AS 17 Leases		
Lease receivables	Policy election at entity level	

Simplified Approach

Feature

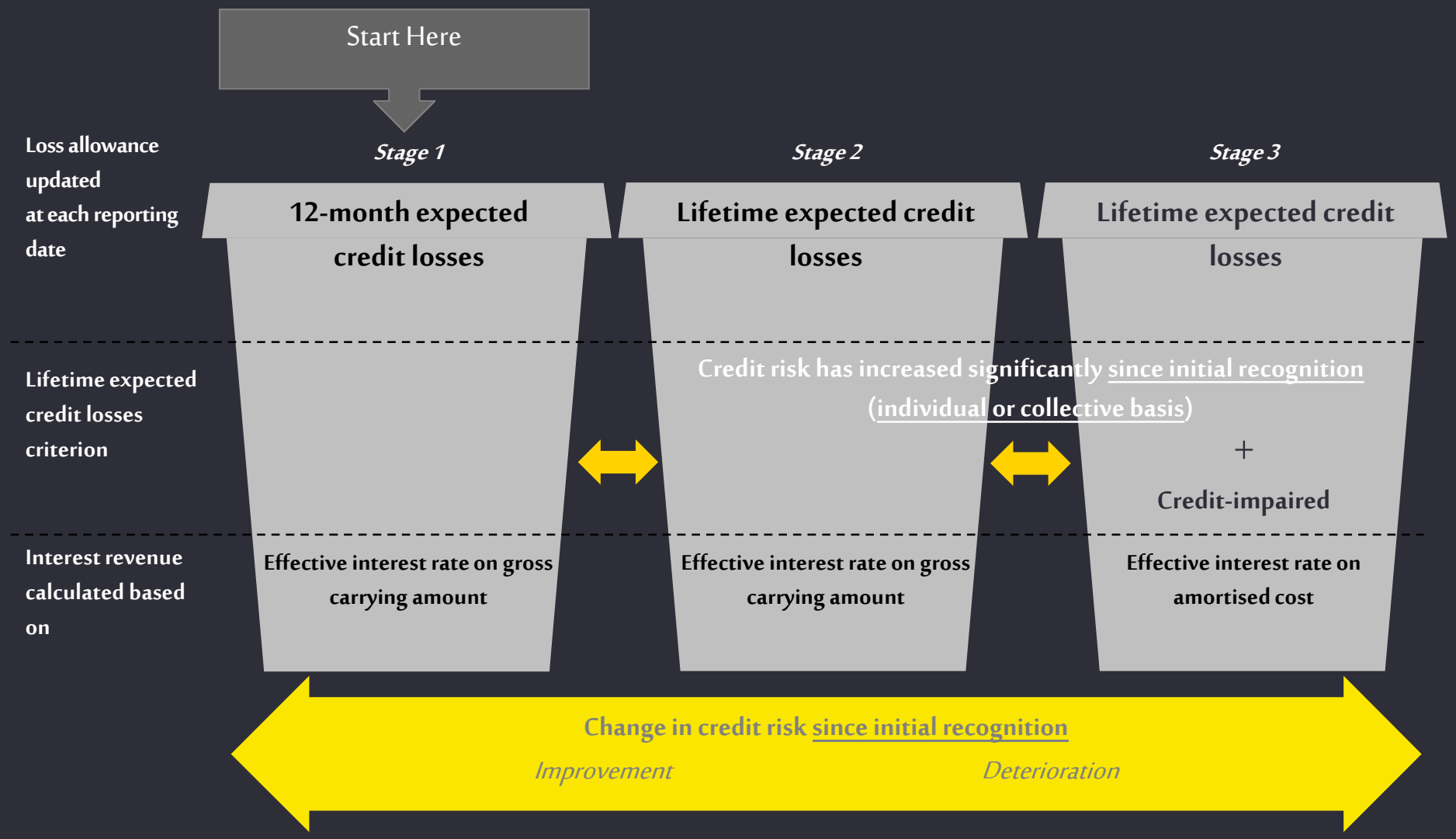
- According to the simplified approach, for trade receivables and contract assets that do not contain a significant financing component, an entity shall always measure loss allowance at an amount equal to lifetime expected credit losses.
- A provision matrix could be used to estimate ECL for these financial instruments.

Example

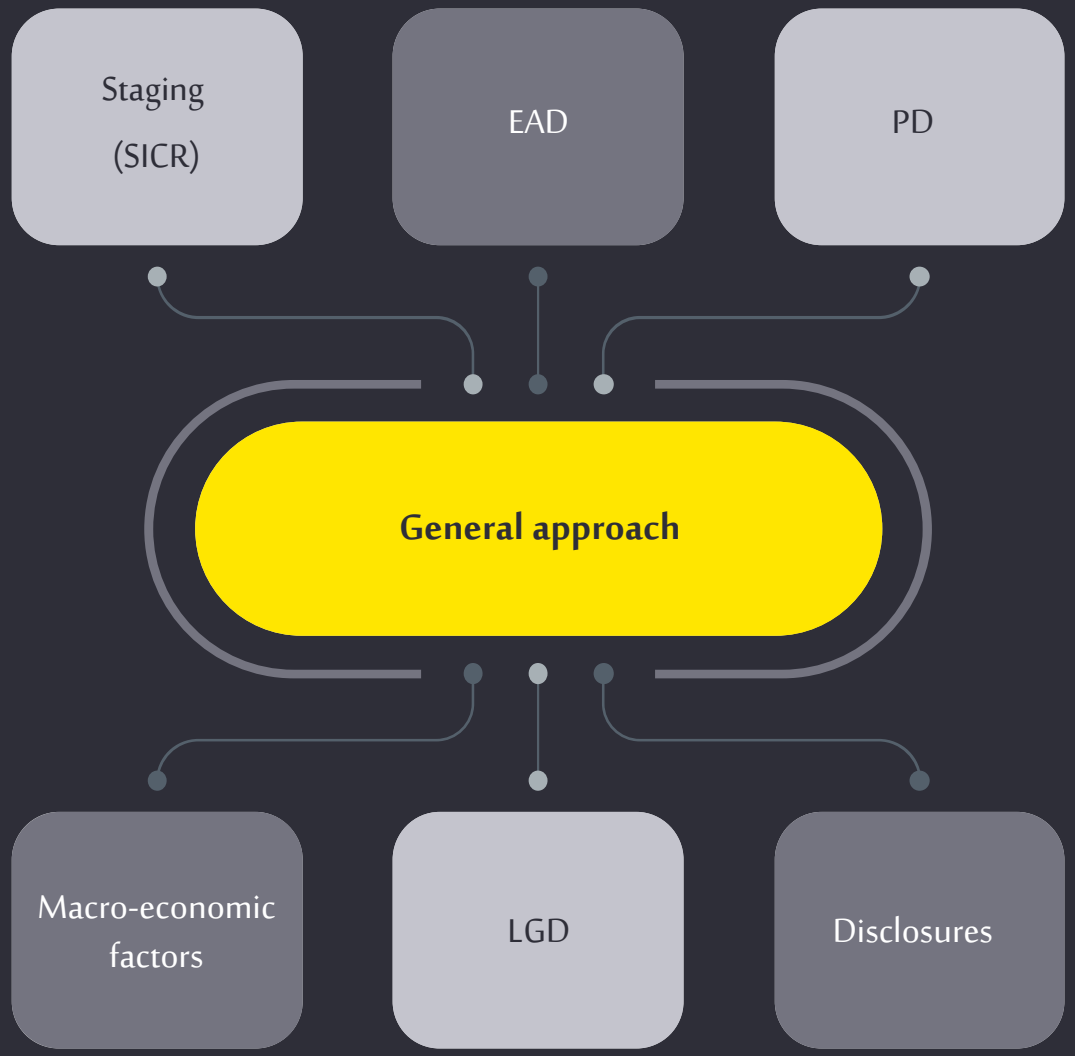
An entity may set up the following provision matrix based on its historical observed default rates, which is adjusted for forward-looking estimates. Same will appear in the Ind AS compliant financial statement of the entity.

Probability of Default	
Non Past due	0.3% of carrying value
30 days past due	1.6% of carrying value
31-60 days past due	3.6% of carrying value
61-90 days past due	6.6% of carrying value
more than 90 days past due	10.6% of carrying value

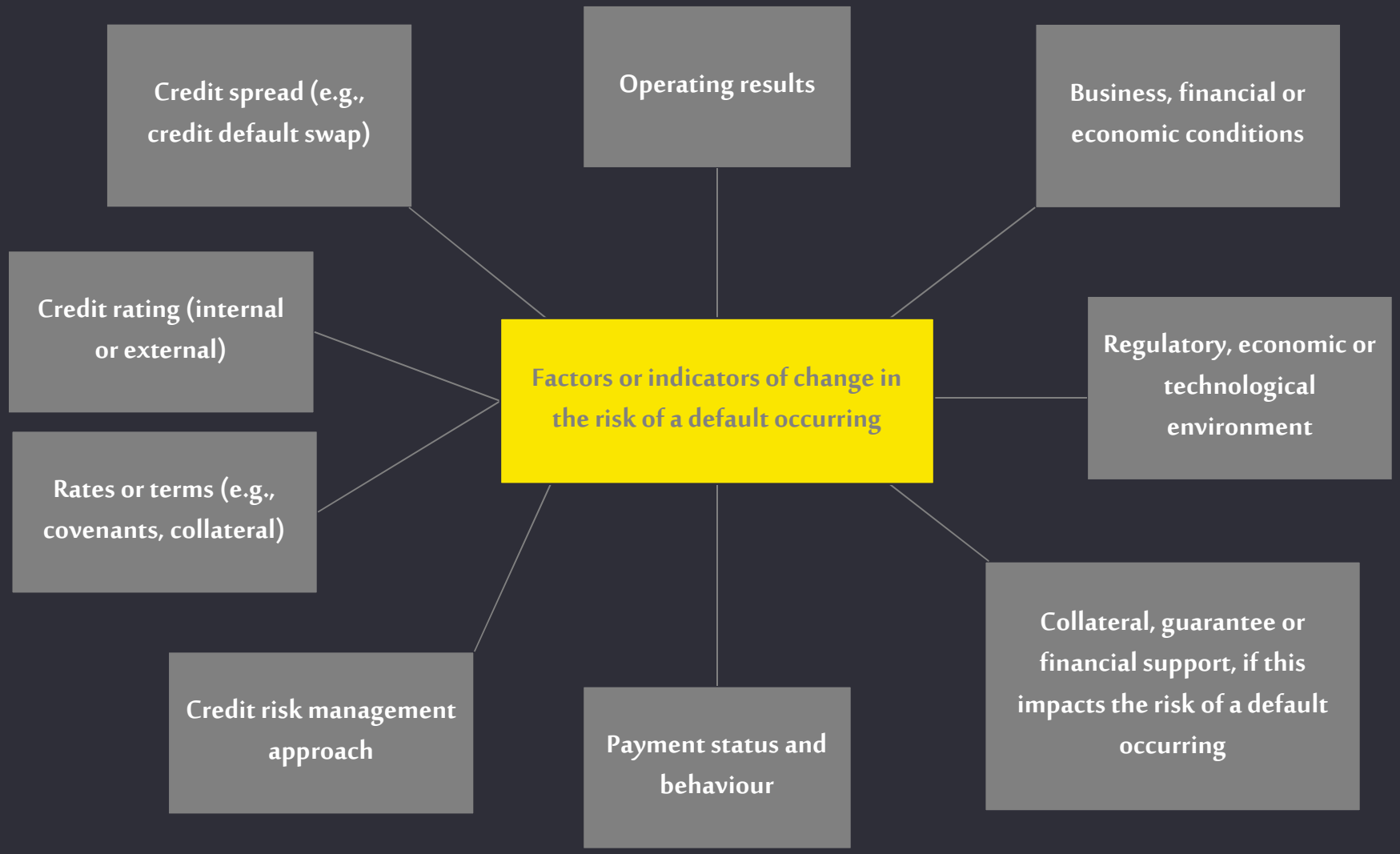
General Approach



ECL – Key aspects



Factors or indicators of change in the risk of a default occurring



Collective Assessment

In some cases, significant increase in credit risk may not be evident on an individual instrument basis, before the financial instrument becomes past due. Example : Retail Loans.

An assessment of whether there has been a significant increase in credit risk on an individual basis would not faithfully represent changes in credit risk since initial recognition.

If more forward-looking information is available on a collective basis, an entity makes the assessment on a collective basis.

To assess significant increases in credit risk on a collective basis, an entity can group financial instruments on the basis of shared credit risk characteristics.

Measurement of ECL

- A credit loss 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 discounted at the original effective the entity expects to receive discounted at the original effective interest rate.
- An Expected Credit Loss (ECL) is the probability weighted estimate of credit loss over the life of a financial instrument.

Dual measurement approach

The model uses two approaches for measurement of expected credit loss:

12 month Expected Credit Loss (12M ECL) (12M ECL)	Cash shortfalls that will result if a default occurs within 12 months (or shorter period if the expected life is less than 12 months), weighted by life is less than 12 months), weighted by probability of the default
Lifetime Expected Credit Loss (Lifetime ECL) (Lifetime ECL)	Cash shortfalls that will result from default events occurring over the expected life (residual maturity) of financial instruments, weighted by of financial instruments, weighted by probability of the default.

Factors to consider:

The calculation of ECL should reflect:

1. an unbiased and probability weighted amount;
2. the time value of money; and
3. reasonable and supportable information that is available without undue cost or effort

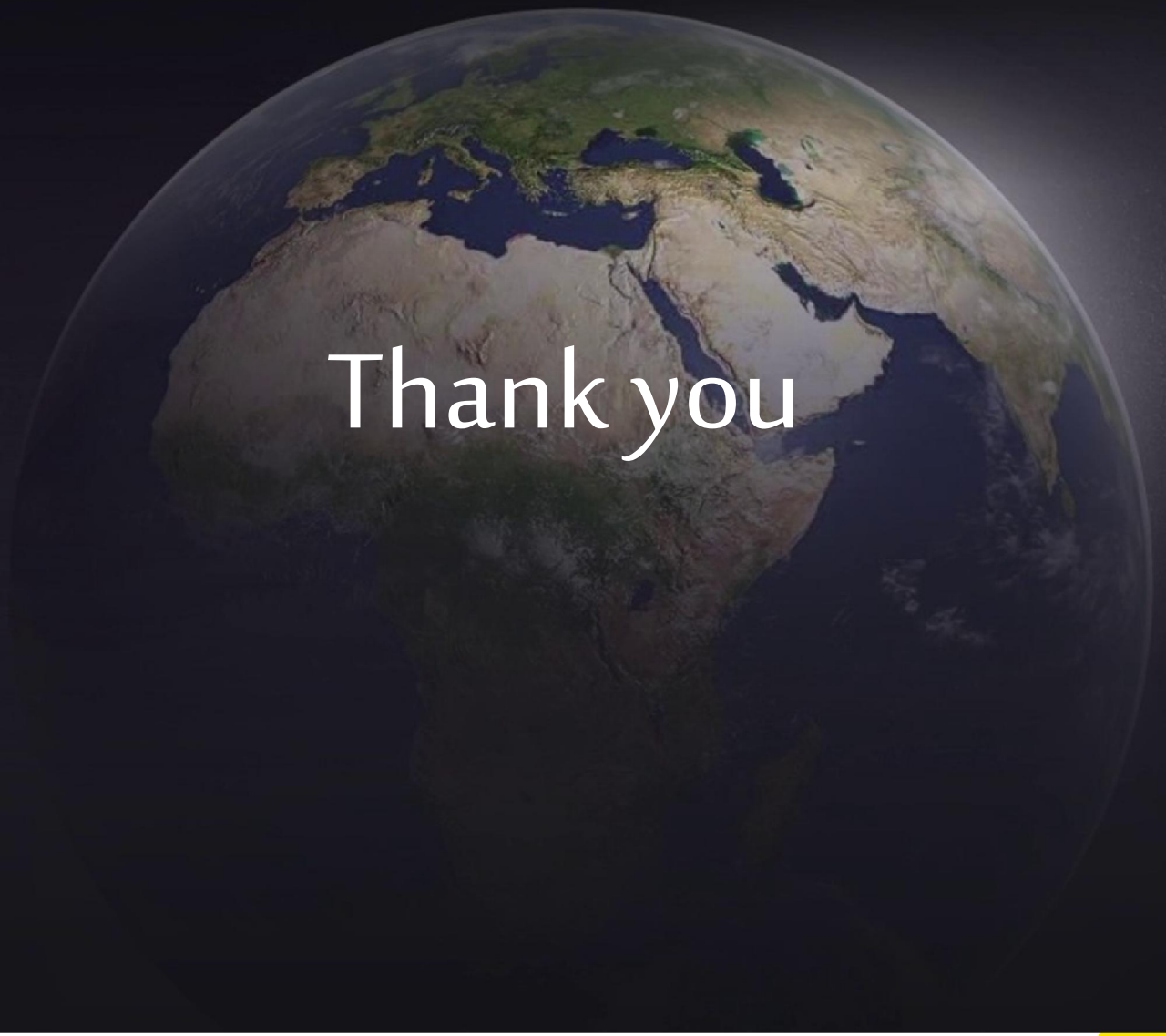
ECL Disclosures

- Given the inherent level of uncertainty and sensitivity of judgements and estimates, disclosures of key assumptions used and judgement made is estimating ECL are particularly important
- In the current scenario this includes how and the extent to which the effect of COVID-19 and related support measures have been factored into SICR, ECL and forward-looking information.
- For example:
  - the values of the key macroeconomic inputs used in the multiple economic scenario analysis;
  - probability weights of these scenarios;
  - the assumptions used to determine the different challenges for specific sectors and regions;
  - effect of any management overlays;
  - nature of any material reliefs offered to their borrowers, including those enforced by governments, whether they result in a substantial modification of the contract, their effect on staging and the impact on the overall ECL.

ECL Presentation

- An entity shall recognise in P&L, as an impairment loss or gain, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.

- An entity should recognize ECL in statement of financial position as:
  - a **loss allowance** for financial assets measured at amortized cost and lease receivables; and
  - **a provision** (that is, a liability) for loan commitments and financial guarantee contracts.
  - the loss allowance shall be recognised in other comprehensive income and shall not reduce the carrying amount of the financial asset in the balance sheet.



Thank you