The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
Western India Regional Council

EXPECTED CREDIT LOSS

(FOR BOTH FINANCIAL AND NON-FINANCIAL SECTORS)

The Institute of Chartered Accountants of India

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Price : ₹300/-

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Foreword

Dear Members,

The transition to Ind AS 109 and its expected credit loss (ECL) framework marks a significant departure from traditional credit risk provisioning methods. Historically reliant on past trends and subjective judgments, financial institutions are now required to adopt a more forward-looking approach that considers historical data, current conditions, and future projections.

This shift has profound implications for banks and non-banking financial companies (NBFCs), impacting their capital and earnings. The ECL model demands a robust credit risk management framework, access to high-quality data, and effective stakeholder involvement.

This guidance material is designed to assist entities in navigating the complexities of Ind AS 109 and its ECL requirements. Drawing on the insights from Ind AS 109, Ind AS 107, Ind AS 32, and their international counterparts, IFRS 9 and IFRS 7, this publication provides a comprehensive overview of the key concepts and practical applications.

We have incorporated illustrative examples and frequently asked questions to enhance understanding and facilitate implementation. However, it is essential to note that this guidance is not intended to replace professional judgment or provide definitive interpretations. It serves as a valuable resource for entities seeking to understand and effectively apply the ECL framework.

I am deeply grateful to CA. Shriraj Bhandari and CA. Bhavya Parekh for their tireless efforts and expertise, which were crucial to the success of this publication.

I am confident that by carefully studying and implementing the principles outlined in this guidance, financial institutions can navigate the complexities of the ECL framework and ensure compliance with regulatory requirements while effectively managing credit risk.

CA. Rathi Ankit
Chairman, WIRC of ICAI

Preface

I am pleased to introduce this publication focused on Expected Credit Loss (ECL), a critical component of financial reporting under Ind AS 109. ECL is not only applicable to companies in the financial sector, such as banks and financial institutions, but also extends to all entities across various industries. This broad applicability underscores the importance of understanding and implementing ECL correctly.

The primary purpose of this publication is to **delve into the practical aspects of ECL, providing readers with real-world examples and insights.** Through detailed explanations and case studies, we **aim to demystify the complexities of ECL calculations and offer guidance on its implementation.** This publication also references from published reports to further illustrate the impact and significance of ECL in financial reporting.

I would like to extend my deepest thanks to the **Chairman of WIRC CA. Ankit Rathi** for entrusting our committee with this important task. I sincerely acknowledge the initiative taken by **CA. Rahul Parikh, Vice Chairman of WIRC** of ICAI during the last tenure, in taking up this project. I also express my sincere gratitude to **Contributors – CA. Shriraj Bhandari and CA. Bhavya Parekh** for their unwavering dedication and hard work, which have been instrumental in the successful completion of this publication.

As you explore the contents of this publication, I hope it serves as a valuable resource in your professional endeavors. Understanding ECL is essential for ensuring accurate financial reporting, and I believe this publication will assist you in mastering this critical area.

Wishing you all the best in your journey towards excellence in financial reporting.

Warm regards,

CA. Chintan N. Patel
Chairman, AS and Ind AS Committee
WIRC of ICAI

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Background and Introduction

The transition to Ind AS 109 – expected credit loss ("ECL") requirements mark a major shift in the approach to credit risk provisioning. Historically, entities relied on past trends and subjective judgment to estimate credit losses. In the banking and financial services sectors, this estimation process was rule-based, adhering to prescribed rates set by the Reserve Bank of India ("RBI") as per prudential norms. Banks are still operating under Indian GAAP regime and continue to follow this rule-based provisioning model. However, RBI has released a discussion paper on introduction of expected credit loss provisioning framework by Banks with additional implementation guidance expected to be released shortly.

The implementation of Ind AS 109 and its expected credit loss framework represents a paradigm shift from an incurred loss model to an expected loss model. This shift has profound implications for an entity's capital and earnings, particularly impacting banks and non-banking financial companies ("NBFCs"). The ECL approach is more forward-looking, encompassing past events (historical data), current conditions, and forward-looking information to estimate potential credit losses. Successfully determining ECL requires access to high-quality data, robust internal credit risk management practices, involvement of the appropriate stakeholders, and rigorous governance and documentation.

This guidance is prepared based on the Indian Accounting Standards ("Ind AS") issued by the Ministry of Corporate Affairs ("MCA"), with a focus on impairment-related requirements outlined in Ind AS 109, Ind AS 107, and Ind AS 32, among other relevant standards. It also incorporates insights and guidance from the globally recognized standards issued by the International Accounting Standards Board (IASB), specifically IFRS 9 (equivalent to Ind AS 109) and IFRS 7 (equivalent to Ind AS 107). Guidance for implementing IFRS 9 and IFRS 7, including Basis for conclusions, Illustrative Examples, and discussions and conclusions from global Transition Resource Group committees, as well as staff discussion papers, have been considered. Moreover, references from the RBI's Discussion Paper on the Introduction of the Expected Credit Loss Framework for Provisioning by Banks have been included to enhance understanding.

These references are intended to provide an understanding of the practical application and interpretation of these standards. Furthermore, this guidance material includes multiple illustrations which also includes frequently asked questions to assist users in implementation of the Ind AS 109 impairment requirements. However, it is important to note that the purpose of this guidance material is not to offer a comprehensive commentary or technical interpretation of Ind AS 109. Instead, it serves as a reference guide for implementing the ECL requirements.

Scope of Impairment Requirements under Ind AS 109

The scope of impairment model includes:

1. Financial assets that are debt instruments measured at amortised cost (for example loans, investments in debt securities, trade receivables etc. measured at amortised cost)
2. Financial assets that are debt instruments measured at Fair Value through Other Comprehensive Income ("FVOCI") (for example loans, investments in debt securities, etc. measured at FVOCI)
3. Lease receivables under Ind AS 116
4. Contract assets as under Ind AS 115

5. Loan commitments not measured at Fair Value through Profit & Loss ("FVTPL")
6. Financial guarantee contracts not measured at FVTPL

Following financial assets are excluded from the scope of Ind AS 109:

1. Investment in equity instruments measured at FVTPL or designated at FVOCI
2. Derivative instruments (incl. embedded derivative) measured at FVTPL
3. Investment in debt instruments measured at FVTPL

Recognition of Expected Credit Losses

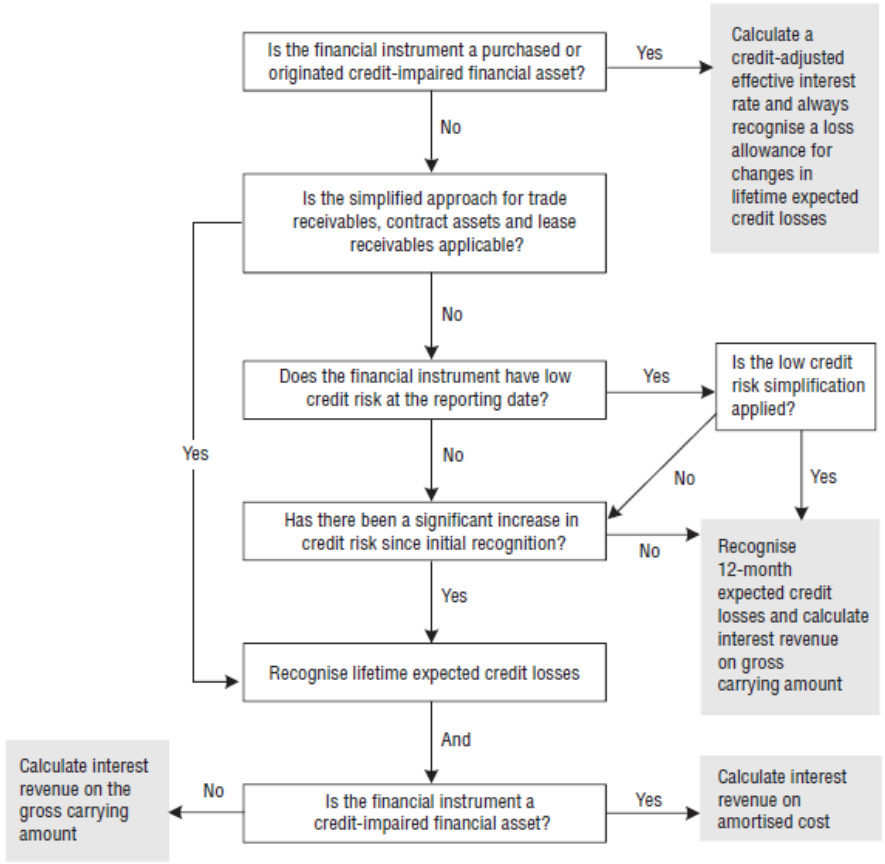
Under Ind AS 109, the impairment approach in Ind AS 109 is based on expected credit losses. i.e. it is not necessary for a loss event to have occurred before credit losses are recognised. Instead, a loss allowance is always recognised for expected credit losses and is remeasured at each reporting date for changes in those expected credit losses.

For recognition of ECL, Ind AS 109 provides below three approaches:

Sr. No.	Approach	Applicability	Illustrative Portfolios
1	General approach	The objective of the impairment requirements under general approach is to recognize: — lifetime ECL for all financial instruments for which there have been significant increases in credit risk since initial recognition (stage 2 and stage 3) — 12-month ECL for all financial instruments where there has been no significant increase in credit risk since initial recognition (stage 1) As a practical measure, an entity may assume that the credit risk on financial instrument has not increased significantly since its initial recognition, if the financial instrument is classified as "low-credit risk". In this case, the impairment for such assets is recognized on the basis of 12 month-ECL only.	Lending Portfolio Investments Trade receivables (with significant financing component) (Classified at amortized cost or FVOCI) Low credit risk illustrations include: — Financial assets that has a low risk of default — Borrower has a strong capacity to meet its obligations
2	Simplified approach	Under simplified approach, an entity provides lifetime ECL and there is no requirement to track changes in credit risk since initial recognition (no distinction of stage 1, stage 2/3).	Mandatory for Trade receivables (without significant financing component) Optional for Trade receivables (with significant financing component)

Sr. No.	Approach	Applicability	Illustrative Portfolios
3	Purchased or originated credit impaired approach	This approach is applicable for instruments which are credit impaired at initial recognition. Under this approach, impairment is always measured on the basis of lifetime ECL and the changes to lifetime ECL since initial recognition is recognised as a loss allowance in P&L.	Credit impaired assets purchased

Fig. 1: Decision Tree (Source: Ind AS 109):



Measurement of Expected Credit Losses

Ind AS 109 defines credit loss as the difference between

— all contractual cash flows that are due to an entity in accordance with the contract and

— all the cash flows that the entity expects to receive (i.e., all cash shortfalls),

discounted at the original Effective Interest Rate ("EIR") (or credit-adjusted EIR for purchased or originated credit-impaired financial assets).

This means, ECL not only considers the losses arising due to cash shortfall (difference between

amount due to the entity in accordance with the contract and the cash flows that the entity expects to receive) but also considers the timing of cash flows to provide for time value losses (i.e. even if the amount is expected to be received in full but later than its contractual due date).

An entity should measure the expected credit losses to reflect:

(a) an unbiased and **probability-weighted** amount that is determined by evaluating a range of possible outcomes

(b) the **time value** of money and

(c) **reasonable and supportable information** that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Probability weighted outcome

Ind AS 109 states that ECLs should reflect an unbiased and probability weighted estimate of credit losses over the expected life of instrument. The purpose is neither to consider a worst case or a best case scenario rather consider a probability weighted outcome over a range of possible scenarios. This involves identifying possible scenarios to understand the amount and timing of cashflows for each outcome and the estimated probability of outcomes.

In practice, generally worst case, best case and base case is considered while estimating the expected losses.

Illustration 1:

[Source: TRG for Impairment of Financial Instruments – Meeting Summary – 11 December 2015]

Whether when measuring expected credit losses an entity can use a single forward-looking economic scenario or whether an entity needs to incorporate multiple forward-looking scenarios, and if so how?

Response:

ITG members first noted that in accordance with paragraph 5.5.17(a) of IFRS 9, the measurement of expected credit losses is required to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. Consequently, it was noted that, for example, when there is a non-linear relationship between the different forward-looking scenarios and their associated credit losses, using a single forward-looking economic scenario would not meet this objective. Instead more than one forward-looking scenario would need to be incorporated into the measurement of expected credit losses.

Illustration: Incorporation of multiple forward-looking scenarios

Scenario	Future Unemployment	Likelihood of occurrence	ECL (INR)
1	4%	20%	30
2	5%	50%	70
3	6%	30%	170

If single forward looking scenario is considered based on most likely outcome in this case

scenario 2, the ECL would be INR 70. However, if the entity used a probability weighted range of scenarios, the ECL would be INR 92 ((INR 30 * 20%) + (INR 70 * 50%) + (INR 170 * 30%)).

Time value of Money

An entity needs to incorporate effects of time value of money while estimating expected credit losses.

To incorporate the same, expected credit losses will be discounted to the reporting date (and not the expected default or some other date). For each portfolio, discount rate to be considered is as follows:

Portfolio	Discount Rate
Fixed Rate Financial Asset	Effective Interest Rate determined at initial recognition
Floating Rate Financial Asset	Current effective interest
Purchased or originated credit impaired	Credit adjusted EIR
Lease Receivables	Same discount rate used in measurement of lease receivable
Loan Commitment	For which EIR can be determined, EIR that will be applied on initial recognition of financial instrument resulting from loan commitment. For which EIR cannot be determined, discount rate that reflects the current market assessment of the time value of money determined by making adjustment to the risk free interest rate for risks attached to the cash flows
Financial Guarantee	Discount rate that reflects the current market assessment of the time value of money determined by making adjustment to the risk free interest rate for risks attached to the cash flows

Reasonable and supportable information

Ind AS 109 refers reasonable and supportable information is the information that is reasonably available at the reporting date without undue cost or effort, including information about

— past events

— current conditions

— forecasts of future economic conditions

The term "undue cost or effort" is not defined under Ind AS 109. However, the standard mentions that the information available for financial reporting purposes is considered to be available without undue cost or effort.

Source of Information

The information to be used for computation of ECL shall include factors that are specific to the borrower, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date.

An entity may use various sources of data, that may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings,

credit loss experience of other entities and external ratings, reports and statistics. Entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument (or groups of financial instruments).

An entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses, including the effect of expected prepayments.

Information relating to past events, current conditions and forecasts of future economic conditions:

Historical information is an important anchor or base from which to measure expected credit losses. However, an entity shall adjust historical data, such as credit loss experience, on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. In some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered. Estimates of changes in expected credit losses should reflect, and be directionally consistent with, changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses on the financial instrument or in the group of financial instruments and in the magnitude of those changes). An entity shall regularly review the methodology and assumptions used for estimating expected credit losses to reduce any differences between estimates and actual credit loss experience.

When using historical credit loss experience in estimating expected credit losses, it is important that information about historical credit loss rates is applied to groups that are defined in a manner that is consistent with the groups for which the historical credit loss rates were observed. Consequently, the method used shall enable each group of financial assets to be associated with information about past credit loss experience in groups of financial assets with similar risk characteristics and with relevant observable data that reflects current conditions.

An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of judgement that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases, and the degree of judgement required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.

Illustration 2:

[Source: TRG for Impairment of Financial Instruments – Meeting Summary – 22 April 2015]

Whether and how to incorporate events and forecasts, when applying the impairment requirements at the reporting date, that occur:

(a) after economic forecasts have been made but before the reporting date (Issue 1); and

(b) between the reporting period end and the date of signing the financial statements (Issue 2).

Response:

Paragraph 5.5.17(c) of IFRS 9 requires that an entity shall measure expected credit losses in a way that reflects reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. Paragraph B5.5.15 of IFRS 9 further emphasizes that when determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect credit risk on a financial instrument in accordance with paragraph 5.5.17(c).

Accordingly, with respect to Issue 1, ITG members noted that reasonable and supportable new information that becomes available before the reporting date is required to be taken into consideration when applying the impairment requirements.

With respect to Issue 2, the ITG members noted that IFRS 9 does not specifically require new information that becomes available after the reporting date to be reflected in the measurement of expected credit losses at the reporting date. Some ITG members observed that whether information that becomes available after the reporting date is an adjusting event in accordance with IAS 10 Events after the Reporting Period depends upon the nature of the event. Accordingly, they emphasized that judgement is needed, based on the specific facts and circumstances.

Some ITG members thought that, with respect to Issue 2, expected credit losses were similar in nature to the measurement of fair value at the reporting date, in that movements in fair value after the reporting date are generally not reflected in the measurement of fair value at the reporting date, as stated in paragraph 11 of IAS 10. For example, a change in interest rates or the outcome of a public vote after the reporting date would not be adjusting events. Therefore, expected credit losses should not be adjusted to reflect the change in interest rates or outcome of the public vote that occurs after the reporting date. None of the members objected to this approach.

However, in accordance with IFRS 9, expected credit losses are a probability-weighted estimate of credit losses at the reporting date. Accordingly, the determination of expected credit losses should take into consideration relevant possible future scenarios based on a range of expectations at the reporting date, using the information available at that date. Hence, with reference to the example above, the probabilities attached to future expected movements in interest rates and expected outcomes of a future public vote based on information available at the reporting date would be reflected in the determination of expected credit losses at that date.

Other observations made by ITG members were that:

(a) from a practical perspective, materiality considerations apply when addressing Issues 1 and 2, just as it does in the application of all Standards, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

(b) entities need proper processes and appropriate governance procedures for incorporating information, including forecasts of future economic conditions, to ensure transparent and consistent application of the impairment requirements in IFRS 9. This includes processes for updating expected credit losses for new information that becomes available after the initial modelling has taken place up until the reporting date.

Impact of Collateral, other credit enhancements (Financial Guarantee), cash flows from sale of default loans

As per Ind AS 109, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements (e.g. Financial Guarantee) that are

— part of the contractual terms and

— are not recognised separately by the entity.

The estimate of expected cash shortfalls on a collateralized financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable (ie the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it).

Consequently, any cash flows that are expected from the realisation of the collateral beyond the contractual maturity of the contract should be included in this analysis. Any collateral obtained as a result of foreclosure is not recognised as an asset that is separate from the collateralised financial instrument unless it meets the relevant recognition criteria for an asset in this or other Standards.

In practice, generally while computation of loss given default, fair value of collateral is considered while estimating the expected credit losses. Further appropriate discount factors are adjusted for distress sell, costs to sell, illiquidity discount etc.

Illustration 3:

Highly collateralized financial asset [IFRS 9 IE18-IE23]

Company H owns real estate assets which are financed by a five-year loan from Bank Z with a loan-to-value (LTV) ratio of 50 per cent. The loan is secured by a first-ranking security over the real estate assets. At initial recognition of the loan, Bank Z does not consider the loan to be originated credit impaired as defined in Appendix A of IFRS 9.

Subsequent to initial recognition, the revenues and operating profits of Company H have decreased because of an economic recession. Furthermore, expected increases in regulations have the potential to further negatively affect revenue and operating profit. These negative effects on Company H's operations could be significant and ongoing.

As a result of these recent events and expected adverse economic conditions, Company H's free cash flow is expected to be reduced to the point that the coverage of scheduled loan payments could become tight. Bank Z estimates that a further deterioration in cash flows may result in Company H missing a contractual payment on the loan and becoming past due.

Recent third-party appraisals have indicated a decrease in the value of the real estate properties, resulting in a current LTV ratio of 70 per cent.

At the reporting date, the loan to Company H is not considered to have low credit risk in accordance with paragraph 5.5.10 of IFRS 9. Bank Z therefore needs to assess whether there has been a significant increase in credit risk since initial recognition in accordance with paragraph 5.5.3 of IFRS 9, irrespective of the value of the collateral it holds. It notes that the loan is subject to considerable credit risk at the reporting date because even a slight deterioration in cash flows could result in Company H missing a contractual payment on the loan. As a result, Bank Z determines that the credit risk (ie the risk of a default occurring) has increased significantly since initial recognition. Consequently, Bank Z recognises lifetime expected credit losses on the loan to Company H.

Although lifetime expected credit losses should be recognised, the measurement of the expected credit losses will reflect the recovery expected from the collateral (adjusting for the costs of obtaining and selling the collateral) on the property as required by paragraph B5.5.55 of IFRS 9 and may result in the expected credit losses on the loan being very small.

Illustration 4:

[Source: TRG for Impairment of Financial Instruments – Meeting Summary – 11 December 2015]

Within this context, what is meant by 'part of the contractual terms'? More specifically, whether the credit enhancement must be an explicit term of the related asset's contract in order for it to be taken into account in the measurement of expected credit losses, or whether other credit enhancements that are not recognised separately can also be taken into account?

Response:

The ITG noted that the definition of credit losses states that when estimating cash flows, an entity shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. Consequently, the ITG observed that credit enhancements included in the measurement of expected credit losses should not be limited to those that are explicitly part of the contractual terms

However, ITG members also noted that an entity:

(a) would be required to apply its judgement in assessing what is meant by 'integral to the contractual terms' and in making that assessment, an entity should consider all relevant facts and circumstances; and

(b) must not include cash flows from credit enhancements in the measurement of expected credit losses if the credit enhancement is accounted for separately. ITG members noted that this was particularly important in order to avoid double counting.

Illustration 5:

Entity A has advanced a loan of INR 100 mn to Entity B. In the same lending arrangement contract, the loan is guaranteed by Entity C (parent of Entity B). The credit assessment for the loan proposal was performed by considering the possible cashflows from the guarantor in case of a default event. Whether such default guarantee implicit in the master lending arrangement contract would be considered as "integral part of contractual terms" in light of the above requirements?

Response: In this scenario, the financial guarantee would be considered as an integral part of the contract considering the fact that the same was entered into at the same time and within the same lending contract and the credit assessment was performed taking into consideration of cash flows from the guarantor in case of any default event. Basis the above, the cashflows from invocation of such financial guarantee can be considered while estimating the expected credit loss.

Illustration 6:

Entity A has advanced a loan of INR 100 mn to Entity B. Separately, after one year, Entity A has secured a financial guarantee from another agency for a portfolio of loans which includes the loan to entity B of INR 100 mn. A fixed guarantee fee is paid to such agency for the tenure of the financial gurantee. In this case, whether financial guarantee obtained subsequently would be considered as "integral part of contractual terms" in light of the above requirements?

Response: In this scenario, the financial guarantee would not be considered as an integral part of the contract considering the fact that the same was secured subsequent to the origination of the loan, this is secured on portfolio basis and through a third party which is in the business of providing such guarantees, the initial credit assessment neither included potential cashflows arising from the guarantor nor adjustment for financial guarantee fees. Basis the above, the cashflows from invocation of such financial guarantee cannot be considered while estimating the expected credit loss. Further, in this case, the accounting of this arrangement should be done in line with Ind AS 115.

Illustration 7:

[Source: TRG for Impairment of Financial Instruments – Meeting Summary – 11 December 2015]

An entity may choose to sell a defaulted loan to a third party in order to maximise recovery cash flows. In this case whether cash flows that are expected to be recovered through such sale could be included in the measurement of expected credit losses?

TRG Meeting Outcome:

The cash flows expected from the sale on default of a loan should be included in the measurement of expected credit losses if:

(a) selling the loan is one of the recovery methods that the entity expected to pursue in a default scenario;

(b) the entity is neither legally nor practically prevented from realising the loan using that recovery method; and

(c) the entity has reasonable and supportable information upon which to base its expectations and assumptions.

In order to support an entity's expectation that loan sales would be used as a recovery method in a default scenario, ITG members observed that an entity's past practice would be an important consideration. However, it was noted that future expectations, which may differ from past practice, would also need to be considered. With respect to the amount of recovery proceeds to be included in the measurement of expected credit losses, ITG members observed that an entity should consider relevant market related information relating to loan sale prices.

ITG members observed that in these circumstances, the inclusion of recovery sale proceeds in the measurement of expected credit losses would be appropriate for financial instruments in all stages; Stage 1 (ie those that have not significantly increased in credit risk), Stage 2 (ie those for which credit risk has increased significantly since initial recognition but are not credit-impaired) and Stage 3 (ie those that are credit-impaired). This is because when measuring expected credit losses, IFRS 9 requires an entity to consider possible default scenarios for financial instruments in all stages

The ITG then discussed how the inclusion of such recovery sale proceeds would be reflected in the measurement of expected credit losses. ITG members first observed that expected sale proceeds would only be relevant when considering the possibility that a credit loss occurs (ie in a default scenario) and would not be relevant when considering the possibility that no credit loss occurs (ie in a performing scenario). For example, if, in the case of a particular loan, an entity concluded that there was a 10 per cent probability of default occurring, it would only be when considering the outcome of this default scenario that expected sale proceeds would be considered. ITG members went on to observe that if, in that default scenario, the entity expected to recover 30 per cent of the contractual cash flows of the loan through sale proceeds but only 25 per cent through continuing to hold, then the loss given default would be 70 per cent rather than 75 per cent. The ITG also noted that expected sale proceeds should be net of selling costs.

Three-stage model:

Ind AS 109 outlines a three-sstage model for measuring impairment:

Stage	Basis of ECL measurement	Criteria	Interest Revenue
Stage 1: Performing	12-month ECL	On Initial Recognition	EIR on Gross Carrying Amount
Stage 2: Under-performing	Lifetime ECL	Significant Increase in credit risk since initial recognition	EIR on Gross Carrying Amount
Stage 3: Non-performing		Credit Impaired Financial Asset or default trigger	EIR on Net Carrying Amount (i.e. net off ECL)

Basis of ECL Measurement (12 month and lifetime)

12-month ECL

Ind AS 109 defines 12-month ECL as a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date weighted by the probability of that default occurring. Here 12 month ECL does not refer to credit loss shortfall from the contractual amounts due in next 12 months only but estimates the total credit loss expected from the entire financial instrument under assessment if a default event occurs within next 12 months.

Illustration 8:

Entity A has determined the following for it's loan portfolio:

Portfolio	Stage	12m PD	Lifetime PD	PV of contractual cash flows that will not be recovered over the expected life in default event	PV of contractual Cash flows due in next 12 months that will not be recovered in default event
A	1	1.50%	6.50%	300	70
B	1	0.50%	6.00%	400	90
C	2	1.75%	7.00%	500	110

In the given scenario,

— for computation of ECL for stage 1 loans (i.e. portfolio A and B), the entity will consider 12m PD and PV of contractual cash flows that will not be recovered over the expected life in default event

— for computation of ECL for stage 2 loans (i.e. Portfolio C), the entity will consider lifetime PD and PV of contractual cash flows that will not be recovered over the expected life

Lifetime ECL:

Ind AS 109 defines lifetime ECL as the expected losses arising from all possible default events expected during the entire expected life of the financial instrument.

In case if the life the instrument is shorter than 12 months, 12month ECL would be equal to Lifetime ECL. For example, a loan which has a remaining life of 8 months, its 12-month ECL will be equal to lifetime ECL as the overall life expected is less than 12 months.

Expected life vs Contractual Life

For determination of the tenure over which the expected credit loss will be computed, Ind AS 109 states that the maximum period over which expected credit losses shall be measured is the maximum contractual period (including extension options if any) over which the entity is exposed to credit risk.

However, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments, and only those financial instruments, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

For example, revolving credit facilities, such as credit cards and overdraft facilities, can be contractually withdrawn by the lender with as little as one day's notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as

a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:

(a) the financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);

(b) the contractual ability to cancel the contract is not enforced in the normal day-to-day management of the financial instrument and the contract may only be cancelled when the entity becomes aware of an increase in credit risk at the facility level; and

(c) the financial instruments are managed on a collective basis.

When determining the period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

(a) the period over which the entity was exposed to credit risk on similar financial instruments;

(b) the length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and

(c) the credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

Illustration 9: Revolving Credit Facilities [Source: IFRS 9 IE 58 – IE 65]

Bank A provides co-branded credit cards to customers in conjunction with a local department store. The credit cards have a one-day notice period after which Bank A has the contractual right to cancel the credit card (both the drawn and undrawn components). However, Bank A does not enforce its contractual right to cancel the credit cards in the normal day-to-day management of the instruments and only cancels facilities when it becomes aware of an increase in credit risk and starts to monitor customers on an individual basis. Bank A therefore does not consider the contractual right to cancel the credit cards to limit its exposure to credit losses to the contractual notice period.

For credit risk management purposes Bank A considers that there is only one set of contractual cash flows from customers to assess and does not distinguish between the drawn and undrawn balances at the reporting date. The portfolio is therefore managed and expected credit losses are measured on a facility level.

At the reporting date the outstanding balance on the credit card portfolio is INR 60,000 and the available undrawn facility is INR 40,000. Bank A determines the expected life of the portfolio by estimating the period over which it expects to be exposed to credit risk on the facilities at the reporting date, taking into account:

(a) the period over which it was exposed to credit risk on a similar portfolio of credit cards;

(b) the length of time for related defaults to occur on similar financial instruments; and

(c) past events that led to credit risk management actions because of an increase in credit risk on similar financial instruments, such as thereduction or removal of undrawn credit limits.

On the basis of the information listed above, Bank A determines that the expected life of the credit card portfolio is 30 months.

At the reporting date Bank A assesses the change in the credit risk on the portfolio since initial recognition and determines in accordance with paragraph 5.5.3 of IFRS 9 that the credit risk on a portion of the credit card facilities representing 25 per cent of the portfolio, has increased significantly since initial recognition. The outstanding balance on these credit facilities for which lifetime expected credit losses should be recognised is INR 20,000 and the available undrawn facility is INR 10,000.

When measuring the expected credit losses in accordance with paragraph 5.5.20 of IFRS 9, Bank A considers its expectations about future draw-downs over the expected life of the portfolio (ie 30 months) in accordance with paragraph B5.5.31 and estimates what it expects the outstanding balance (ie exposure at default) on the portfolio would be if customers were to default. By using its credit risk models Bank A determines that the exposure at default on the credit card facilities for which lifetime expected credit losses should be recognised, is INR 25,000 (ie the drawn balance of INR 20,000 plus further draw-downs of INR 5,000 from the available undrawn commitment). The exposure at default of the credit card facilities for which 12-month expected credit losses are recognised, is INR 45,000 (ie the outstanding balance of INR 40,000 and an additional draw-down of INR 5,000 from the undrawn commitment over the next 12 months).

The exposure at default and expected life determined by Bank A are used to measure the lifetime expected credit losses and 12-month expected credit losses on its credit card portfolio.

Bank A measures expected credit losses on a facility level and therefore cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component. It recognises expected credit losses for the undrawn commitment together with the loss allowance for the loan component in the statement of financial position. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be presented as a provision (in accordance with IFRS 7 Financial Instruments: Disclosure).

Illustration 10:

Entity B has provided a sanction of INR 100 mn to Entity P. Entity P has initially drawn down only INR 80 mn and remaining INR 20 mn is considered as sanctioned but undisbursed limit in the books of Entity B. Whether Entity B is required to compute ECL on the sanctioned but undisbursed limit in following scenarios:

A. Entity B reserves right to review the credit risk and if required cancel the sanctioned but undisbursed limit on the date when the draw down request is made by Entity P. For example, if Entity B has observed significant increase, it credit risk, entity B can consider cancellation based on it's unilateral decision. Entity B has approved policy and an in-practice history of such cancellation which can be demonstrated through data.

B. Entity B reserves right to review the credit risk and if required cancel the sanctioned but undisbursed limit on the date when the draw down request is made by Entity P. For example, if Entity B has observed significant increase, it credit risk, entity B can consider cancellation based on its unilateral decision. Entity B has in-practice has never cancelled any such request and always extended loans.

C. The undrawn commitment is a non-cancellable commitment which means in any case Entity B will be required to disburse the loans as and when Entity P issues the request within the timeframe agreed in the sanction letter.

Response:

When determining the period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

(a) the period over which the entity was exposed to credit risk on similar financial instruments;

(b) the length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and

(c) the credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

A. In scenario A, since the Entity B has a cancellation right and also evidence from historic data that such cancellation is exercised as part of its credit risk management actions and hence Entity B is not required to consider the sanctioned but undisbursed value in the computation of period over which ECL needs to be computed

B. In scenario B, while the Entity B has a cancellation right, but historic data provides evidence that such cancellation is never exercised as part of its credit risk management actions and hence Entity B will be required to consider the sanctioned but undisbursed value in the computation of period over which ECL needs to be computed

C. In scenario C, the Entity B does not have a cancellation right and hence Entity B will be required to consider the sanctioned but undisbursed value in the computation of period over which ECL needs to be computed.

Significant Increase in Credit Risk

Whether expected credit losses are based on 12-month expected credit losses or lifetime expected credit losses will depend on whether there has been a significant increase in credit risk since initial recognition.

To make that assessment, an entity should compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.

Ind AS 109 provides guidance parameters on how the assessment of significant increase in credit risk can be performed to identify the financial instruments where the lifetime expected credit losses are to be provided. The guidance parameters include:

Level of assessment (Individual or Collective)

Credit risk analysis is a multifactor and holistic analysis; whether a specific factor is relevant, and its weight compared to other factors, will depend on the type of product, characteristics of

the financial instruments and the borrower as well as the geographical region. Some of these factors or indicators may not be identifiable on an individual financial instrument level.

To achieve the objective of recognising lifetime expected credit losses for significant increases in credit risk since initial recognition, it may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk on, for example, a group or sub-group of financial instruments. This is to ensure that an entity meets the objective of recognising lifetime expected credit losses when there are significant increases in credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available.

For the purpose of determining significant increases in credit risk and recognising a loss allowance on a collective basis, an entity can group financial instruments on the basis of shared credit risk characteristics with the objective of facilitating an analysis that is designed to enable significant increases in credit risk to be identified on a timely basis. The entity should not obscure this information by grouping financial instruments with different risk characteristics. Examples of shared credit risk characteristics may include, but are not limited to, the:

- Instrument type
- Credit risk ratings
- Collateral type
- Date of initial recognition
- Remaining term to maturity
- Industry
- Geographical location of borrower
- the value of collateral relative to the financial asset if it has an impact on the probability of a default occurring (for example, non-recourse loans in some jurisdictions or loan-to-value ratios).

Under the general approach, lifetime expected credit losses are recognised on all financial instruments for which there has been a significant increase in credit risk since initial recognition. In applying this, if an entity is not able to group financial instruments for which the credit risk is considered to have increased significantly since initial recognition based on shared credit risk characteristics, lifetime expected credit losses should be recognised on a portion of the financial assets for which credit risk is deemed to have increased significantly. The aggregation of financial instruments to assess whether there are changes in credit risk on a collective basis may change over time as new information becomes available on groups of, or individual, financial instruments.

Illustration 11:

Bank ABC provides agri-loans to multiple geographies across the country. The portfolio performance has been extremely good and there are less quantum of delinquencies. In one of the geographies, there has been extensive rainfall and floods due to which a large portion of agri-loans provided in the geography as expected to come under stress as the cash flow from agricultural produce will be affected. In this case, how does the Bank assess significant increase in credit risk i.e. assess individual loans or on collective basis entire geography?

Response:

As noted above, to achieve the objective of recognising lifetime expected credit losses for significant increases in credit risk since initial recognition, it may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk on, for example, a group or sub-group of financial instruments. This is to ensure that an entity meets the objective of recognising lifetime expected credit losses when there are significant increases in credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available.

Accordingly, the Bank if considers there is high risk of delinquencies expected from the geography affected, on collective basis the entire portfolio should be evaluated for significant increase in credit risk assessment rather than performing review of individual cases.

Illustration 12: Responsiveness to changes in credit risk [Source IFRS 9: IE:29-IE39]

Bank ABC provides mortgages to finance residential real estate in three different regions. The mortgage loans are originated across a wide range of LTV criteria and a wide range of income groups. As part of the mortgage application process, customers are required to provide information such as the industry within which the customer is employed and the post code of the property that serves as collateral on the mortgage.

Bank ABC sets its acceptance criteria based on credit scores. Loans with a credit score above the 'acceptance level' are approved because these borrowers are considered to be able to meet contractual payment obligations. When new mortgage loans are originated, Bank ABC uses the credit score to determine the risk of a default occurring as at initial recognition.

At the reporting date Bank ABC determines that economic conditions are expected to deteriorate significantly in all regions. Unemployment levels are expected to increase while the value of residential property is expected to decrease, causing the LTV ratios to increase. As a result of the expected deterioration in economic conditions, Bank ABC expects default rates on the mortgage portfolio to increase.

Individual Assessment

In Region One, Bank ABC assesses each of its mortgage loans on a monthly basis by means of an automated behavioural scoring process. Its scoring models are based on current and historical past due statuses, levels of customer indebtedness, LTV measures, customer behaviour on other financial instruments with Bank ABC, the loan size and the time since the origination of the loan.

Bank ABC updates the LTV measures on a regular basis through an automated process that re-estimates property values using recent sales in each post code area and reasonable and supportable forward-looking information that is available without undue cost or effort.

Bank ABC has historical data that indicates a strong correlation between the value of residential property and the default rates for mortgages. That is, when the value of residential property declines, a customer has less economic incentive to make scheduled mortgage repayments, increasing the risk of a default occurring.

Through the impact of the LTV measure in the behavioural scoring model, anincreased risk of a default occurring due to an expected decline in residential property value adjusts the behavioural scores. The behavioural score can be adjusted as a result of expected declines in

property value even when the mortgage loan is a bullet loan with the most significant payment obligations at maturity (and beyond the next 12 months). Mortgages with a high LTV ratio are more sensitive to changes in the value of the residential property and Bank ABC is able to identify significant increases in credit risk since initial recognition on individual customers before a mortgage becomes past due if there has been a deterioration in the behavioural score.

When the increase in credit risk has been significant, a loss allowance at an amount equal to lifetime expected credit losses is recognised. Bank ABC measures the loss allowance by using the LTV measures to estimate the severity of the loss, ie the loss given default (LGD). The higher the LTV measure, the higher the expected credit losses all else being equal.

If Bank ABC was unable to update behavioural scores to reflect the expected declines in property prices, it would use reasonable and supportable information that is available without undue cost or effort to undertake a collective assessment to determine the loans on which there has been a significant increase in credit risk since initial recognition and recognise lifetime expected credit losses for those loans.

Collective Assessment

In Regions Two and Three, Bank ABC does not have an automated scoring capability. Instead, for credit risk management purposes, Bank ABC tracks the risk of a default occurring by means of past due statuses. It recognises a loss allowance at an amount equal to lifetime expected credit losses for all loans that have a past due status of more than 30 days past due. Although Bank ABC uses past due status information as the only borrower-specific information, it also considers other reasonable and supportable forward-looking information that is available without undue cost or effort to assess whether lifetime expected credit losses should be recognised on loans that are not more than 30 days past due. This is necessary in order to meet the objective in paragraph 5.5.4 of IFRS 9 of recognising lifetime expected credit losses for all significant increases in credit risk.

Region Two

Region Two includes a mining community that is largely dependent on the export of coal and related products. Bank ABC becomes aware of a significant decline in coal exports and anticipates the closure of several coal mines. Because of the expected increase in the unemployment rate, the risk of a default occurring on mortgage loans to borrowers who are employed by the coal mines is determined to have increased significantly, even if those customers are not past due at the reporting date. Bank ABC therefore segments its mortgage

portfolio by the industry within which customers are employed (using the information recorded as part of the mortgage application process) to identify customers that rely on coal mining as the dominant source of employment (ie a 'bottom up' approach in which loans are identified based on a common risk characteristic). For those mortgages, Bank ABC recognises a loss allowance at an amount equal to lifetime expected credit losses while it continues to recognise a loss allowance at an amount equal to 12-month expected credit losses for all other mortgages in Region Two (Except for those mortgages that are determined to have significantly increased in credit risk based on an individual assessment, such as those that are more than 30 days past due. Lifetime expected credit losses would also be recognised on those mortgages). Newly originated mortgages to borrowers who rely on the coal mines for employment in this community would, however, have a loss allowance at an amount equal to 12-month expected credit losses because they would not have experienced significant increases in credit risk since

initial recognition. However, some of these mortgages may experience significant increases in credit risk soon after initial recognition because of the expected closure of the coal mines.

Region Three

In Region Three, Bank ABC anticipates the risk of a default occurring and thus an increase in credit risk, as a result of an expected increase in interest rates during the expected life of the mortgages. Historically, an increase in interest rates has been a lead indicator of future defaults on mortgages in Region Three — especially when customers do not have a fixed interest rate mortgage. Bank ABC determines that the variable interest-rate portfolio of mor tgages in Region Three is homogenous and that unlike for Region Two, it is not possible to identify particular sub portfolios on the basis of shared risk characteristics that represent customers who are expected to have increased significantly in credit risk. However, as a result of the homogenous nature of the mortgages in Region Three, Bank ABC determines that an assessment can be made of a proportion of the overall portfolio that has significantly increased in credit risk since initial recognition (ie a 'top down' approach can be used). Based on historical information, Bank ABC estimates that an increase in interest rates of 200 basis points will cause a significant increase in credit risk on 20 per cent of the variable interest-rate portfolio. Therefore, as a result of the anticipated increase in interest rates, Bank ABC determines that the credit risk on 20 per cent of mortgages in Region Three has increased significantly since initial recognition. Accordingly Bank ABC recognises lifetime expected credit losses on 20 per cent of the variable rate mortgage portfolio and a loss allowance at an amount equal to 12-month expected credit losses for the remainder of the portfolio (Except for those mortgages that are determined to have significantly increased in credit risk based on an individual assessment, such as those that are more than 30 days past due. Lifetime expected credit losses would also be recognised on those mortgages).

Timing of assessment

Ind AS 109 clearly prescribes that an entity cannot align the timing of significant increases in credit risk and the recognition of lifetime expected credit losses to when a financial asset is regarded as credit-impaired or an entity's internal definition of default.

Lifetime credit losses are generally expected to be recorded before a financial instrument becomes past due. Typically, credit risk increases significantly before a financial instrument becomes past due or other lagging borrower-specific factors (for example, a modification or restructuring) are observed which means that the financial asset should normally be assessed as having increased significantly in credit risk earlier than when they become credit-impaired or default occurs.

However, depending on the nature of the financial instruments and the credit risk information available for particular groups of financial instruments, an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due. This may be the case for financial instruments such as retail loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a customer breaches the contractual terms.

Considering the above, an assessment of whether credit risk has increased significantly is a continuous process (and also generally forms part of regular credit risk management practices as well) and the determination of the same is made at each reporting date. When making such

assessment, an entity should use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses.

For example, it is possible for the ECL on a loan asset (let say housing loan) backed by collateral (underlying property) to fall because of increase in market value of collateral but at the same time the credit risk of the instrument goes up because the borrower has become unemployed which increases the risk of default.

Considering ECL is not only an accounting estimate and should closely align with the internal credit risk management practices, inputs from regular risk monitoring of the portfolio should continuously be considered while determination of significant increase credit risk.

Timing of recognition of expected credit losses

Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs. The assessment of whether lifetime expected credit losses should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition (irrespective of whether a financial instrument has been repriced to reflect an increase in credit risk) instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring.

The significance of a change in the credit risk since initial recognition depends on the risk of a default occurring as at initial recognition. Thus, a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring.

The risk of a default occurring on financial instruments that have comparable credit risk is higher the longer the expected life of the instrument; for example, the risk of a default occurring on an AAA-rated bond with an expected life of 10 years is higher than that on an AAA-rated bond with an expected life of five years.

Because of the relationship between the expected life and the risk of a default occurring, the change in credit risk cannot be assessed simply by comparing the change in the absolute risk of a default occurring over time. For example, if the risk of a default occurring for a financial instrument with an expected life of 10 years at initial recognition is identical to the risk of a default occurring on that financial instrument when its expected life in a subsequent period is only five years, that may indicate an increase in credit risk. This is because the risk of a default occurring over the expected life usually decreases as time passes if the credit risk is unchanged and the financial instrument is closer to maturity. However, for financial instruments that only have significant payment obligations close to the maturity of the financial instrument the risk of a default occurring may not necessarily decrease as time passes. In such a case, an entity should also consider other qualitative factors that would demonstrate whether credit risk has increased significantly since initial recognition.

An entity may apply various approaches when assessing whether the credit risk on a financial instrument has increased significantly since initial recognition or when measuring expected credit losses. An entity may apply different approaches for different financial instruments. An approach that does not include an explicit probability of default as an input per se, such as a credit loss rate approach, can be consistent with the requirements in this Standard, provided that an entity is able to separate the changes in the risk of a default occurring from changes

in other drivers of expected credit losses, such as collateral, and considers the following when making the assessment:

(a) the change in the risk of a default occurring since initial recognition;

(b) the expected life of the financial instrument; and

(c) reasonable and supportable information that is available without undue cost or effort that may affect credit risk.

Illustration 13:

An entity originates two loans: Loan 1 at credit rating of BBB and Loan 2 at credit rating of AAA. The entity as part of its policy has defined a parameter for identifying significant increase in credit risk as two grade down from its initial credit rating. In this case, what will be the implication if Loan 1's credit rating drops to A (two notch down) at the reporting date? Should the entity consider Loan 1 as Stage 2 even if in comparison Loan 2 which is BBB rating (comparatively lower then A) at the reporting date is considered as Stage 1?

Note: The pricing of loan at initial recognition factors the impact of initial rating during the loan assessment.

Response: Ind AS 109 requires an entity to compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition to identify significant increase in credit risk by considering reasonable and supportable information, that is available without undue cost or effort.

In this case, since the credit rating of Loan 1 was AAA and it would have been priced accordingly, as per the management policy if the rating drops to A which is two notches down, the entity will have to consider Loan 1 as Stage 2 asset. On the contrary, since loan B was originated itself as BBB rated instrument and was priced accordingly, the same would not be considered as stage 2.

Illustration 14:

Comparison to maximum credit risk [IFRS 9: IE40-42]

Bank A has two portfolios of automobile loans with similar terms and conditions in Region W. Bank A's policy on financing decisions for each loan is based on an internal credit rating system that considers a customer's credit history, payment behavior on other products with Bank A and other factors, and assigns an internal credit risk rating from 1 (lowest credit risk) to 10 (highest credit risk) to each loan on origination. The risk of a default occurring increases exponentially as the credit risk rating deteriorates so, for example, the difference between

credit risk rating grades 1 and 2 is smaller than the difference between credit risk rating grades 2 and 3. Loans in Portfolio 1 were only offered to existing customers with a similar internal credit risk rating and at initial recognition all loans were rated 3 or 4 on the internal rating scale. Bank A determines that the maximum initial credit risk rating at initial recognition it would accept for Portfolio 1 is an internal rating of 4. Loans in Portfolio 2 were offered to customers that responded to an advertisement for automobile loans and the internal credit risk ratings of these customers range between 4 and 7 on the internal rating scale. Bank A never originates an automobile loan with an internal credit risk rating worse than 7 (ie with an internal rating of 8–10).

For the purposes of assessing whether there have been significant increases in credit risk, Bank A determines that all loans in Portfolio 1 had a similar initial credit risk. It determines that given the risk of default reflected in its internal risk rating grades, a change in internal rating from 3 to 4 would not represent a significant increase in credit risk but that there has been a significant increase in credit risk on any loan in this portfolio that has an internal rating worse than 5. This means that Bank A does not have to know the initial credit rating of each loan in the portfolio to assess the change in credit risk since initial recognition. It only has to determine whether the credit risk is worse than 5 at the reporting date to determine whether lifetime expected credit losses should be recognised in accordance with paragraph 5.5.3 of IFRS 9.

However, determining the maximum initial credit risk accepted at initial recognition for Portfolio 2 at an internal credit risk rating of 7, would not meet the objective of the requirements as stated in paragraph 5.5.4 of IFRS 9. This is because Bank A determines that significant increases in credit risk arise not only when credit risk increases above the level at which an entity would originate new financial assets (i.e. when the internal rating is worse than 7). Although Bank A never originates an automobile loan with an internal credit rating worse than 7, the initial credit risk on loans in Portfolio 2 is not of sufficiently similar credit risk at initial recognition to apply the approach used for Portfolio 1. This means that Bank A cannot simply compare the credit risk at the reporting date with the lowest credit quality at initial recognition (for example, by comparing the internal credit risk rating of loans in Portfolio 2 with an internal credit risk rating of 7) to determine whether credit risk has increased significantly because the initial credit quality of loans in the portfolio is too diverse. For example, if a loan initially had a credit risk rating of 4 the credit risk on the loan may have increased significantly if its internal credit risk rating changes to 6.

Illustration 15:

Counterparty assessment of credit risk [IFRS 9: IE43-44]

Scenario 1:

In 20X0 Bank A granted a loan of INR 10,000 with a contractual term of 15 years to Company Q when the company had an internal credit risk rating of 4 on a scale of 1 (lowest credit risk) to 10 (highest credit risk). The risk of a default occurring increases exponentially as the credit risk rating deteriorates so, for example, the difference between credit risk rating grades 1 and 2 is smaller than the difference between credit risk rating grades 2 and 3. In 20X5, when Company Q had an internal credit risk rating of 6, Bank A issued another loan to Company Q for INR 5,000 with a contractual term of 10 years. In 20X7 Company Q fails to retain its contract with a major customer and correspondingly experiences a large decline in its revenue. Bank A considers that as a result of losing the contract, Company Q will have a significantly reduced ability to meet its loan obligations and changes its internal credit risk rating to 8.

Bank A assesses credit risk on a counterparty level for credit risk management purposes and determines that the increase in Company Q's credit risk is significant. Although Bank A did not perform an individual assessment of changes in the credit risk on each loan since its initial recognition, assessing the credit risk on a counterparty level and recognising lifetime expected credit losses on all loans granted to Company Q, meets the objective of the impairment requirements as stated in paragraph 5.5.4 of IFRS 9. This is because, even since the most recent loan was originated (in 20X7) when Company Q had the highest credit risk at loan origination, its credit risk has increased significantly. The counterparty assessment would therefore achieve the same result as assessing the change in credit risk for each loan individually.

Scenario 2:

Bank A granted a loan of INR 150,000 with a contractual term of 20 years to Company X in 20X0 when the company had an internal credit risk rating of 4. During 20X5 economic conditions deteriorate and demand for Company X's products has declined significantly. As a result of the reduced cash flows from lower sales, Company X could not make full payment of its loan instalment to Bank A. Bank A re-assesses Company X's internal credit risk rating and determines it to be 7 at the reporting date. Bank A considered the change in credit risk on the loan, including considering the change in the internal credit risk rating, and determines that there has been a significant increase in credit risk and recognises lifetime expected credit losses on the loan of INR 150,000.

Despite the recent downgrade of the internal credit risk rating, Bank A grants another loan of INR 50,000 to Company X in 20X6 with a contractual term of 5 years, taking into consideration the higher credit risk at that date.

The fact that Company X's credit risk (assessed on a counterparty basis) has previously been assessed to have increased significantly, does not result in lifetime expected credit losses being recognised on the new loan. This is because the credit risk on the new loan has not increased significantly since the loan was initially recognised. If Bank A only assessed credit risk on a counterparty level, without considering whether the conclusion about changes in credit risk applies to all individual financial instruments provided to the same customer, the objective in paragraph 5.5.4 of IFRS 9 would not be met.

Changes in credit risk (incl. illustrative examples)

One of the major challenge is determining what results into significant increase in credit risk and how does an entity monitors the same.

Ind AS 109 provides illustrative examples (non-exhaustive) to assist in assessing whether there has been a significant increase in credit risk:

- Significant changes in terms & conditions of the instrument:
  - — internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date
  - — other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated or issued at the reporting date (such as more stringent covenants, increased amounts of collateral or guarantees, or higher income coverage) because of changes in the credit risk of the financial instrument since initial recognition
- significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:
  - (i) the credit spread;
  - (ii) the credit default swap prices for the borrower;

(iii) the length of time or the extent to which the fair value of a financial asset has been less than its amortised cost; and

(iv) other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.

(v) an actual or expected significant change in the financial instrument's external credit rating.

- an actual or expected internal credit rating downgrade for the borrower or decrease in behavioural scoring used to assess credit risk internally. Internal credit ratings and internal behavioural scoring are more reliable when they are mapped to external ratings or supported by default studies.
- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates.

o an actual or expected significant change in the operating results of the borrower. Examples include actual or expected declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality, increased balance sheet leverage, liquidity, management problems or changes in the scope of business or organizational structure (such as the discontinuance of a segment of the business) that results in a significant change in the borrower's ability to meet its debt obligations.

o an actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.

o significant changes in the value of the collateral supporting the obligation or in the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments or to otherwise have an effect on the probability of a default occurring. For example, if the value of collateral declines because house prices decline, borrowers in some jurisdictions have a greater incentive to default on their mortgages.

o significant increases in credit risk on other financial instruments of the same borrower.

o a significant change in the quality of the guarantee provided by a shareholder (or an individual's parents) if the shareholder (or parents) have an incentive and financial ability to prevent default by capital or cash infusion.

o significant changes, such as reductions in financial support from a parent entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, that are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in securitisations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security).

o expected changes in the loan documentation including an expected breach of contract that may lead to covenant waivers or amendments, interest payment holidays, interest

rate step-ups, requiring additional collateral or guarantees, or other changes to the contractual framework of the instrument.

- o significant changes in the expected performance and behavior of the borrower, including changes in the payment status of borrowers in the group (for example, an increase in the expected number or extent of delayed contractual payments or significant increases in the expected number of credit card borrowers who are expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount).
- o changes in the entity's credit management approach in relation to the financial instrument; i.e. based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.

Illustration 16:

Significant increase in credit risk [IFRS 9: IE7-11]

Company Y has a funding structure that includes a senior secured loan facility with different tranches. Bank X provides a tranche of that loan facility to Company Y. At the time of origination of the loan by Bank X, although Company Y's leverage was relatively high compared with other issuers with similar credit risk, it was expected that Company Y would be able to meet the covenants for the life of the instrument. In addition, the generation of revenue and cash flow was expected to be stable in Company Y's industry over the term of the senior facility. However, there was some business risk related to the ability to grow gross margins within its existing businesses.

At initial recognition, because of the considerations outlined above, Bank X considers that despite the level of credit risk at initial recognition, the loan is not an originated credit-impaired loan because it does not meet the definition of a credit-impaired financial asset in Appendix A of IFRS 9.

Subsequent to initial recognition, macroeconomic changes have had a negative effect on total sales volume and Company Y has underperformed on its business plan for revenue generation and net cash flow generation. Although spending on inventory has increased, anticipated sales have not materialised. To increase liquidity, Company Y has drawn down more on a separate revolving credit facility, thereby increasing its leverage ratio. Consequently, Company Y is now close to breaching its covenants on the senior secured loan facility with Bank X.

Bank X makes an overall assessment of the credit risk on the loan to Company Y at the reporting date by taking into consideration all reasonable and supportable information that is available without undue cost or effort and that is relevant for assessing the extent of the increase in credit risk since initial recognition. This may include factors such as:

(a) Bank X's expectation that the deterioration in the macroeconomic environment may continue in the near future, which is expected to have a further negative impact on Company Y's ability to generate cash flows and to deleverage.

(b) Company Y is closer to breaching its covenants, which may result in a need to restructure the loan or reset the covenants.

(c) Bank X's assessment that the trading prices for Company Y's bonds have decreased and that the credit margin on newly originated loans have increased reflecting the increase in credit risk, and that these changes are not explained by changes in the market environment (for example, benchmark interest rates have remained unchanged). A further comparison with the pricing of Company Y's peers shows that reductions in the price of Company Y's bonds and increases in credit margin on its loans have probably been caused by company-specific factors.

(d) Bank X has reassessed its internal risk grading of the loan on the basis of the information that it has available to reflect the increase in credit risk.

Bank X determines that there has been a significant increase in credit risk since initial recognition of the loan in accordance with paragraph 5.5.3 of IFRS 9. Consequently, Bank X recognises lifetime expected credit losses on its senior secured loan to Company Y. Even if Bank X has not yet changed the internal risk grading of the loan it could still reach this conclusion—the absence or presence of a change in risk grading in itself is not determinative of whether credit risk has increased significantly since initial recognition.

Illustration 17: No Significant increase in credit risk [IFRS 9: IE12-17]

Company C, is the holding company of a group that operates in a cyclical production industry. Bank B provided a loan to Company C. At that time, the prospects for the industry were positive, because of expectations of further increases in global demand. However, input prices were volatile and given the point in the cycle, a potential decrease in sales was anticipated.

In addition, in the past Company C has been focused on external growth, acquiring majority stakes in companies in related sectors. As a result, the group structure is complex and has been subject to change, making it difficult for investors to analyse the expected performance of the group and to forecast the cash that will be available at the holding company level. Even though leverage is at a level that is considered acceptable by Company C's creditors at the time that

Bank B originates the loan, its creditors are concerned about Company C's ability to refinance its debt because of the short remaining life until the maturity of the current financing. There is also concern about Company C's ability to continue to service interest using the dividends it receives from its operating subsidiaries. At the time of the origination of the loan by Bank B, Company C's leverage was in line with that of other customers with similar credit risk and based on projections over the expected life of the loan, the available capacity (i.e. headroom) on its coverage ratios before triggering a default event, was high. Bank B applies its own internal rating methods to determine credit risk and allocates a specific internal rating score to its loans. Bank B's internal rating categories are based on historical, current and forward-looking information and reflect the credit risk for the tenor of the loans. On initial recognition, Bank B determines that the loan is subject to considerable credit risk, has speculative elements and that the uncertainties affecting Company C, including the group's uncertain prospects for cash generation, could lead to default. However, Bank B does not consider the loan to be originated credit-impaired because it does not meet the definition of a purchased or originated credit-impaired financial asset in Appendix A of IFRS 9.

Subsequent to initial recognition, Company C has announced that three of its five key subsidiaries had a significant reduction in sales volume because of deteriorated market conditions but sales volumes are expected to improve in line with the anticipated cycle for the industry in the following months. The sales of the other two subsidiaries were stable.

Company C has also announced a corporate restructure to streamline its operating subsidiaries. This restructuring will increase the flexibility to refinance existing debt and the ability of the operating subsidiaries to pay dividends to Company C.

Despite the expected continuing deterioration in market conditions, Bank B determines, in accordance with paragraph 5.5.3 of IFRS 9, that there has not been a significant increase in the credit risk on the loan to Company C since initial recognition. This is demonstrated by factors that include:

(a) Although current sale volumes have fallen, this was as anticipated by Bank B at initial recognition. Furthermore, sales volumes are expected to improve, in the following months.

(b) Given the increased flexibility to refinance the existing debt at the operating subsidiary level and the increased availability of dividends to Company C, Bank B views the corporate restructure as being credit enhancing. This is despite some continued concern about the ability to refinance the existing debt at the holding company level.

(c) Bank B's credit risk department, which monitors Company C, has determined that the latest developments are not significant enough to justify a change in its internal credit risk rating.

As a consequence, Bank B does not recognise a loss allowance at an amount equal to lifetime expected credit losses on the loan. However, it updates its measurement of the 12-month expected credit losses for the increased risk of a default occurring in the next 12 months and for current expectations of the credit losses that would arise if a default were to occur.

Illustration 18:

[Source: TRG for Impairment of Financial Instruments – Meeting Summary – 16 September 2015]

Whether behavioral indicators (for example if a customer has failed to make a payment on a facility with another lender) can be used as a proxy for the assessment of significant increase in credit risk since initial recognition?

Response**:**

When assessing whether there has been a significant increase in credit risk, entities are required to consider a range of indicators rather than focusing on only one and behavioural factors can play a role in the assessment if they are considered in conjunction with other forward looking information.

When considering the use of behavioural indicators, it was noted that an entity should:

(a) focus on identifying pre-delinquency behavioural indicators of increases in credit risk, for example increased utilisation rates or increased cash drawings on specific products;

(b) only use indicators that are relevant to the risk of default occurring;

(c) establish a link between the behavioural indicators of credit risk and changes in the risk of default occurring since initial recognition;

(d) be mindful that while behavioural indicators are often predictive of defaults in the short term, they are often less predictive of defaults in the longer term; and

(e) consider whether the use of behavioural indicators is appropriate for the type of product being assessed—for example, if a loan has only back-ended payments, behavioural indicators based on timeliness of payment will not be appropriate.

Illustration 19:

Should the entity develop independent parameters for the purpose of identifying significant increase in credit risk which will be used in determination of expected credit losses, or can it leverage some of the existing parameters for example watchlist or early warning signal policy for determination of the significant increase in credit risk since initial recognition?

Response:

The parameters and assumptions used in the development of ECL estimates should be aligned to the internal credit risk management practices. In this scenario, it would be recommended to identify parameters for the purpose of identifying significant increase in credit risk since initial recognition from the watchlist / early warning signal policy keeping in view that the same should reflect the risk of default over the expected life and should include information which is forward looking as required by Ind AS 109.

Use of reasonable and supportable information

When determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect the credit risk on a financial instrument. An entity need not undertake an exhaustive search for information when determining whether credit risk has increased significantly since initial recognition.

Further, if reasonable and supportable forward-looking information is available without undue cost or effort, an entity cannot rely solely on past due information when determining whether credit risk has increased significantly since initial recognition. However, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, an entity may use past due information to determine whether there have been significant increases in credit risk since initial recognition.

In some cases, the qualitative and non-statistical quantitative information available may be sufficient to determine that a financial instrument has met the criterion for the recognition of a loss allowance at an amount equal to lifetime expected credit losses. That is, the information does not need to flow through a statistical model or credit ratings process in order to determine whether there has been a significant increase in the credit risk of the financial instrument. In other cases, an entity may need to consider other information, including information from its statistical models or credit ratings processes. Alternatively, the entity may base the assessment on both types of information, i.e. qualitative factors that are not captured through the internal ratings process and a specific internal rating category at the reporting date, taking into consideration the credit risk characteristics at initial recognition, if both types of information are relevant.

a) More than 30 days past due rebuttable presumption

Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due.

When an entity determines that there have been significant increases in credit risk before contractual payments are more than 30 days past due, the rebuttable presumption does not apply.

An entity can rebut the 30 days past due presumption. However, it can do so only when it has reasonable and supportable information available that demonstrates that even if contractual payments become more than 30 days past due, this does not represent a significant increase in the credit risk of a financial instrument. For example

— when non-payment was an administrative oversight, instead of resulting from financial difficulty of the borrower, or

— the entity has access to historical evidence that demonstrates that there is no correlation between significant increases in the risk of a default occurring and financial assets on which payments are more than 30 days past due, but that evidence does identify such a correlation when payments are more than 60 days past due.

Credit Impaired Financial Asset:

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is impaired includes observable data about such events. Illustrative events include:

(a) significant financial difficulty of the issuer or the borrower;

(b) a breach of contract, such as a default or past due event;

(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;

(d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(e) the disappearance of an active market for that financial asset because of financial difficulties; or

(f) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

Definition of Default:

The term "default" is not defined under Ind AS 109. An entity will have to establish it's own policy for what it considers as default and apply a definition consistent with that used for internal credit risk management purposes for the relevant financial instrument. Further, Basel committee has also recommended that the definition of default adopted for accounting purposes can be guided by the definition used for regulatory purpose *(Guidance on credit risk and accounting for expected losses - Basel Committee on Banking Supervision -December 2015)*.

Ind AS 109 includes a rebuttable presumption that a default does not not occur later than when a financial asset is 90 days past due, unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

Illustration 20: Upgradation of financial instrument

Entity A has advanced INR 100 mn to a corporate customer Entity B. Entity B was classified as credit impaired for a considerable period due to overdue interest and principal for more than 90 days past due. Entity B had repaid the entire overdue however the financial stress continues in the industry in which entity B operates. In such situations, can the entity upgrade from Stage 3 (credit impaired / default) to stage 1 when the overdue is fully paid off as on the reporting date?

Response:

In principle, the financial instrument should be considered to be upgraded from credit impaired / default category when the parameters which led to such default no longer exists and is fully rectified on sustainable basis. A temporary rectification may not completely indicate that the stress in the account is completely resolved and hence in such cases it would be recommended to consider a cooling off period within stage 3 or a transitionary move to stage 2 and then stage 1. This cooling off period would assist the bank to assess the sustainability of the reduction in credit risk to consider the loan as performing. The tenure and manner in which the cooling off period should be applied is a matter of judgement and the same should be defined internally in line with it's own credit risk monitoring policy.

Expected Credit Loss Computation Approach

Expected credit losses is defined in Ind AS 109 as the weighted average of credit losses with the respective risks of a default occurring as the weights. The standard states that an entity shall measure expected credit losses of a financial instrument in a way that reflects:

(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

(b) the time value of money; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Ind AS 109 does not prescribe specific approaches to estimate ECLs. The requirement is for the entity to use all reasonable and available information to estimate reasonable future scenarios that would lead to credit losses and then arrive at the discounted value of credit losses on a probability weighted basis. Thus, the measurement of expected credit losses is dependent upon the experienced judgment of the management of the entity about the credit risk of lending exposures. Some of the common approaches include the Probability of Default (PD) / Loss given default (LGD) and loss rate approaches.

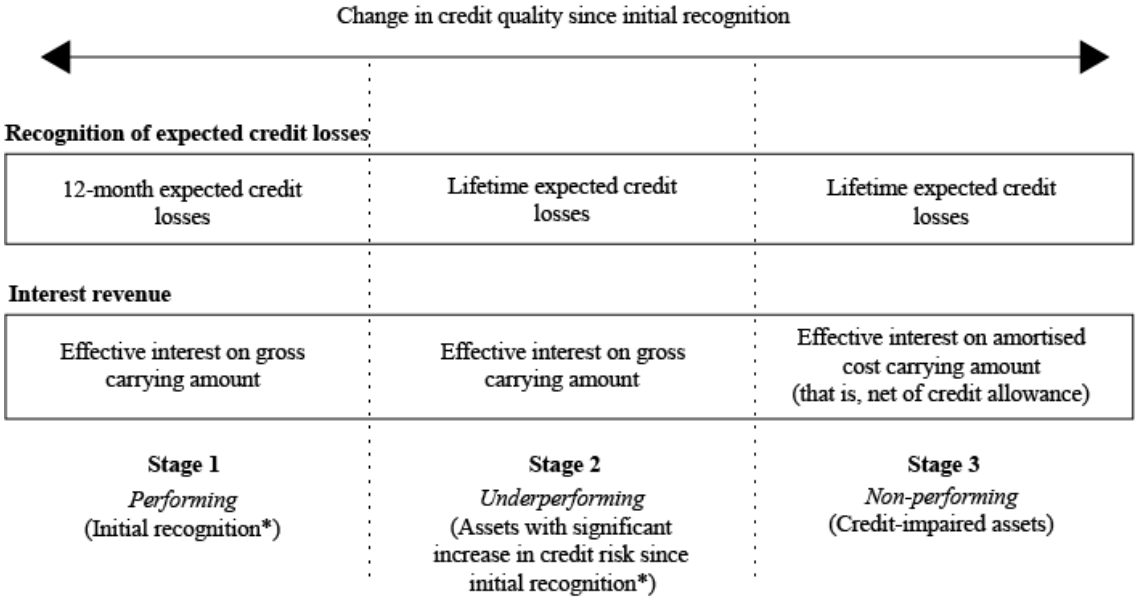
As per the General Approach, the financial instruments under scope are classified into 3 stages:

Stage 1: Stage 1 includes financial assets that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date. For these assets, 12-month expected credit losses are recognized and interest revenue is calculated on the gross carrying amount of the asset (that is, without deduction for credit allowance).

Stage 2: Stage 2 includes financial instruments that have had a significant increase in credit risk since initial recognition (unless they have low credit risk at the reporting date) but that do not have objective evidence of impairment. For these assets, lifetime expected credit losses are recognized, but interest revenue is still calculated on the gross carrying amount of the asset.

Stage 3: Stage 3 includes financial assets that have objective evidence of impairment at the reporting date. For these assets, lifetime expected credit loss is recognized and interest revenue is calculated on the net carrying amount (that is, net of credit allowance).

Summary:



Portfolio Segmentation

Portfolio Segmentation is the first step for development of ECL model. Under Ind AS 109, portfolio segmentation is a critical requirement for developing accurate and reliable Expected Credit Loss (ECL) estimates. This segmentation involves grouping financial assets based on shared (homogeneous) risk characteristics to ensure that ECL calculations appropriately reflect the credit risk of each segment. Here are the key considerations for portfolio segmentation:

— Shared risk characteristics:

Segmentation should be based on characteristics that influence the credit risk of the financial assets. These may include factors such as asset type, industry sector, geographical location, credit rating, loan-to-value ratios, or other relevant risk factors.

— Homogeneity:

Within each segment, the assets should have similar risk profiles. This homogeneity ensures that the ECL models and assumptions applied are appropriate and consistent for all assets in the segment.

— Granularity:

While segmentation should be granular enough to capture significant differences in risk characteristics, it should also be practical and manageable. Overly granular segmentation can lead to complexity and may not significantly improve the accuracy of ECL estimates.

— Regular Review

Segmentation is not a one-time exercise. As market conditions, credit risks, or the composition of the portfolio change, the segmentation may need to be adjusted. This dynamic approach ensures that ECL calculations remain accurate and relevant over time.

— Consistency with Risk Management Practices:

The segmentation approach used for ECL estimation should be consistent with how the entity manages and monitors credit risk internally. This alignment helps in ensuring that the ECL estimation process is integrated with the entity's overall risk management framework.

— Documentation:

Entities must document the criteria and rationale used for segmentation. This documentation is important for transparency and for demonstrating compliance with IFRS 9 requirements, especially during audits or regulatory reviews.

— Impact on Staging:

In some circumstances the segmentation of portfolios based on shared credit risk characteristics may assist in determining significant increases in credit risk for groups of financial instruments.

Probability of Default (PD) / Loss given default (LGD) Approach

Probability of Default: PD is the likelihood of a borrower defaulting on its obligations within a given interval of time.

12-month PDs: This is the estimated probability of default occurring within the next 12 months (or over the remaining life of the financial instrument if that is less than 12 months).

Lifetime PDs: This is the estimated probability of a default occurring over the remaining life of the financial instrument. This is used to calculate lifetime ECLs for 'stage 2' and 'stage 3' exposures.

Loss Given Default: LGD refers to the estimate of loss given a default event takes place i.e. portion of the non-recovered credit. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral.

Exposure at Default: Exposure at Default is an estimation of the extent to which an entity may be exposed to an obligor in the event of, and at the time of, that obligor's default. This estimate takes into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.

Forward looking / macro-economic adjustments: Ind AS 109 requires the ECL estimate which are point in time i.e. based on current conditions and adjusted for forward looking marcro-economic adjustments without any prudential adjustments.

Stage	ECL	ECL measurement**	Interest Revenue
Stage 1: Performing	12 months ECL	EAD*12month PD* LGD	EIR on Gross Carrying Amount
Stage 2: Under-performing	Lifetime ECL	EAD*Lifetime PD* LGD	EIR on Gross Carrying Amount
Stage 3: Non-performing	Lifetime ECL	EAD*Lifetime PD*LGD	EIR on Net Carrying Amount (i.e. net off ECL)

** This ECL computed should be adjusted for forward looking macro-economic adjustment and also should incorporate effects of time value of money by discounting using EIR (refer above section "Time Value of Money")

Illustration 21: 12month ECL measurement using PD / LGD approach – Single financial Instrument [IFRS 9: IE49-50]

Entity A originates a single 10 year amortising loan for INR 1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PD) of 0.5 per cent over the next 12 months. Entity A also determines that changes in the 12-month PD are a reasonable approximation of the changes in the lifetime PD for determining whether there has been a significant increase in credit risk since initial recognition.

At the reporting date (which is before payment on the loan is due63), there has been no change in the 12-month PD and Entity A determines that there was no significant increase in credit risk since initial recognition. Entity A determines that 25 per cent of the gross carrying amount will be lost if the loan defaults (ie the LGD is 25 per cent).64 Entity A measures the loss allowance at an amount equal to 12-month expected credit losses using the 12-month PD of 0.5 per cent. Implicit in that calculation is the 99.5 per cent probability that there is no default. At the reporting date the loss allowance for the 12 month expected credit losses is INR1,250 (0.5% × 25% × INR 1,000,000).

Illustration 22:

12month ECL measurement using PD / LGD approach – Portfolio of financial Instrument [IFRS 9: IE 51-52]

Entity B acquires a portfolio of 1,000 five-year bullet loans for INR 1,000 each (ie INR 1million in total) with an average 12-month PD of 0.5 per cent for the portfolio. Entity B determines that because the loans only have significant payment obligations beyond the next 12 months, it would not be appropriate to

consider changes in the 12-month PD when determining whether there have been significant increases in credit risk since initial recognition. At the reporting date Entity B therefore uses changes in the lifetime PD to determine whether the credit risk of the portfolio has increased significantly since initial recognition.

Entity B determines that there has not been a significant increase in credit risk since initial recognition and estimates that the portfolio has an average LGD of 25 per cent. Entity B

determines that it is appropriate to measure the loss allowance on a collective basis in accordance with IFRS 9. The 12-month PD remains at 0.5 per cent at the reporting date. Entity B therefore measures the loss allowance on a collective basis at an amount equal to 12-month expected credit losses based on the average 0.5 per cent 12-month PD. Implicit in the calculation is the 99.5 per cent probability that there is no default. At the reporting date the loss allowance for the 12-month expected credit losses is INR1,250 (0.5% × 25% × CU1,000,000).

Illustration 23: Estimation of Exposure at Default

How is Exposure at Default computed? How does an entity factor in undrawn commitment for computation of ECL?

EAD = Expected Outstanding Loan exposure on default + Expected exposure on undrawn commitment

Expected outstanding loan exposure on default incorporates the following:

— monthly required repayments of principal and interest component (amortization schedule),

— pre-payments if any

— changes in utilization of an undrawn commitment within the agreed credit limits in advance of defaults

In practice, multiple statistical models can be used to forecast EAD (e.g. EAD term structure, modelling of pre-payment factors etc.). Further, EAD also factors the undrawn commitment on which ECL is to be estimated. In practice, a credit conversion factor is derived to estimate the potential EAD using historic data.

Further, some entities also prefer to keep the EAD computation on outstanding balances simple which is consider the current outstanding plus interest accrued instead of preparation of EAD term structure.

Illustration 24:

Whether Probability of Default computation should be based on count of borrowers or amount outstanding?

Response: A very commonly debated question is whether PD should be based on count of borrowers or amount outstanding. Generally, PD being a statistical measure representing the probability that a borrower or proportion of borrowers in a given portfolio are expected to default within a given timeframe. For example, 3% PD means 3 out of 100 borrowers are expected to default within the given timeframe. Using count-based PD ensures that the probability aspect of default risk is assessed independently of the size of the loan. This allows for a standardized measure of credit risk across different loans and portfolios.

In practice, mixed views exist in these areas and generally it is better to test check the outcome based on both approaches. If segmentation is appropriately performed which covers the bucketing based on ticket size of the loans as well, the variation is the outcome will be very low.

Illustration 25:

How many years of historical data should be considered for PD and LGD computation? What should an entity do if it lacks sufficient historical data?

Response:

There is no strict rule specifying the exact number of years of historical data required for developing PD and LGD estimates. Generally, it is advisable to use data covering 2-3 complete loan cycles to provide a robust basis for these estimates. When sufficient historical data is not available, entities should exercise judgment in their estimation process, potentially using proxy data or industry benchmarks. Additionally, it is important to exclude outlier or abnormal data to ensure the estimates accurately reflect the typical risk profile of the portfolio.

If an entity lacks sufficient historical data, it can use proxy data, such as default data from credit bureaus for borrowers with similar risk profiles. However, the entity should ensure that appropriate data points are captured and regularly review the model outcomes using its own historical data as it becomes available, to facilitate a timely transition to models developed from its own data.

Illustration 26:

What are the general models used for estimation of Exposure at Default, Probability of Default, Loss given default and macro-economic modelling?

Response:

Generally, it has been observed that following are the models which are used by entities in practice while estimation of EAD, PD, LGD and macro-economic modelling:

Parameter	Models (Illustrative and not exhaustive)
Exposure at Default	• Simplified Approach (Outstanding plus interest accrued) • EAD term structure based on contractual or behavioral analysis
Probability of Default	• Observed Default Rate • Transition Matrix • Roll rate Model • Markov Chain Model • External Rating based Model • Pluto Tasche Model (for low default portfolio)
Loss Given Default	• Workout / Vintage LGD • Collateral based Model • FIRB • External Rating based Model • Pluto Tasche Model (for low default portfolio)
Macro-economic Modelling	• Vasicek Model • Linear Regression • Beta Regression

Illustration 27:

What are the key considerations while developing a macro-economic model for incorporating forward looking element in the ECL model?

Response:

Developing a macroeconomic model to incorporate forward-looking elements into the Expected Credit Loss (ECL) model under IFRS 9 involves several key considerations. These considerations ensure that the ECL estimates reflect potential future changes in credit risk due to macroeconomic conditions.

1. Selection of macro-economic variables:
    a. Relevance: Choose variables that are relevant to the credit risk of the portfolio, such as GDP growth, unemployment rates, inflation, interest rates, housing prices etc.
    b. Data Availability: Ensure that data for the selected variables is available and reliable, with a sufficient historical time series for model development and validation.
2. Economic scenarios:
    a. Multiple Scenarios: Develop multiple scenarios, including a baseline, optimistic, and pessimistic scenario, to capture a range of possible future economic conditions.
    b. Scenario Weighting: Assign appropriate weights to each scenario based on their likelihood and use these weights in the ECL calculation to produce a probability-weighted outcome.
3. Model Development and Calibration:
    a. Model Specification: Define the relationship between macroeconomic variables and credit risk parameters (PD, LGD, and EAD). This may involve statistical techniques such as regression analysis.
    b. Calibration: Regularly calibrate the model using historical data to ensure it accurately captures the observed relationships. This involves adjusting model parameters based on new data and changing economic conditions. However, this does not involve use of different variables year on year to ensure only statistical relevance.
4. Forward looking adjustments:
    a. Incorporating Projections: Use economic forecasts and projections to adjust PD, LGD, and EAD estimates. Ensure these adjustments reflect expected changes in the economic environment.
    b. Expert Judgment: Where data or models are insufficient, expert judgment may be necessary to adjust model outputs. Document and justify such adjustments clearly.
5. Documentation and Governance:
    a. Documentation: Maintain comprehensive documentation of the model development process, including the rationale for variable selection, model assumptions, and calibration processes.

b. Governance: Implement robust governance and oversight mechanisms to review and approve the model, including inputs, assumptions, and outputs.

Illustration 28:

[Source: TRG for Impairment of Financial Instruments – Meeting Summary – 16 September 2015]

When applying the impairment requirements, IFRS 9 requires entities to consider all reasonable and supportable information that is available without undue cost and effort, including information that is forward-looking. The ITG considered two potential implementation issues related to forward-looking information:

(a) whether forward-looking information, including macroeconomic information, should be incorporated into the determination of expected credit losses in a differentiated way–for example, country by country, bank by bank, portfolio by portfolio; and

(b) how to determine whether forward-looking information is reasonable and supportable for inclusion in the application of the impairment model. The question is particularly relevant within the context of information about emerging issues and uncertain future events, which is not usually included in an entity's current budgeting and forecasting processes.

Response:

With respect to the first issue, ITG members confirmed that, as noted in paragraphs B5.5.16 and B5.5.51 of IFRS 9, forward-looking information should be relevant for the particular financial instrument or group of financial instruments to which the impairment requirements are being applied. Different factors may be relevant to different financial instruments and accordingly the relevance of particular items of information may vary between financial instruments, depending on the specific drivers of credit risk. For example, this is highlighted in Example 5 to IFRS 9, in which expectations about future levels of unemployment in a specific industry and specific region are only relevant to a sub-portfolio of mortgage loans in which the borrowers work in that industry in that specific region. Conversely, it was also noted that if different financial instruments or portfolios being assessed share some similar risk characteristics, then relevant forward-looking information should be applied in a comparable and consistent manner to reflect those similar characteristics.

With respect to the second issue, ITG members discussed the principles associated with determining whether forward-looking information is reasonable and supportable and therefore should be included in the application of the impairment requirements, as summarised below. The ITG did not comment on the appropriateness of the structured approach proposed by the submitter.

ITG members noted that the objective in the Standard is to determine expected credit losses by considering all reasonable and supportable information, including forward-looking information, that is relevant and available without undue cost or effort. Information with these characteristics is used in both the assessment of significant increases in credit risk and in the measurement of expected credit losses.

ITG members acknowledged that this was a challenging area. They observed that there will be a spectrum of forward-looking information available, some of which will be reasonable and supportable and some of which will have little or no supportable basis. Determining the information that is relevant and reasonable and supportable and its impact on the assessment

of significant increases in credit risk and measurement of expected credit losses can require a high level of judgement. In addition, ITG members observed that it can be particularly challenging and difficult to determine the economic consequences (or 'second-order effects') of uncertain future outcomes. For example, while it may be possible to assess the likelihood of particular event occurring, it may be more difficult to determine the effect of the event on the risk of a default occurring and/or on the credit loses that would be associated with that event using reasonable and supportable information.

ITG members noted that the objective of the IFRS 9 requirements for measuring expected credit losses is to reflect probability-weighted outcomes. Accordingly, information should not be excluded from the assessment of expected credit losses simply because: (a) the event has a low or remote likelihood of occurring; or (b) the effect of that event on the credit risk or the amount of expected credit losses is uncertain.

ITG members emphasised that an entity should make an effort in good faith to estimate the impact of uncertain future events, including second-order effects, on the credit risk of financial instruments and the measurement of expected credit losses. The estimate should be based on all reasonable and supportable information that is relevant and available without undue cost and effort. Some ITG members made the following observations:

(a) Estimates of expected credit losses should reflect an entity's own expectations of credit losses; however, entities should be able to explain how they have arrived at their estimate and how it is based on reasonable and supportable information.

(b) Estimates of expected credit losses are, by their nature, approximations, which will be updated as more reasonable and supportable information becomes available over time.

(c) Information does not necessarily need to flow through a statistical model or creditrating process in order to determine whether it is reasonable and supportable and relevant for a particular financial instrument or group of financial instruments.

Some ITG members observed that if an entity could determine that an uncertain event has an impact on the risk of a default occurring, then it should be possible to make an estimate of the impact on expected credit losses, despite the potentially large range of outcomes. However, in some exceptional cases, it was acknowledged that it may not be possible to estimate the impact on expected credit losses, despite an entity's best efforts.

In this regard, ITG members emphasised the importance of disclosure of forward-looking information that is relevant, but that cannot be incorporated into the determination of significant increases in credit risk and/or the measurement of expected credit losses because of the lack of reasonable and supportable information. Such disclosures should be consistent with the objective in IFRS 7, which is to enable users of the financial statements to understand the credit risk to which the entity is exposed.

Several ITG members mentioned that the impact of scenarios about some uncertain future events for which there is reasonable and supportable information may need to be incorporated into the assessment of significant increases in credit risk and measurement of expected credit losses through the use of overlays to the 'base model', on a collective basis. However, in doing so, care needs to be taken to avoid double-counting the impact of events (in both the base model and the overlay) and to take into account the implications of significant correlations; for example, if the impact of a specific uncertain future event had already been captured through the macroeconomic forecasts included in the base model. ITG members highlighted that the estimate of expected credit losses must be consistent with the requirements in the Standard and in particular with the measurement objective for expected credit losses.

ITG members emphasised the need for good governance and processes in this area, because of the uncertainties and continually changing circumstances associated with forward-looking information. Furthermore, an entity should be able to explain what information it had considered and why that information had been included or excluded from the determination of expected credit losses.

Loss Rate Approach:

Using a 'loss rate' approach, the PD and LGD are assessed as a single combined measure, based on past losses, adjusted for current conditions and forecasts of future conditions. It may be easier to use when there is insufficient data to measure the separate components. This approach can be considered consistent with the requirements in this Standard, provided that an entity is able to separate the changes in the risk of a default occurring from changes in other drivers of expected credit losses, such as collateral, and considers the following when making the assessment:

(a) the change in the risk of a default occurring since initial recognition;

(b) the expected life of the financial instrument; and

(c) reasonable and supportable information that is available without undue cost or effort that may affect credit risk.

Bank A originates 2,000 bullet loans with a total gross carrying amount of INR 500,000. Bank A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per client of CU200, for a total gross carrying amount of INR 200,000. Group Y comprises 1,000 loans with a gross carrying amount per client of INR 300, for a total gross carrying amount of INR 300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees.

Bank A measures expected credit losses on the basis of a loss rate approach for Groups X and Y. In order to develop its loss rates, Bank A considers samples of its own historical default and loss experience for those types of loans. In addition, Bank A considers forward-looking information, and updates its historical information for current economic conditions as well as reasonable and supportable forecasts of future economic conditions. Historically, for a population of 1,000 loans in each group, Group X's loss rates are 0.3 per cent, based on four defaults, and historical loss rates for Group Y are 0.15 per cent, based on two defaults.

Group	No. of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per anum average default	Estimated total gross carrying amount at default	Present value of observed loss*	Loss rate
	A	B	C=A x B	D	E=B x D	F	G=F / C
X	1,000	CU 200	CU 2,00,000	4	CU 800	CU 600	0.3%
Y	1,000	CU 300	CU 3,00,000	2	CU 600	CU 450	0.15%

*In accordance with paragraph 5.5.17(b) expected credit losses should be discounted using the effective interest rate. However, for purposes of this example, the present value of the observed loss is assumed.

At the reporting date, Bank A expects an increase in defaults over the next 12 months compared to the historical rate. As a result, Bank A estimates five defaults in the next 12 months for loans in Group X and three for loans in Group Y. It estimates that the present value of the observed credit loss per client will remain consistent with the historical loss per client.

On the basis of the expected life of the loans, Bank A determines that the expected increase in defaults does not represent a significant increase in credit risk since initial recognition for the portfolios. On the basis of its forecasts, Bank A measures the loss allowance at an amount equal to 12-month expected credit losses on the 1,000 loans in each group amounting to INR 750 and INR 675 respectively. This equates to a loss rate in the first year of 0.375 per cent for Group X and 0.225 per cent for Group Y.

Group	No. of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per anum average default	Estimated total gross carrying amount at default	Present value of observed loss*	Loss rate
	A	B	C = A x B	D	E = B x D	F	G = F / C
X	1,000	CU 200	CU 2,00,000	5	CU 1000	CU 750	0.375%
Y	1,000	CU 300	CU 3,00,000	3	CU 900	CU 675	0.225%

*In accordance with paragraph 5.5.17(b) expected credit losses should be discounted using the effective interest rate. However, for purposes of this example, the present value of the observed loss is assumed.

Bank A uses the loss rates of 0.375 per cent and 0.225 per cent respectively to estimate 12-month expected credit losses on new loans in Group X and Group Y originated during the year and for which credit risk has not increased significantly since initial recognition.

Specific considerations

Financial Assets measured at FVOCI

Financial Assets measured at FVOCI are under the scope of impairment requirements under Ind AS 109. Conceptually the application of general approach remains the same for financial assets measured at FVOCI as in the case of financial assets measured at amortised cost.

Measurement:

- Balance Sheet: These assets are carried at fair value.
- Other Comprehensive Income (OCI): Changes in fair value are recognized in OCI.

Loss Allowance:

- A loss allowance (for expected credit losses) is recognized, but it is reported in OCI rather than reducing the carrying amount of the asset on the balance sheet.
- The carrying value of the asset on the balance sheet remains at fair value.

Profit or Loss Impact:

- Although the asset is measured at fair value and the loss allowance is recognized in OCI, the amount recognized in profit or loss (P&L) for impairment is consistent with the treatment for financial assets measured at amortized cost.

Key difference as compared to financial assets measured at amortised cost:

- **Recognition:** For FVOCI assets, the loss allowance is recognized in OCI, while for amortized cost assets, it is recognized in P&L.
- **Carrying Value:** The carrying value of FVOCI assets on the balance sheet is always fair value, whereas for amortized cost assets, it is reduced by the loss allowance.
- **P&L Impact:** Despite the differences in balance sheet treatment and OCI involvement, the P&L impact of impairment is treated similarly under both models in terms of the actual loss allowance recognized.

Illustration 29:

Significant increase in credit risk [IFRS 9: IE78-81]

An entity purchases a debt instrument with a fair value of CU1,000 on 15 December 20X0 and measures the debt instrument at fair value through other comprehensive income. The instrument has an interest rate of 5 percent over the contractual term of 10 years, and has a 5 percent effective interest rate. At initial recognition the entity determines that the asset is not purchased or originated credit-impaired.

		INR	INR
Financial Assets at FVOCI	Dr.	1,000	
Cash	Cr.		1,000
To recognise the debt instrument at its fair value			

On 31 December 20X0 (the reporting date), the fair value of the debt instrument has decreased to CU950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that expected credit losses should be measured at an amount equal to 12-month expected credit losses, which amounts to CU30. For simplicity, journal entries for the receipt of interest revenue are not provided.

		INR	INR
Impairment Loss (P&L)	Dr.	30	
Other Comprehensive Income	Dr.	20	
Financial Assets at FVOCI	Cr.		50
To recognise the expected losses and other fair value changes on the debt instrument			

Disclosure would be provided about the accumulated impairment amount of CU30.

On 1 January 20X1, the entity decides to sell the debt instrument for CU950, which is its fair value at that date.

		INR	INR
Cash	Dr.	950	
Loss (P&L)	Dr.	20	
Financial Assets at FVOCI	Cr.		950
Other Comprehensive Income	Cr.		20
To derecognise the fair value through other comprehensive income asset and recycle amounts accumulated in OCI to P&L			

Modified financial instruments

In many instances, borrowers request renegotiation of terms and conditions of the debt instruments for varied reasons. For example, to obtain favorable terms, to mitigate financial difficulty faced by the borrower wherein the request could include interest discount, principal haircut, moratorium period, moving the timing of cashflows etc. These instances lead to modification of contractual cash flows agreed on initial recognition. Ind AS 109 provides guidance on application of impairment requirements for such renegotiations of contractual cash flows which either result into

— de-recognition of such financial assets

— modification of financial assets or

Modification that leads to De-recognition of Financial Assets

When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of Ind AS 109.

Accordingly the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset.

This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses is met.

However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset should be recognised as an originated credit-impaired financial asset. This might occur, for example, in a situation in which there was a substantial modification of a distressed asset that resulted in the derecognition of the original financial asset. In such a case, it may be possible for the modification to result in a new financial asset which is credit impaired at initial recognition.

Modifications that do not lead to de-recognition

If the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not derecognised, an entity shall on the basis of all reasonable and supportable information (including historical and forward looking information, information on

the circumstances that lead to modification etc.) that is available without undue cost or effort whether there has been a significant increase in credit risk by comparing:

— the risk of a default occurring at the reporting date (based on the modified contractual terms) and

— the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms).

A financial asset that is has been renegotiated or modified is not automatically considered to have lower credit risk. Evidence that the criteria for the recognition of lifetime expected credit losses are no longer met may include a history of up-to-date and timely payment performance against the modified contractual terms. Typically a customer would need to demonstrate consistently good payment behaviour over a period of time before the credit risk is considered to have decreased. For example, a history of missed or incomplete payments would not typically be erased by simply making one payment on time following a modification of the contractual terms.

Illustration 29: Significant increase in credit risk [IFRS 9: IE66-73]

Bank A originates a five-year loan that requires the repayment of the outstanding contractual amount in full at maturity. Its contractual par amount is INR 1,000 with an interest rate of 5 per cent payable annually. The effective interest rate is 5 per cent. At the end of the first reporting period (Period 1), Bank A recognises a loss allowance at an amount equal to 12-month expected credit losses because there has not been a significant increase in credit risk since initial recognition. A loss allowance balance of INR 20 is recognised.

In the subsequent reporting period (Period 2), Bank A determines that the credit risk on the loan has increased significantly since initial recognition. As a result of this increase, Bank A recognises lifetime expected credit losses on the loan. The loss allowance balance is INR 30.

At the end of the third reporting period (Period 3), following significant financial difficulty of the borrower, Bank A modifies the contractual cash flows on the loan. It extends the contractual term of the loan by one year so that the remaining term at the date of the modification is three years. The modification does not result in the derecognition of the loan by Bank A.

As a result of that modification, Bank A recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows discounted at the loan's original effective interest rate of 5 per cent. In accordance with paragraph 5.4.3 of IFRS 9, the difference between this recalculated gross carrying amount and the gross carrying amount before the modification is recognised as a modification gain or loss. Bank A recognises the modification loss (calculated as INR 300) against the gross carrying amount of the loan, reducing it to INR 700, and a modification loss of INR 300 in profit or loss.

Bank A also remeasures the loss allowance, taking into account the modified contractual cash flows and evaluates whether the loss allowance for the loan shall continue to be measured at an amount equal to lifetime expected credit losses. Bank A compares the current credit risk (taking into consideration the modified cash flows) to the credit risk (on the original unmodified cash flows) at initial recognition. Bank A determines that the loan is not credit-impaired at the reporting date but that credit risk has still significantly increased compared to the credit risk at

initial recognition and continues to measure the loss allowance at an amount equal to lifetime expected credit losses. The loss allowance balance for lifetime expected credit losses is INR 100 at the reporting date.

Period	Beginning Gross Carrying Amount	Impairment (Loss)/Gain	Modification (Loss)/Gain	Interest Revenue	Cash flows	Ending Gross Carrying Amount	Loss Allowances	Ending Amortised Cost Amount
	A	B	C	D Gross: A x 5%	E	F = A + C + D – E	G	H = F - G
1	1,000	(20)		50	50	1000	20	980
2	1,000	10		50	50	1000	30	970
3	1,000	70	(300)	50	50	700	100	600

(Amounts in INR)

At each subsequent reporting date, Bank A evaluates whether there is a significant increase in credit risk by comparing the loan's credit risk at initial recognition (based on the original, unmodified cash flows) with the credit risk at the reporting date (based on the modified cash flows), in accordance with paragraph 5.5.12 of IFRS 9.

Two reporting periods after the loan modification (Period 5), the borrower has outperformed its business plan significantly compared to the expectations at the modification date. In addition, the outlook for the business is more positive than previously envisaged. An assessment of all reasonable and supportable information that is available without undue cost or effort indicates that the overall credit risk on the loan has decreased and that the risk of a default occurring over the expected life of the loan has decreased, so Bank A adjusts the borrower's internal credit rating at the end of the reporting period.

Given the positive overall development, Bank A re-assesses the situation and concludes that the credit risk of the loan has decreased and there is no longer a significant increase in credit risk since initial recognition. As a result, Bank A once again measures the loss allowance at an amount equal to 12-month expected credit losses.

Loan Commitments and Financial Guarantee Contracts

Loan Commitments as well as Financial guarantee contracts not measured at FVTPL are within the scope of impairment requirements under Ind AS 109.

Loan commitments are defined as firm commitments to provide credit under pre-specified terms and conditions.

For written undrawn loan commitments, a credit loss is the present value of the difference between:

(a) the contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and

(b) the cash flows that the entity expects to receive if the loan is drawn down.

An entity's estimate of expected credit losses on loan commitments should be consistent with its expectations of drawdowns on that loan commitment, i.e. it should consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses.

Financial guarantee contract is defined as a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

For written financial guarantee contracts payments only arise in the event of a default by the debtor in accordance with the terms of the debt instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder of the debt instrument for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

Contractual vs Expected Life:

For loan commitments and financial guarantee contracts, Expected Credit Losses are to be measured for the maximum contractual period over which an entity has a present contractual obligation to extend credit. However, there is an exception for financial instruments that include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments only, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

Assessment of SICR:

For loan commitments, an entity considers changes in the risk of a default occurring on the loan to which a loan commitment relates. For financial guarantee contracts, an entity considers the changes in the risk that the specified debtor will default on the contract.

Inter-company loans

Generally, in the consolidated financial statements, inter-company loans get eliminated however, in the standalone financial statements, the inter-company loan continues to remain as an financial asset which requires assessment for measurement and classification under Ind AS 109. Based on the classification assessment, if the inter-company loans classify as a amortised cost or FVOCI loan, the same would be under the scope of impairment.

Further, in absence of a definite contractual arrangement, the analysis of business model and solely payment of principal is generally difficult.

Consider the inter-company loan qualifies for amortised cost or FVOCI classification, further practical questions may arise in terms of how the expected credit loss should be measured in various scenarios.

Illustration 30:

If the inter-company loan is payable on demand,

— what period should be considered in measurement of expected credit losses?

— how should an entity measure expected credit losses?

Response:

According to Ind AS 109, the maximum period for measuring expected credit losses is the maximum contractual period during which the entity is exposed to credit risk, and not beyond that. Since the lending entity (typically the parent company) can demand repayment with as little as one day's notice, the maximum period under Ind AS 109 is one day or less.

However, Ind AS 109 permits a loss allowance to be measured over a period longer than the contractual period if the financial instrument includes both a loan and an undrawn commitment component.

As a result, for intercompany loans with no specified terms and considered repayable on demand, there is no difference between 12-month and lifetime expected credit losses from a measurement perspective. This is because the lender's credit exposure is effectively limited to the time required to demand repayment, which can be as short as one day or less.

Considering this would be a debt instrument, general approach for computation of ECL is applicable i.e. use of PD/LGD approach can be considered.

Ind AS 109 requires the lender to measure the expected credit loss (ECL) as a probability-weighted amount, reflecting both the possibility of a credit loss occurring and not occurring, even if the likelihood of a credit loss is low.

For intercompany loans repayable on demand, there are typically two scenarios:

1. The borrower can repay immediately if demanded (having sufficient highly liquid resources)
    - In this case, the ECL could be negligible
2. The borrower cannot repay immediately if demanded
    - If the borrower cannot repay immediately, the lender should assess the expected recovery method and period (the lender's 'recovery scenarios').

Simplified Model - Receivables

These simplifications eliminate the need to calculate 12-month ECL and to assess when a significant increase in credit risk has occurred.

There is often a misconception that the expected credit loss (ECL) is primarily relevant for entities in the financial service sector; however it is important to note that the ECL model equally applies to entities in the non-financial sector. The model includes some operational

simplifications for trade receivables, contract assets and lease receivables, because they are often held by entities that do not have sophisticated credit risk management systems.

For trade receivables or contract assets that do not contain a significant financing component, the loss allowance should be measured at initial recognition and throughout its life at an amount equal to lifetime ECL. As a practical expedient, a provision matrix can be used to estimate ECL for these financial instruments.

An entity has an accounting policy choice for lease receivables, and trade receivables and contract assets which contain a significant financing component in accordance with Ind AS 115, Revenue from contract with customers. It can either apply the simplified approach (that is, to measure the loss allowance at an amount equal to lifetime ECL at initial recognition and throughout its life) or it can apply the general model.

The concept of the provision matrix has been explained below by way of an example.

Illustration 31: Example of a provision matrix:

A non-financial entity has trade receivables of INR 70,000 that do not have a significant financing component at the reporting date. The entity wants to use a provision matrix to determine the lifetime expected credit loss (ECL) for its trade receivables, as permitted by Ind AS 109. It is proposing to analyse its trade receivables into time buckets and apply a standard historical loss rate to those time buckets as illustrated below:

(Amounts in INR)

	Total receivables	Current	30–60 days	60–90 days	After 90 days
Trade receivable balances at reporting date: [1]	70,000	25,000	20,000	15,000	10,000
Loss rate: [2]		3%	3%	3%	3%
Expected credit loss: [1] × [2]	2,100	750	600	450	300

Does the above provision matrix comply with Ind AS 109 requirements?

Response:

No. This is because, to the extent that reasonable and supportable information is available without undue cost or effort, a provision matrix for Ind AS 109 purposes should reflect:

- relevant forward-looking information; and
- different loss rates for different time buckets of receivables, because older receivables would be expected to have a lower probability of settlement and hence a higher loss rate.

In addition, depending on the diversity of its customer base, the entity should use different provision matrices for different groups of receivables on the basis of shared credit risk characteristics. This would be the case if historical (and/or forecast) credit loss experience shows significantly different loss patterns for different customer segments. For example, receivables might be grouped by geographical region, product type, customer rating, collateral or trade credit insurance, or type of customer.

Ind AS 109 is not prescriptive about how to develop a provision matrix. One approach is illustrated below. However, other approaches might be appropriate, provided that they are consistent with principles in Ind AS 109.

Step 1: Define the period of sales and bad debts related to those sales

For each group of receivables, the entity defines a historical period of sales, and then it determines how much of the receivables in respect of those sales resulted in cash losses i.e. bad debts. The period of sales chosen should be such that the historical losses arising are a valid representation of loss patterns. For example, data for only a few months is unlikely to be sufficiently long; however, using too long a period might not be appropriate if there have been significant changes in the marketplace over that period. A newly established entity or an entity entering a new market might not have sufficient historical data of its own, in which case it might need to rely on external data, such as industry loss ratios.

In this illustrative example, for illustrative purposes only, a period of one year is determined to be appropriate, but the period to be used in practice would depend on the facts and circumstances of each case. In that year, INR 500,000 of sales were made on credit (that is, trade receivables recognised) and cash losses of INR 15,000 were incurred in relation to those sales.

Step 2: Calculate the historical payment profile of the trade receivables

To determine the historical default rate for each time bucket of receivables, the payment profile for the receivables arising in the historical period of sales must be determined.

In this example, of the total sales of INR 500,000, customers paid INR 100,000 within 30 days of the sale date. Therefore INR 400,000 of the sales were still outstanding after 30 days. Customers paid an additional INR 175,000 within the next 30 days, resulting in INR 225,000 of sales that were not paid within 60 days. This analysis continues until ultimately the remaining unpaid receivables of INR 15,000 are written off as losses by the entity.

Step 3: Calculate the historical loss rate

This step calculates the historical loss rate for each time bucket of receivables. From the INR 5,00,000 sales made in the period, there were losses of INR 15,000. Therefore, these INR 15,000 receivables are included within the amount outstanding in each of the time buckets (because the cash was never received), even though the amount outstanding reduces for each subsequent period. For each time bucket, the historical loss rate can be determined by dividing the ultimate loss (of INR 15,000) by the amounts outstanding in that time bucket, as illustrated below:

(Amounts in INR)

	Current sales	**Payments outstanding after 30 days**	**Payments outstanding after 60 days**	**Payments outstanding after 90 days**
Ageing profile of sales: [1]	500,000	400,000	225,000	75,000
Loss: [2]	15,000	15,000	15,000	15,000
Loss rate: [2] / [1]	3.00%	3.75%	6.67%	20.00%

The above table depicts the historical loss rates for each bucket. The receivables which are not yet due in the first bucket have a loss rate of 3% whereas the loss rate in the second bucket is 3.75% which is higher than the loss rate in the first bucket. The above table clearly demonstrates that the older receivables would be expected to have a lower probability of settlement and hence a higher loss rate.

Step 4: Adjust the loss rate for current and forward-looking information

The historical loss rate should be adjusted to reflect current and forward-looking information that might affect the ability of customers to settle the receivables. Such information should be reasonable and supportable, and it should be available without undue cost or effort. Consideration should be given to the impact of expected changes in the economic, regulatory and technological environment (such as industry outlook, GDP, employment, politics), and external market indicators.

For example, there might be a historical correlation between unemployment rates and the loss rate. In that case, if unemployment over the expected period of outstanding receivables is expected to be higher or lower than the historical average over the period in which losses have been observed, an adjustment would be needed to the historical loss.

In this example, an economic downturn and increase in unemployment rates compared with the historical period of sales is expected to lead to losses of INR 20,000, rather than INR 15,000, per INR 500,000 of sales. Provided that sales and the payment profile are expected to remain materially the same as for the historical sales period, the expected loss rates are recalculated as illustrated below:

(Amounts in INR)

	Current sales	Payments outstanding after 30 days	Payments outstanding after 60 days	Payments outstanding after 90 days
Ageing profile of sales: [1]	500,000	400,000	225,000	75,000
Loss: [2]	20,000	20,000	20,000	20,000
Loss rate:[2] / [1]	4.00%	5.00%	8.89%	26.67%

This is expected to be a difficult assessment as the entities may not have this information readily available.

Step 5: Calculate the ECL using the expected loss rates

The final step is to apply the expected loss rates to the ageing profile of the receivables at the reporting date to determine the total ECL:

(Amounts in INR)

	Total receivables	Current	30–60 days	60–90 days	After 90 days
Trade receivable balances at reporting date: [1]	70,000	25,000	20,000	15,000	10,000
Loss rate: [2]		4.00%	5.00%	8.89%	26.67%
Expected credit loss: [1] × [2]	6,000	1,000	1,000	1,333	2,667

The expected credit loss is INR 6,000, which is higher than the INR 2,100 that resulted from the method set out in the question. The difference reflects the impact of forward-looking information and that the loss rate of the receivables by ageing profile at the reporting date is not the same as the average loss rate in the historical reference period.

Illustration 32:

What balances are considered to be 'accounts receivable', and are therefore subject to the Ind AS 109 impairment model and likely to be able to benefit from the 'simplified approach'?

Response:

Clearly, normal trade receivables (including intercompany trade receivables) will be included when assessing impairment for accounts receivable.

However, in addition, contract assets as recognised under Ind AS 115, *Revenue from contracts with customers* are also within the scope of impairment under Ind AS 109. This includes those assets that might be described as 'unbilled receivables' or 'accrued income' and any variable consideration.

Other financial assets, such as loans (both inter-company and external to the group), investments in debt instruments, deposits, guarantees or most items currently classified as 'other financial assets' in financial statements, will also be subject to the Ind AS 109 impairment rules, but they will have to comply with the general model, where initially only a 12-month expected credit loss is recognised, but monitoring for significant increases in credit risk is required and, at that point, a lifetime expected credit loss would be recognised.

Illustration 33:

What does Ind AS 109 means by the 'simplified approach' to calculating expected credit losses?

Response**:**

For trade receivables (as well as contract assets and lease receivables), the standard provides a simplified approach for calculating the expected credit loss. This allows entities to dispense with the full general (that is, three-stage) impairment model. However, where any 'trade receivable' contains a significant financing component (normally, where the standard terms extended to the customer exceed 12 months), an entity has a policy choice between the simplified or three-stage model. The policy choice is also available for lease receivable.

Under the simplified approach, at initial recognition of each accounts receivable balance and throughout its life, a lifetime expected credit loss should be recognised in order to arrive at the appropriate impairment under Ind AS 109.

There are various methods to calculate a lifetime expected credit loss, but a suggested method in Ind AS 109 for trade receivables is through the use of a provision matrix. This method is not mandatory, but many non-financial institutions have adopted this approach.

Illustration 34:

What type of historical data should an entity collect to develop a provision matrix?

Response:

The first step is for an entity to gather information on past history of uncollectible accounts, and generally the profile of payment within its accounts receivable balances. This could be a period of one year, three years or even longer, dependent on the typical business cycle of the entity. Entities would take this data and split accounts receivable balances into different populations before applying the provision matrix. This could be based on geographical regions, product type, customer ratings, collateral (letters of credit or trade credit insurance), and the nature of the customer (for example, wholesale versus retail). In all cases, the objective is to try to understand the drivers of credit risk for the underlying receivables. For example, one population could be product A in region B being sold to customer type C. The level of segmentation required is a matter of judgement and, in developing segments, the entity should consider whether further segmentation would be expected to lead to only immaterial changes.

Illustration 35:

Can entities make a specific provision against a particular customer?

Response**:**

In some cases, the population might be as specific as individual customers. For example, where a particular customer is known to be in financial difficulty, it might require an increased or specific provision compared to historical averages. In such a scenario, it is important to consider and avoid any double counting of losses as a result of the balance being provided for specifically and also being included within the wider general provision default rate for that customer type.

Illustration 36:

If an entity's credit control policy requires it to obtain letters of credit or credit insurance, does this mean that no ECL provision is needed?

Response:

Ind AS 109 is clear that 'credit enhancements', the term it uses to refer to collateral posted or the effect of insurance taken out, cannot be used to justify an assumption that there is no probability of default. However, provided that the credit enhancement is integral to the receivable, it can be considered when looking at how big any loss might be on the receivable.

Illustration 37:

Should the historical default rates be adjusted for future or forward looking information?

Response:

Yes. Ind AS 109 specifically requires ECL to be adjusted for forward looking information. One of the important steps in the creation of a provision matrix is to consider whether the historical experience is reflective of the future, and whether provision levels or default rates should be changed based on factors in the wider economic environment. This could be as simple as changes in the unemployment rate, interest rates or economic growth, and how this would be expected to flow through to provisioning factors. Management will need to do an assessment – based on its historical experience, understanding of the industry and its customer base – to determine what factors are likely to have the greatest impact on its levels of uncollected

accounts receivable. For example, if it is expected that the economic conditions will deteriorate over the next year and it will impact the loss rates then an adjustment will have to be made in the historical loss rates to take into account the forward looking information.

Illustration 38:

Should price adjustments/concessions to customers be disclosed as ECL?

Response:

Only those losses that are due to credit risk are within the scope of the Ind AS 109 ECL provision. Pricing adjustments or concessions – where the resulting loss relates to factors such as customer disputes, inefficiencies by the entity or sales incentives in difficult trading conditions, rather than being credit losses related to the debtor's credit risk – are subject to guidance in Ind AS 115, which needs to be applied prior to Ind AS 109. Conversely, losses from credit notes issued to debtors who do not have the ability to pay are included in the measurement of ECL.

Write off of Financial Assets

Ind AS 109 states an entity shall reduce the gross carrying amount of a financial asset when the entity has no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. Such a write-off event is considered as a de-recognition event under Ind AS 109.

Write-offs play a crucial role in the overall determination of expected credit losses (ECL), as they are part of historical data analysis and influence the key parameters used in ECL estimation. Moreover, if write-offs are not conducted in a timely manner, they can adversely affect the non-performing assets ratio. It is therefore recommended that entities establish an appropriate write-off policy, detailing the timing and scenarios in which write-off events may be considered by management. Examples of write-off triggers include:

— Time-based write-offs (e.g., accounts remaining in stage 3 for a specified number of years)

— Status-based write-offs (e.g., determining whether the account is operational or non-operational)

— Recovery action-based write-offs (e.g., NCLT-CIRP, NCLT-liquidation, DRT, SARFESI, etc.)

— Collateral type-based write-offs (e.g., securities, CRE/RRE, etc.) and coverage

Presentation & Disclosures

Presentation of Impairment losses in financial statements:

Profit & Loss Account:

Ind AS 1 (Presentation of financial statements) states that impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of Ind AS 109 shall be presented separately on the face of the statement of profit and loss. Accordingly, where the amounts of ECL are material, compliance of Paragraph 82 of Ind AS 1 should be ensured.

Statement of Financial Position (Balance Sheet):

Unlike profit & loss account, there is no requirement to present the impairment losses on the face of statement of financial position as Ind AS 109 requires the financial assets to be carried at amortised cost (i.e. gross carrying amount net off loss allowances). However, generally, the loss allowance is presented separately in schedules to statement of financial position.

Below is the requirement in line with the Indian Company's Act 2013.

Corporates (Schedule III – Division II to the Company's Act 2013)

[Source ICAI Guidance Note on DIVISION II - IND AS SCHEDULE III TO THE COMPANIES ACT, 2013]

Statement of Financial Position (Balance Sheet):

GN on Division II - Ind AS Schedule III to the Companies Act 2013
Part I - Balance Sheet

Name of the Company.....

Balance Sheet as at .....

(Rupees in.....)

	Particulars	Note No.	Figures as at the end of current reporting period	Figuresas at the end of the previous, reporting period
	1	2	3	4
	ASSETS			
(1)	**Non-current assets**			
	(a) Property, Plant andEquipment			
	{b) Capital work-in- progress			
	(c) Investment Property			
	(d) Goodwill			
	(e) Other Intangible assets			
	Intangible assets under development			
	(g) Biological Assets other than bearer plants			
	(h) Financial Assets			
	(i) Investments			
	(ii) Trade receivables			
	(iii) Loans			
	(i) Deferred tax assets (net)			
	(ii) Other non-current			

	Particulars	Note No.	Figures as at the end of current reporting period	Figuresas at the end of the previous, reporting period
	1	2	3	4
(2)	**Current Assets**			
	(a) Inventories			
	(b) Financial Assets			
	(i) Investments			
	(ii) Trade receivables			
	(iii) Cash and cash equivalents			
	(iv) Bank balances other than(iii) above			
	(v) Loans			
	(vi) Others (to be specified)			
	(c) Current Tax Assets (Net)			
	(d) Other current assets			
	Total Assets			
	EQUITY AND LIABILITIES			
	Equity			
	(a) Equity Share Capital			
	(b) Other Equity			
	Liabilities			
(1)	Non-current liabilities			
	(a) Financial Liabilities			

Notes to Balance Sheet – Trade Receivables:

	Rs.	Rs.
Considered good - Secured	—	
Considered good - Unsecured*	1,25,000	
Trade Receivables which have significant increase in credit risk	20,000	
Trade Receivables - credit impaired	5,000	1,50,000
Less: Loss allowance		(27,000)
		1,23,000

Presentation of loss allowance:

Except in case of purchased or originated credit-impaired trade receivables where a company only recognises cumulative changes in lifetime expected credit losses since initial recognition, the impairment loss allowance does not reduce the carrying amount of the trade receivables. Accordingly, the total expected credit loss allowance is presented as a deduction in a single line item from the total carrying amount of the trade receivables, as shown above.

The above disclosure is consistent with the requirements of Ind AS 109 and modification of the requirements under Ind AS Schedule III may be done in light of para 2 of 'General Instructions for Preparation of Financial Statements of a Company Required to comply with Ind AS' to Ind AS Schedule III.

Non-Banking Financial Company (Schedule III – Division III to the Company's Act 2013)

[Source ICAI Guidance Note on DIVISION III - IND AS SCHEDULE III TO THE COMPANIES ACT, 2013]

Statement of Financial Position (Balance Sheet):

Part I — Balance Sheet

Name of the Non-Banking Financial Company.....

Balance Sheet as at.....

(Rupees in)

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
	1		2	3
	ASSETS			
(1)	**Financial Assets**			
(a)	Cash and Cash equivalents			
(b)	Bank Balance other than (a) above			
(c)	Derivative financial instruments			
(d)	Receivables			
	(I) Trade Receivables			
	(II) Other Receivables			
(e)	Loans			
(f)	Investments			
(g)	Other Financial assets (to be specified)			

Notes to Balance Sheet – Loans & Investments:

(D) Loans

	(Current Year)						(Previoius Year)					
	Amount Issued Cost	At Fair Value			Sub Total	Total	Amount Issued Cost	At Fair Value			Sub Total	Total
		Through Other Compre-hensive Income	Through profit or loss	Desig-nated at fair value through profit or loss				Through Other Compre-hensive Income	Through profit or loss	Desig-nated at fair value through profit or loss		
	(1)	(2)	(3)	(4)	(5=2+3+4)	(6= 1 + 5)	(7)	(8)	(9)	(10)	(11 = 8 + 9 + 10)	(12 = (7) + (11)
Loans												
(A)												
(i) Bills Purchaged and Bills Discounted												
(ii) Loan repayable on Demands												
(iii) Term Loan												
(iv) Leasing												
(v) Others (to be specified)												
Total A Gross												
Less : Impairment loss allow-ance												
Total (A) - Net												
(B)												
(i) Secured by tangible assets												
(ii) Secured by intangible												

(E) Investments:

Investments																	
Invest-ments	(Current Year)								(Previous Year)								
	Amor-tised cost	At Fair Value			Sub Total	Others*	Total	Amor-tised cost	Through Other Compre-hensive Income	Through profit or loss	Desig-nated at fair value through profit or loss	Sub Total	Others*	Total			
		Through Other Compre-hensive Income	Through profit or loss	Desig-nated at fair vlue through profit or loss													
	(1)	(2)	(3)	(4)	(5) = (2) + (3) + (4)	(6)	(7) = (1) + (5) + (6)	(8)	(9)	(10)	(11)	(12) = (9) + (10) + (11)	(13)	(14) = (8) + (12) + 13)			
Mutual funds																	
Govern-ment securities																	
Other																	
approved securities																	
Debt se-curities																	
Equity instru-ments																	
Subsidies																	
Associate																	
Joint Ventures																	
Others (specify)																	
Total																	

Investments														
Investments	(Current Year)							(Previous Year)						
	Amortised cost	At Fair Value				Others*	Total	Amortised cost	At Fair Value				Others*	Total
		Through Other Comprehensive Income	Through profit or loss	Designated at fair vlue through profit or loss	Sub Total				Through Other Comprehensive Income	Through profit or loss	Designated at fair value through profit or loss	Sub Total		
	(1)	(2)	(3)	(4)	(5) = (2) + (3) + (4)	(6)	(7) = (1) + (5) + (6)	(8)	(9)	(10)	(11)	(12) = (9) + (10) + (11)	(13)	(14) = (8) + (12) + 13)
Gross (A)														
(i) Investments outside India														
(ii) Investments in India														
Total (B)														
Total (A) to tally with (D)														
Less: Allowance for Impairment loss (C)														
Total d = (A)-(C)														

*Other basis of measurement such as cost may be explained as a footnote.

Disclosures under Ind AS:

For entities applying Ind AS 109, disclosure requirements for financial instruments are provided under Ind AS 107 which covers disclosures relating to impairment requirements.

Ind AS 107 has two key objectives:

— Firstly, to show the significance of financial instruments and,

— secondly, to require entities to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period

Both qualitative and quantitative disclosures are required regarding the risks that arise from financial instruments and how those risks have been managed. The risks typically include, but are not limited to, credit risk, liquidity risk and market risk. In this guidance book, we will primarily discuss the disclosures in regard to credit risk.

The disclosures provided should depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks, although certain minimum disclosures are required for all entities. The guidance on how the disclosures should be provided has been developed so as to be consistent with the Basel Committee disclosure requirements for banks (generally referred to as 'Pillar 3' of Basel II) to allow banks to prepare a single set of co-ordinated disclosures about financial risk.

The disclosures should either be provided in the financial statements or incorporated by clear cross-reference from the financial statements to some other statement (e.g., a management commentary or risk report). Such a report must be available to users on the same terms as the financial statements and be available at the same time. Without such information, the financial statements are incomplete.

Qualitative Disclosures:

For each type of risk to which an entity is exposed, disclosure is required regarding:

— the exposures to the risk and how those exposures arose;

— the entity's objectives, policies and processes for managing the risk and the methods used to measure it; and

— any changes in the information disclosed under the previous two bullets from the previous period.

Quantitative Disclosures:

For each type of risk arising from financial instruments, Ind AS 107 requires an entity to provide quantitative information about exposure to that risk at the end of the reporting period, based on information reported internally to key management personnel. If more than one method is used to manage and report information about risk exposures, then the method that provides the most relevant and reliable information should be disclosed. The advantages of basing disclosures on management information are that such disclosures:

— provide a useful insight into how risk is viewed and managed by the entity;

— are based on information that has a more predictive value than information based on assumptions and methods that management does not use; and

— adapt to changes in the manner in which risk is measured and managed and allows users to use the same data that management uses to measure and manage risk.

Credit Risk Disclosures

Credit risk is defined as "the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation".

The credit risk disclosures made in accordance with Ind AS 109 to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this objective, credit risk disclosures shall provide:

(a) information about an entity's **credit risk management practices** and how they relate to the recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses;

(b) **quantitative and qualitative information** that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses, including changes in the amount of expected credit losses and the reasons for those changes; and

(c) information about an entity's **credit risk exposure** (ie the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant credit risk concentrations.

To meet the above objectives, an entity shall (except as otherwise specified) consider

— how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements,

— the appropriate level of aggregation or disaggregation, and

— whether users of financial statements need additional explanations to evaluate the quantitative information disclosed.

If the disclosures provided are insufficient to meet the objectives set above, an entity shall disclose additional information that is necessary to meet those objectives.

Credit Risk Management Practices:

An explanation of an entity's credit risk management practices, including how they relate to the recognition and measurement of expected credit losses, is a key component of the credit risk disclosures. Ind AS 107 specifically requires the disclosure of information that enables users of financial statements to understand and evaluate:

(a) how an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including, if and how:

  (i) financial instruments are considered to have low credit risk in accordance with para 5.5.10 of Ind AS 109, including the classes of financial instruments to which it applies; and

  (ii) the presumption in para 5.5.11 of Ind AS 109, that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted (and therefore the instrument still has a 12-month expected loss allowance);

(b) an entity's definitions of default, including the reasons for selecting those definitions;

(c) how the instruments were grouped if expected credit losses were measured on a collective basis;

(d) how an entity determined that financial assets are credit-impaired financial assets;

(e) an entity's write-off policy, including the indicators that there is no reasonable expectation of recovery and information about the policy for financial assets that are written-off but are still subject to enforcement activity; and

(f) how the requirements in para 5.5.12 of Ind AS 109 for the modification of contractual cash flows of financial instruments have been applied, including how an entity:

  (i) determines whether the credit risk on a financial asset that has been modified while the loss allowance was measured at an amount equal to lifetime expected credit losses, has decreased to the extent that the loss allowance reverts to being measured at an amount equal to 12-month expected credit losses in accordance with para 5.5.5 of Ind AS 109; and

  (ii) monitors the extent to which the loss allowance on financial assets meeting the criteria in (i) subsequently remeasured at an amount equal to lifetime expected credit losses in accordance with para 5.5.3 of Ind AS 109

An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of Ind AS 109. For this purpose an entity shall disclose:

(a) the basis of inputs and assumptions and the estimation techniques used to:

  (i) measure the 12-month and lifetime expected credit losses;

  (ii) determine whether the credit risk of financial instruments has increased significantly since initial recognition; and

  (iii) determine whether a financial asset is a credit-impaired financial asset.

(b) how forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information and

(c) changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

Quantitative & Qualitative Information

Ind AS 107.35H: Reconciliation of changes in loss allowance

An entity should explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for:

(a) the loss allowance measured at an amount equal to 12-month expected credit losses;

(b) the loss allowance measured at an amount equal to lifetime expected credit losses for:

  (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;

(ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and

(iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with paragraph 5.5.15 of Ind AS 109.

(c) financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognised during the reporting period.

In addition, it may be necessary to provide a narrative explanation of the changes in the loss allowance during the period. This narrative explanation may include an analysis of the reasons for changes in the loss allowance during the period, including:

— the portfolio composition

— the volume of financial instruments purchased or originated

— the severity of ECLs

For loan commitments and financial guarantee contracts the loss allowance is recognised as a provision. An entity should disclose information about the changes in the loss allowance for financial assets separately from those for loan commitments and financial guarantee contracts. However, if a financial instrument includes both a loan (i.e. financial asset) and an undrawn commitment (i.e. loan commitment) component and the entity cannot separately identify the expected credit losses on the loan commitment component from those on the financial asset component, the expected credit losses on the loan commitment should be recognised together with the loss allowance for the financial asset. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognised as a provision.

Illustration: 39 Changes in loss allowance [IFRS 7: IG20B]

Mortgage loans-loss allowance	**12-month expected credit losses**	**Lifetime expected credit losses (collectively assessed)**	**Lifetime expected credit losses (Individually assessed)**	**Credit Impaired financial assets (Lifetime expected credit losses)**
CU'000				
Loss allowance as at 1 January	X	X	X	X
Changes due to financial instruments recognised as at 1 January:				
— Transfer to lifetime expected credit losses	(X)	X	X	—
— Transfer to credit-impaired financial assets	(X)	—	(X)	X
— Transfer to 12-month expected credit losses	X	(X)	(X)	—

Mortgage loans-loss allowance	12-month expected credit losses	Lifetime expected credit losses (collectively assessed)	Lifetime expected credit losses (Individually assessed)	Credit Impaired financial assets (Lifetime expected credit losses)
— Financial assets that have been derecognised during the period	(X)	(X)	(X)	(X)
New financial assets oririnated or purchased	X	—	—	—
Write-offs	—	—	(X)	(X)
Changes in model/risk parameters	X	X	X	X
Foreign exchange and other movements	X	X	X	X
Loss allowance as at 31 December	**X**	**X**	**X**	**X**

Significant changes in the gross carrying amount of mortgage loans that contributed to changes in the loss allowance were:

- The acquisition of the ABC prime mortgage portfolio increased the residential mortgage book by x per cent, with a corresponding increase in the loss allowance measured on a 12-month basis.
- The write off of the CUXX DEF portfolio following the collapse of the local market reduced the loss allowance for financial assets with objective evidence of impairment by CUX.
- The expected increase in unemployment in Region X caused a net increase in financial assets whose loss allowance is equal to lifetime expected credit losses and caused a net increase of CUX in the lifetime expected credit losses allowance.

Ind AS 107.35I: Reconciliation of changes in gross carrying amount

To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 35H, an entity shall provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance.

The information shall be provided separately for financial instruments that represent the loss allowance and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include:

(a) changes because of financial instruments originated or acquired during the reporting period;

(b) the modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with Ind AS 109;

(c) changes because of financial instruments that were derecognized (including those that were written-off) during the reporting period; and

(d) changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.

Illustration 40: Changes in gross carrying amount [IFRS 7: IG20B]

The significant changes in the gross carrying amount of mortgage loans (in continuation of the above illustration 39) are further explained below:

Mortgage loans-loss allowance	**12-month expected credit losses**	**Lifetime expected credit losses (collectively assessed)**	**Lifetime expected credit losses (Individually assessed)**	**Credit Impaired financial assets (Lifetime expected credit losses)**
CU'000				
Gross carrying amount as at 1 January	X	X	X	X
Individual financial assets transferred to lifetime expected credit losses	(X)	—	X	—
Individual financial assets transferred to credit-impaired financial assets	(X)	—	(X)	X
Financial assets assessed on collective basis	(X)	X	—	—
New financial assets originated or purchased	X	—	—	—
Write-Offs	—	—	(X)	(X)
Financial assets that have been derecognised	(X)	(X)	(X)	(X)
Changes due to modifications that did not result in derecognition	(X)	—	(X)	(X)
Other changes	X	X	X	X
Gross carrying as at 31 December	**X**	**X**	**X**	**X**

Ind AS 107.35J: Modification that does not lead to de-recognition

To enable users of financial statements to understand the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of expected credit losses, an entity shall disclose:

(a) the amortised cost before the modification and the net modification gain or loss recognised for financial assets for which the contractual cash flows have been modified during the reporting period while they had a loss allowance measured at an amount equal to lifetime expected credit losses; and

(b) the gross carrying amount at the end of the reporting period of financial assets that have been modified since initial recognition at a time when the loss allowance was measured at an amount equal to lifetime expected credit losses and for which the loss allowance

has changed during the reporting period to an amount equal to 12-month expected credit losses.

Ind AS 107.35K: Collateral and other credit enhacnements

To enable users of financial statements to understand the effect of collateral and other credit enhancements on the amounts arising from expected credit losses, an entity shall disclose by class of financial instrument:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with Ind AS 32).

(b) a narrative description of collateral held as security and other credit enhancements, including:

  (i) a description of the nature and quality of the collateral held;

  (ii) an explanation of any significant changes in the quality of that collateral or credit enhancements as a result of deterioration or changes in the collateral policies of the entity during the reporting period; and

  (iii) information about financial instruments for which an entity has not recognised a loss allowance because of the collateral.

  Ind AS 107:B8G: A narrative description of collateral and its effect on amounts of expected credit losses might include information about:

  (a) the main types of collateral held as security and other credit enhancements;

  (b) the volume of collateral held and other credit enhancements and its significance in terms of the loss allowance;

  (c) the policies and processes for valuing and managing collateral and other credit enhancements;

  (d) the main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

  (e) information about risk concentrations within the collateral and other credit enhancements.

(c) quantitative information about the collateral held as security and other credit enhancements (for example, quantification of the extent to which collateral and other credit enhancements mitigate credit risk) for financial assets that are credit-impaired at the reporting date.

It is important to note that an entity is neither required to disclose information about the fair value of collateral and other credit enhancements nor is it required to quantify the exact value of the collateral that was included in the calculation of expected credit losses (ie the loss given default).

Ind AS 107.35K: Write off

An entity shall disclose the contractual amount outstanding on financial assets that were written off during the reporting period and are still subject to enforcement activity.

Credit Risk Exposure

Ind AS 107.35 M: Disclosure by credit rating grades

To enable users of financial statements to assess an entity's credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts.

This information shall be provided separately for financial instruments:

(a) for which the loss allowance is measured at an amount equal to 12-month expected credit losses;

(b) for which the loss allowance is measured at an amount equal to lifetime expected credit losses and that are:
   (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;
   (ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and
   (iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured

(c) that are purchased or originated credit-impaired financial assets

Illustration 41: IFRS 7:IG20C

The following example illustrates some ways of providing information about an entity's credit risk exposure and significant credit risk concentrations in accordance with paragraph 35M of IFRS 7. The number of grades used to disclose the information in accordance with paragraph 35M of IFRS 7 shall be consistent with the number that the entity uses to report internally to key management personnel for internal credit risk management purposes. However, if information about credit risk rating grades is not available without undue cost or effort and an entity uses past due information to assess whether credit risk has increased significantly since initial recognition in accordance with paragraph 5.5.11 of IFRS 9, the entity shall provide an analysis by past due status for those financial assets.

Consumer loan credit risk exposure by Internal rating grades				
20XX	**Consumer-Credit card Gross carrying amount**		**Consumer-automotive Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
Internal Grade 1-2	X	X	X	X
Internal Grade 3-4	X	X	X	X
Consumer loan credit risk exposure by Internal rating grades				
Internal Grade 5-6	X	X	X	X
Internal Grade 7	**X**	**X**	**X**	**X**
Total	**X**	**X**	**X**	**X**

Corporate loan credit risk profile by external rating grades				
20XX CU'000	**Corporate-equipment Gross carrying amount**		**Corporate-construction Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
AAA-AA	X	X	X	X
A	X	X	X	X
BBB-BB	X	X	X	X
B	X	X	X	X
CCC-CC	X	X	X	X
C	X	X	X	X
D	X	X	X	X
Total	**X**	**X**	**X**	**X**

Corporate loan risk profile by probability of default				
20XX CU'000	**Corporate-unsecured Gross carrying amount**		**Corporate - secured Gross carrying amount**	
	Lifetime	**12-month**	**Lifetime**	**12-month**
0.00 - 0.10	X	X	X	X
0.11 - 0.40	X	X	X	X
0.41 - 1.00	X	X	X	X
1.01 - 3.00	X	X	X	X
3.01 - 6.00	X	X	X	X
6.01 - 11.00	X	X	X	X
11.01 - 17.00	X	X	X	X
17.01 - 25.00	X	X	X	X
25.01 - 50.00	X	X	X	X
50.01+	X	X	X	X
Total	X	X	X	X

Ind AS 107.35 N: Trade Receivables and Lease Receivables

For trade receivables, contract assets and lease receivables to which an entity applies paragraph 5.5.15 of Ind AS 109, the information provided in accordance with paragraph 35M may be based on a provision matrix (as per paragraph B5.5.35 of Ind AS 109).

Illustration 42: IFRS 7:IG20D

Entity A manufactures cars and provides financing to both dealers and end customers. Entity A discloses its dealer financing and customer financing as separate classes of financial instruments and applies the simplified approach to its trade receivables so that the loss allowance is always measured at an amount equal to lifetime expected credit losses. The following table illustrates the use of a provision matrix as a risk profile disclosure under the simplified approach:

Expected Credit Loss for Both Financials and Non-Financial Sectors

20xx	Trade receivables days past due				
INR'000	Current	More than 30 days	More than 60 days	More than 90 days	Total
Dealer Financing					
Expected credit loss rate	0.10%	2%	5%	13%	
Estimated total gross carrying amount at default	20,777	1,416	673	235	23,101
Lifetime expected credit losses - Dealer Financing	21	28	34	31	114
Customer Financing					
Expected credit loss rate	0.20%	3%	8%	15%	
Estimated total gross carrying amount at default	19,222	2,010	301	154	21,687
Lifetime expected credit losses - Customer Financing	38	60	24	23	145

Ind AS 107.36: Financial Instruments within the scope of Ind AS 109 but to which impairment requirements does not apply

For all financial instruments within the scope of this Ind AS, but to which the impairment requirements in Ind AS 109 are not applied, an entity shall disclose by class of financial instrument:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not quality for offset in accordance with Ind AS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

(b) a description of collateral held as security and other credit enhancements, and their financial effect (eg quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).

Above paragraph (b) requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. An entity might meet this requirement by disclosing:

(a) the policies and processes for valuing and managing collateral and other credit enhancements obtained;

(b) a description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with Ind AS 32);

(c) the main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

(d) information about risk concentrations within the collateral or other credit enhancements.

Illustration 43: Sample Disclosure for illustrative purpose only:

(Source: Bajaj Finance Limited Annual Report 2022-23)

Significant Accounting Policies:

Impairment of financial assets

(i) General approach

Expected credit losses ('ECL') are recognised for applicable financial assets held underamortised cost, debt instruments measured at FVOCI, and certain loan commitments as per the Board approved policy.

Financial assets where no significant increase in credit risk has been observed are considered to be in 'stage 1' for which a 12 month ECL is recognised. Financial assets that are considered to have significant increase in credit risk are considered to be in 'stage 2' and those which are in default or for which there is an objective evidence of impairment are considered to be in 'stage 3'. Life time ECL is recognised for stage 2 and stage 3 financial assets.

At initial recognition, allowance for provision in the case of loan commitments is required for ECL towards default events that are possible in the next 12 motnhs.

In the event of a significant increase in credit risk, allowance (or provision) is required for ECL towards all possible default events over the expected life of the financial assets ('lifetime ECL').

Financial assets are written off infull, when there is no realistic prospect of recovery. The Company may apply enforcement activities to certain qualifying fincnail assets written off.

Treatment of the different stages of financial assets andthe methodology of determination of ECl

(a) Credit impaired (stage 3)

The Company recognises a financial asset to be credit impaired andin stage 3 by considering relevant objective evidence. primarily whether:

- Contractual payments of principal and/or interest are past due for more than 90 days;
- The loan is otherwise considered to be in default.

Loan accounts where principal and/or interest are past due for more than 90 days along with all other loans of such customer. continue to be classified as stage 3. till overdue across all loan acc0unts are cleared.

Restructured loans where repayment terms are renegotiated as compared to the original contracted terms due to significant credit distress of the borrower are classified as credit impaired. Such loans are upgraded to stage 1if-

- The loan which was restructured is not in default for a period till repayment of 10% of principal outstanding or 12 months. whichever is tater: and
- Other loans of such customer are not in defauft during this period; and
- There are no other indications of impairment.

(b) Significant increase in credit risk (stage 2)

An assessment of whether credit riskhas increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default of the loan exposure. However. unless identified at an earlier stage. any overdue of more than1day past due and up to 90 days past due as on the reporting date is considered as an indication of financial assets to have suffered a significant increase in credit risk. Additionally. for mortgage loans. the Company recognised stage 2 based on other indicators such as frequent delay in payments beyond due dates.

One time restructuring (OTR) of loan accounts was permitted by R81 vide circulars dated 6 August 2020 'resolution framework for COVID-19 related stress' and 'Micro. Small and Medium Enterprises (MSME) sector - Restructuring of Advances' and circulars dated 5 May 2021 'Resolution Framework - 2.0: Resolution of COVI0-19 related stress of Individuals and Small Businesses' and 'Resolution Framework. 2.0 - Resolution of COVID-19 related stress of Micro, Small and Medium Enterprises (MSMEs)'. The Company considers OTR as an indicator of significant increase in credit risk and accordingly classifies such Joans as stage 2. The Company reclassifies such loans to stage 1 on demor,stration of regular payrr.ent of 12 instalments of principal and/or interest as per revised termssubject to no overdues as on the reporting date and no other Indicators suggesting significant increase in credit risk.

The measurement of risk.of defaults under stage 2 is compufod on homogenous portfolios. generally by nature of loans. tenors, underlying collateral, geographies and borrower profiles. The default risk Is assessed using PD (probability o'f default) derived from past behavioural trends of default across the identiiied homogenous portfolios. These past trends factor in the past customer behavioural trends. credit transition probabilities and macroeconomic conditions. The assessed PDs are then aligned considering future economic conditions that are determined to have a bearing on ECL.

(c) Without significant increase in credit risk since initial recognition (stage 1)

ECL resulting from default events that are possible in the next 12 months are recognised for financial assets in stage 1. The Company has ascertained default possibilities on past behavioural trends witnessed for each homogenous portfolio using behavioural and other performance indicators, determined statistically.

(d) Measurement of FC

The assessment of credit risk and estimation of ECL are unb,ased and probability weighted. It incorporates all information that is relevant Including past events, current conditions and current profile of customers. Additionally, forecasts of future macro situations and economic conditions are considered as part of forward eccncmic guidance (FEG) model.

Forward lookJng economic scenarios determined withreference to external forecasts of economic para eters that have demonstrated a linkage to the performance of our portfolios over a period of time have been applied to determine impact of

macro-economic factors. In addition, the estimation of ECL takes into account the time value of money.

The Company has calculated ECL using three main components: a probability of default (PD). a loss given default (LGD) and the exposure at default (EAD). ECL is calculated by multiplying the PO. LGD and EAD and adjusted for time value of money using a rate whtch is a reasonable approximation of EIR.

- Determination of PD is covered above for each stages of ECL.
- EAD represents th expected balance at default. taking into account the repayment of principal and interest from the Balance Sheet date to the date of default together with any expected drawdowns of committed facilities.
- LGDrepresents expected losses on the EAD in the event of default. taking into account. among other attributes. the mitigating effect of collateral value at the time it ls expected to be realised and the time value of money.

The Company recalibrates above components of its ECL model on a periodical basis by using the available incremental and recent information. except where this informations does not represent the future outcome. Further. the Company assesses changes to its statistical techniques for a granular estimation of ECL.

A more detailed dP.scription of the methodology used for ECL is covered in the 'cred;t risk' section of note no. 47.

(II) Simplified Approach

The Company follows 'simplified approach·for recognition of impairment loss allowance on trade receivables falling under the scope of Ind AS115. The application of simplified approach does not require the Company to track changes in credit risk. Rather. it recognises impairment loss allowance based on lifetime ECLs at each reporting date. right from its initial recognition. The Company uses a provision matrix to determine impairment !oss allowance on portfolio of its trade receivables falling under the scope of Ind AS 115. The provision matrix is based on its historically observed default rates over the expected life of the trade receivables and other financial assets and is adjusted for forward-looking estimates. At every reporting date, the historically observed default rates are updated for changes in the forward looking estimates.

Quantitative Disclosures:

Summary of loans by stage distribution

Term loans

Particulars	As at 31st March 2023				As at 31st March 2022			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount	178,089.48	2,672.99	2.175.49	182,937.96	141.969.01	3,256.94	2,987.14	148.213.09
Less: Impairment loss allowance	1.597.05	854.92	1.388.87	3,840.84	1,246.44	951.24	1.739.16	3,936.84
Net carrying amount	176492.43	1.818.07	786.62	179,097.12	140,722.57	2.305.70	1.247.98	144.276.25

Expected Credit Loss for Both Financials and Non-Financial Sectors

Analysis of changes in the gross carrying amount and corresponding ECL allowances inrelation to loans

Particulars	For the year ended 31 March 2023							
	Stage 1		Stage 2		Stage 3		Total	
	Term loans (Gross	Imparment loss allownace	Term loans (Gross	Imparment loss allownace	Term loans (Gross	Imparment loss allownace	Term loans (Gross	Imparment loss allownace
As at 31 March 2022	1,41,969.01	1.246.44	3,256.94	951.24	2.987.14	1,739.16	148.213.09	3,936.84
Transfers during the year								
transfers to stage1	544.38	109.38	(409.93)	(59.97)	(134.45)	(49.41)	—	—
transfers to stage 2	(1,772.24)	(31.12)	1,821.53	50.35	(49.29)	(19.23)	—	—
transfers to stage3	(2.706.55)	(43.82)	(1.401.97)	(401.09)	4,108.52	444.91	—	—
	(3,934.41)	34.44	9.63	(410.71)	3.924.78	376.27	—	—
Impact of changes in credit risk on account of stage movements	—	(99.27)	—	518.48	—	3,736.11	—	4,155.32
Changes in opening credit exposures (repayments net of additional disbursements)	(69,036.62)	(129.54)	(1,173.38)	(408.15)	(2.044.01)	(1,600.83)	(72,254.01)	(2.138.52)
New credit exposures during the year net of repayments	109,091.50	544.98	579.80	204.06	634.17	464.75	110,305.47	1.213.79
Amounts written off during the year	—	—	—	—	(3,326.59)	(3,326.59)	(3,326.59)	(3,326.59)
As at 31 March 2023	178,089.48	1,597.05	2,672.99	854.92	2,175.49	1.388.87	182.937.96	3,840.84

Details of impairment of financial instruments disclosed in the Statement of Profit and Loss

(₹ in crore)

For the year ended 31 March

Particulars	2023	2022
(i) Net impairment loss allowance charge/(release) for the year	(96.00)	(15.31)
(ii) Amounts written off during the year	3,326.59	4.738.08
Impairment on loans	3,230.59	4,722.77
Less : Claimable amount under CGTMSE. ECLGS and other arrangements	200.74	101.55
Add: Impairment on other assets	36.61	0.84
Impairment on financial instruments	3,066.46	4,622.06

Credit Risk Disclosures:

Nature of risk	Arising from	Executive governance structure	Measurement, monitoring and management of risk
Credit risk	Credit risk is the risk of financial loss arising out of customers or counterparties failing to meet their repayment obligations to the Company.	Board constituted RMC and Chief Risk Officer (CRO)	Credit risk is: • measured as the amount at risk due to repayment default by customers or counterparties to the Company. Various metrics such as instalment default rate, overdue position, restructuring, resolution plans, debt management efficiency, credit bureau information, contribution of stage 2 and stage 3 assets etc. are used as leading indicators to assess credit risk. • monitored by RMC and CRO through review of level of credit exposure, portfolio monitoring, contribution of repeat customers, bureau data, concentration risk of geography, customer and portfolio; and assessment of any major change in the business environment including economic, political as well as natural calamity/ pandemic. • managed by a robust control framework by the risk and debt management unit. This is achieved by continuously aligning credit and debt management policies and resourcing, obtaining external data from credit bureaus and review of portfolios and delinquencies by senior and middle management team comprising of risk, analytics, debt management and risk containment along with business. The same is periodically reviewed by the Board constituted RMC.

(c) Credit risk

Credit risk is the risk of financial loss arising out of customers or counterparties failing to meet their repayment obligations to the Company. The Company has a diversified lending model and focuses on seven broad categories viz: (i) urban lending, (ii) two and three wheeler lending, (iii) SME lending, (iv) rural lending, (v) mortgages, (vi) loan against securities, and (vii) commercial lending. The Company assesses the credit quality of all financial instruments that are subject to credit risk.

Classification of financial assets under various stages

The Company classifies its financial assets in three stages having the following characteristics:

- Stage 1: unimpaired and without significant increase in credit risk since initial recognition on which a 12-month allowance for ECL is recognised;
- Stage 2: a significant increase in credit risk since initial recognition on which a lifetime ECL is recognised; and
- Stage 3: objective evidence of impairment and therefore considered to be in default or otherwise credit impaired on which a lifetime ECL is recognised.

Treatment and classification methodology of different stages of financial assets is detailed in note no. 3.4(i)

Computation of impairment on financial instruments

The Company calculates impairment on financial instruments as per ECL approach prescribed under Ind AS 109 'Financial instrument'. ECL uses three main components: PD (Probability of Default), LGD (loss given default) and EAD (exposure at default) along with an adjustment considering forward macro economic conditions. For further details of computation of ECL please refer to significant accounting policies note no 3.4 (i).

The Company recalibrates components of its ECL model periodically by: (1) using the available incremental and recent information, except where such information do not represent the future outcome, and (2) assessing changes to its statistical techniques for a granular estimation of ECL. Accordingly, during the year, the Company has redeveloped its ECL model and implemented the same with the approval of Audit Committee and the Board.

The Company follows simplified ECL approach under Ind AS 109 'Financial instruments' for trade receivables, pass through certificates ('PTC') and other financial assets.

The table below summarises the approach adopted by the Company for various components of ECL viz. PD, EAD and LGD across major product lines using empirical data where relevant:

<table>
<tr><th rowspan="2">Lending verticals</th><th rowspan="2">Nature of businesses</th><th colspan="3">PD</th><th>EAD</th><th>LGD</th></tr>
<tr><th>Stage 1</th><th>Stage 2</th><th>Stage 3</th><th></th><th></th></tr>
<tr><td>Urban Sales finance</td><td>Financing for products such as consumer electronics, furniture, digital products, e-commerce purchases and retail spends</td><td rowspan="6">Use of statistical automatic interaction detector tools to identify PDs across a homogenous set of customers and empirical default rates.</td><td rowspan="7">Empirical performance across different OPD (Days Past Due) ranges</td><td rowspan="3">100%</td><td rowspan="7">Ascertained based on past trends of proportion of outstanding at time of default to the opening outstanding of the analysis period. except Stage 3 where EAAis 100%.</td><td rowspan="8">LGD is ascertained using past trends of recoveries for each set of portfolios and discounted using a reasonable approximation of the original effective rates of interest.</td></tr>
<tr><td>Two and three wheeler finance</td><td>Two and three wheeler financing</td></tr>
<tr><td>Urban B2C</td><td>Personal loans to salaried and self employed individuals</td></tr>
<tr><td>SME lending</td><td>Unsecured and secured loans to SME's. self employed customers and professionals</td><td rowspan="3">100%</td></tr>
<tr><td>Rural Sales finance</td><td>Financing for products such as consumer electronics. furniture. digital products. e-commerce purchases and retail spends</td></tr>
<tr><td>Rural B2C</td><td>Personal loans to salaried. self employed customers. professionals and gold loans</td></tr>
<tr><td>Mortgages</td><td>Home loans. loans against property. developer finance and lease rental discounting</td><td colspan="2">Use of statistical automatic interaction detector tools to identify PDs across a homogenous set of customers. and also basis DPD bucket approach for retail loans and management evaluation/ judgement for wholesale loans.</td><td>100%</td></tr>
<tr><td>Loan against securities</td><td>Loans against shares. mutual funds. deposits and insurance policies</td><td colspan="2">Determined basis empirical risk performance</td><td>100%</td><td>Determined basis empirical risk performance</td><td>Based on associated risk of the underlying securities</td></tr>
</table>

Expected Credit Loss for Both Financials and Non-Financial Sectors

Lending verticals	Nature of businesses	PD			EAD	LGD
		Stage 1	Stage 2	Stage 3		
Commercial lending	Lending to auto component manufacturers. light engineering industry. financial institutions. specialty chemical. pharma. packaging and other mid-market companies.	Internal evaluation/ judgement applied at customer or industry segment.		100%	100%	Based on estimates of cash flows

The table below summarises the gross carrying values and the associated allowances for expected credit loss (ECL) stage wise for loan portfolio:

As at 31 March 2023

(₹ in crore)

Particulars	Secured			Unsecured		
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
Gross carrying value	78,849.04	1,280.08	1,108.53	99,240.44	1,392.91	1,066.96
Allowance for ECL	348.84	282.41	586.57	1,248.21	572.51	802.30
ECL coverage ratio	0.44%	22.06%	52.91%	1.26%	41.10%	75.19%

As at 31 March 2022

(₹ in crore)

Particulars	Secured			Unsecured		
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
Gross carrying value	59,809.13	1,842.83	1,696.05	82,159.88	1,414.11	1,291.09
Allowance for ECL	345.52	458.51	862.69	900.92	492.73	876.47
ECL coverage ratio	0.58%	24.88%	50.86%	1.10%	34.84%	67.89%

Collateral Valuation

The Company offers loans to customers across various lending verticals as articulated above. These loans includes both unsecured loans and loans secured by collateral. Although collateral is an important risk mitigant of credit risk, the Company's practice is to lend on the basis of assessment of the customer's ability to repay than placing primary reliance on collateral. Based on the nature of product and the Company's assessment of the customer's credit risk, a loan may be offered with suitable collateral. Depending on its form, collateral can have a significant effect in mitigating the Company's credit risk.

The main types of collateral across various products obtained are as follows:

Product group	Nature of securities
Urban sales finance	Hypothecation of underlying product financed e.g. consumer durable, furniture, digital products etc.
Two and three wheeler finance	Hypothecation of underlying two and three wheeler
Rural sales finance	Hypothecation of underlying product financed e.g. consumer durable, furniture and digital products etc.
Rural B2C Gold loans	Pledge of gold jewellery.
SME lending (Secured)	Hypothecation of underlying product e.g. used car and medical equipment etc.
Mortgages	Equitable mortgage of residential and commercial properties.
Loan against securities	Pledge of equity shares and mutual funds and lien on deposits and insurance policies.
Commercial lending	Plant and machinery, book debts etc.

The Company periodically monitors the market value of collateral and evaluates its exposure and loan to value metrics for high risk customers. The Company exercises its right of repossession across all secured products and primarily in its two wheeler and three wheeler financing business. It also resorts to invoking its right under the SARFAESI Act and other judicial remedies available against its mortgages and commercial lending business. The repossessed assets are either sold through auction or released to delinquent customers in case they come forward to settle their dues. For its loan against securities business, the Company recoups shortfall in value of securities through part recall of loans or additional securities from the customer, or sale of underlying securities. The Company does not record repossessed assets on its Balance Sheet as non-current assets held for sale.

Guarantee cover taken on loans

To secure its eligible pool, the Company takes guarantee cover for its portfolios across B2C, MSME and three-wheeler financing business under Credit Guarantee Fund Scheme for NBFCs (CGS-II) from Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) governed by the SIDBI. As on 31 March 2023, the Company has covered ₹ 3,711 crore of its loan assets under this scheme. This has helped the Company to offset * 171 crore worth of credit losses during the current year with further claims maturing over FY2024 and FY2025.

Further, the Company has also granted loans under RBI's Emergency Credit Line Guarantee Scheme (ECLGS) to its qualifying customers, as of 31 March 2023 447 crore of loans are outstanding under ECLGS.

Analysis of concentration risk

The Company focuses on granulisation of loans portfolios by expanding its geographic reach to reduce geographic concentrations while continually calibrating its product mix across its seven categories of lending mentioned above.

ECL sensitivity analysis to forward economic conditions and management overlay

Expected Credit Loss for Both Financials and Non-Financial Sectors

Allowance for impairment on financial instruments recognised in the financial statements reflect the effect of a range of possible economic outcomes, calculated on a probability-weighted basis, based on the economic scenarios described below. The recognition and measurement of expected credit losses ('ECL') involves the use of estimation. It is necessary to formulate multiple forward-looking economic forecasts and its impact as an integral part of ECL model.

The ECL model and its input variables are recalibrated periodically using available incremental and recent information. It is possible that internal estimates of PD and LGD rates used in the ECL model may not always capture all the characteristics of the market and the external environment as at the reporting date. To reflect this, qualitative adjustments or overlays are made as temporary adjustments to reflect the emerging risks reasonably.

Methodology

The Company has adopted the use of three scenarios, representative of its view of forecast economic conditions, required to calculate unbiased estimation of forward looking economic adjustment to its ECL. They represent a most likely outcome i.e. central scenario and two less likely outer scenarios referred to as the Upside and Downside scenarios. The Company has assigned a 10% probability to the two outer scenarios, while the Central scenario has been assigned an 80% probability. These weights are deemed appropriate for the unbiased estimation of impact of macro factors on ECL. The key scenario assumptions are used keeping in mind external forecasts and management estimates which ensure that the scenarios are unbiased.

The Company uses multiple economic factors and test their correlations with past loss trends witnessed for building its forward economic guidance (FEG) model. During the current year, the Company evaluated various macro factors GDP growth rates, growth of bank credit, wholesale price index (WPI), consumer price index (CPI), industrial production index, unemployment rate, crude oil prices and policy interest rates.

Based on past correlation trends, CPI (inflation) and unemployment rate reflected acceptable correlation with past loss trends and were considered appropriate by the Management. Unemployment has a direct relation with the income levels and thus the growth of the economy from the expenditure side. Inflation and inflationary expectations affect the disposable income of people. Accordingly, both these macro- variables directly and indirectly impact the economy. These factors were assigned appropriate weights to measure ECL in forecast economic conditions.

For Unemployment, the Company has considered data published by a leading business information (BI) company engaged in monitoring of Indian economic indicators.

In FY2023, Unemployment rate over the quarters has been oscillating around 7.5% versus pre COVID levels of around 7%, indicating normalisation towards its central scenario.

- While formulating the Central Scenario, the Company has considered that the current unemployment rate of 7.69% may move towards an average of 7.4% over the next few years
- For the downside scenario, the Company believes that the downside risks might have passed, however, the downside peak unemployment rate might reach 8.78%. However, as per mean reversion approach, the downside scenario assumes it to fall from the peak and normalise to around 7.4% within next three years.

- For the upside scenario, the Company acknowledges various surveys and studies indicating improving employment situation as also industrial recovery. Therefore, while forecasting, a positive stance has been adopted with the expectation that the unemployment levels may not drop significantly. The unemployment rate may improve to a best case of 3.4% by the end of June 2024 but may come back to an historical (excluding COVID period) 4-year average of 7.4%.

Consumer Price Index (CPI or inflation) crossed the RBI comfort level of 6% and remained above 6% for first seven months of FY2023. Later again in Jan'23 and Feb'23, it crossed 6%. The inflation as at Mar'23 has moderated to 5.7%, which is within the RBI comfort level. MPC is taking appropriate measures to control inflation through monetary tightening and has projected inflation to reach a level of 5.3% in FY2024.

- The Central Scenario assumed by the Company considers a persistent inflation around 6.2% in Q4 FY2023. We have, however, seen higher levels of inflation in the first half of FY2023 and the Company expects inflation to come down in FY2024, which is in line with the Central bank's projection. However, keeping a conservative approach, company expects inflation to range between 6.3% to 6.2% during FY2024, suggesting inflation to decline moderately compared to previous year.
- For the downside scenario, the Company considers that the inflation risk may continue due to various uncertainties (SVB crisis, geopolitical conflict, elections the Company), and therefore assumes the inflation to touch a peak of around 9.66% in Q2 FY2024, and subsequently normalise to around 5.94% within next three years.
- For the upside scenario, we believe that there would be certain factors which might come into play viz, base effect, higher food grain production, continuously falling WPI, better supply chain management the Company, and, therefore, inflation may see easing to a level of around 2.2% before averaging back to the average of 5.94%.

Additionally, the ECL model and its input variables are recalibrated periodically using available incremental and recent information. It is possible that internal estimates of PD and LGD rates used in the ECL model may not always capture all the characteristics of the market/external environment as at the date of the financial statements. To reflect this, qualitative adjustments or overlays are made as temporary adjustments to reflect the emerging risks reasonably.

ECL sensitivity to future economic conditions

ECL coverage of financial instruments under forecast economic conditions

(* in crore)

	As at 31 March	
Particulars	**2023**	**2022**
Gross carrying amount of loans	182,937.96	148,213.09
Reported ECL on loans	3,840.84	3,936.84
Reported ECL coverage	2.10%	2.66%
Base ECL without macro overlay	3,117.84	3,087.84
Add: Management overlay	592.00	676.00
ECL before adjustment for macro economic factors	3,709.84	3,763.84
ECL amounts for alternate scenario		
Central scenario (80%)	3,833.79	3,916.05

Expected Credit Loss for Both Financials and Non-Financial Sectors

Particulars	2023	2022
Downside scenario (10%)	4,723.67	4,506.05
Upside scenario (10%)	3,014.43	3,533.94
Reported ECL	3,840.84	3,936.84
Management and Macro economic overlay	723.00	849.00
-Management overlay	592.00	676.00
-Overlay for macro economic factors	131.00	173.00
ECL Coverage ratios by scenario		
Central scenario (80%)	2.10%	2.64%
Downside scenario (10%)	2.58%	3.04%
Upside scenario (10%)	1.65%	2.38%

Disclosure as per RBI Circular:

For the year ended 31 March 2023

(in crore)

Asset classification as per RBI norms (1)	Asset classification as per Ind AS 109 (2)	Gross carrying amount as per Ind AS(3)	Loss allowance (provisions) as required under Ind AS 109(4)	Net carrying amount (5)=(3) - (4)	Provision required as per IRACP norms* (6)	Difference between Ind AS 109 provision and IRACP norms (7)=(4)-(6) (a)
(a) Performing assets Standard						
Standard	Stage 1	178,089.48	1,597.05	176,492.43	752.10	844.95
	Stage 2	2,672.99	854.92	1,818.07	28.75	826.17
Subtotal (a)		180,762.47	2,451.97	178,310.50	780.85	1,671.12
(b) Non-performing assets (NPA)						
(i) Substandard	Stage 3	2,072.11	1,325.00	747.11	207.34	1,117.66
(ii) Doubtful up to:						
1 year	Stage 3	72.50	49.15	23.35	21.91	27.24
1 to 3 years	Stage 3	30.87	14.72	16.15	9.27	5.45
More than 3 years	Stage 3	0.01	—	0.01	—	0.00
		103.38	63.87	39.51	31.18	32.69
(iii) Loss	Stage 3		-	-	-	-
Subtotal (b)		2,175.49	1,388.87	786.62	238.52	1,150.35
(C) Other Items						
	Stage 1	146.98	-	146.98	0.59	(0.59
	Stage 2	-	-	-	-	-
	Stage 3	-	-	-	-	-
Subtotal (c)		146.98	-	146.98	0.59	(0.59)
Stage 1	Stage 1	178,236.46	1,597.05	176,639.41	752.69	844.36
	Stage 2	2,672.99	854.92	1,818.07	28.75	826.17
	Stage 3	2,175.49	1,388.87	786.62	238.52	1,019.96
Total (a+b+c)		183,084.94	3,840.84	179,244.10	1,150.35	2,820.88

RBI Guidance on Implementation of Ind AS for NBFCs and ARCs [March 2020]

In order to promote a high quality and consistent implementation as well as facilitate comparison and better supervision, the Reserve Bank of India issued regulatory guidance on Ind AS which is applicable to NBFCs and Asset Reconstruction Companies (ARCs) for preparation of their financial statements under Ind AS.

Governance Framework:

Sr. No.	Policies	Approving Authority
1	Business Model Policy: — For determination classification & restrictions on subsequent reclassification of financial assets — Should clearly articulate and document their business models incl. objectives for managing each portfolio	Board
2	Expected Credit Loss: — Document sound methodologies2 for computation of Expected Credit Losses(ECL) that address policies, procedures and controls for assessing and measuring credit risk on all lending exposures, commensurate with the size, complexity and risk profile specific to the company — The parameters and assumptions considered as well as their sensitivity to the ECL output — Rationale and justification for any change in ECL model	Board
3	Management Overlay: — Any adjustments to the model output i.e. management overlay should be clearly document with rationale	Audit Committee of the Board

Further, guidance is provided on the rebuttable presumption provided by Ind AS 109:

Definition of default: Ind AS 109 does not explicitly define default, but requires entities to define default in a manner consistent with that used for internal credit risk management. It is recommended that the definition of default adopted for accounting purposes is guided by the definition used for regulatory purposes. The ACB should approve the classification of accounts that are past due beyond 90 days but not treated as impaired, with the rationale for the same clearly documented. Further, the number of such accounts and the total amount outstanding and the overdue amounts should be disclosed in the notes to the financial statements.

Significant increase in credit risk: Regardless of the way in which NBFC/ARC assesses significant increase in credit risk, there is a rebuttable presumption under Ind AS 109 that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. Ind AS 109 also permits that an NBFC/ARC can rebut this presumption if it has reasonable and supportable information that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due. NBFCs/ARCs should educate

their customers on the need to make payments in a timely manner. However, in limited circumstances, where NBFCs/ARCs do rebut the presumption, it should be done only with clear documentation of the justification for doing so. All such cases shall be placed before the ACB. NBFCs/ARCs shall not defer the recognition of significant increase in credit risk for any exposure that is overdue beyond 60 days.

Use of Prudential Floor:

NBFCs / ARCs are required to compute and hold provisions as per Ind AS 109. In parallel, NBFCs/ARCs shall also maintain the asset classification and compute provisions as per extant prudential norms on Income Recognition, Asset Classification and Provisioning (IRACP) including borrower/beneficiary wise classification, provisioning for standard as well as restructured assets, NPA ageing, etc.

Comparison Ind AS vs Prudential norms:

NBFCs / ARCs are required to compare:

— Impairment allowance as per ECL framework under Ind AS 109

— Provisions as per IRACP norms

and where impairment allowance under Ind AS 109 is lower than the provisioning required under IRACP (including standard asset provisioning), NBFCs/ARCs shall appropriate the difference from their net profit or loss after tax to a separate 'Impairment Reserve'.

The balance in the 'Impairment Reserve' shall not be reckoned for regulatory capital. Further, no withdrawals shall be permitted from this reserve without prior permission from the Department of Supervision, RBI.

Illustration 44: ECL Framework / Methodology Document

What should be the contents of the ECL framework / methodology document which should by approved by the management?

Response: Typically, the ECL framework / methodology document prepared by the entities for management approval includes the following:

Sr. No.	Contents
1	Background and applicable regulations
2	Applicability & Scope of ECL requirements
3	Portfolio Segmentation
4	Level of Computation
5	Overall ECL approach
6	Staging Criteria (incl. significant increase in credit risk and definition of default)
7	Determination of ECL parameters (EAD, PD, LGD)
8	Impairment reserve in line with RBI requirements if applicable
9	Write off
10	Governance

The above list is illustrative and not exhaustive. Entities should tailor the document based on their specific scenarios and requirements.

Disclosure Requirements:

A comparison (as per the template in Appendix) between provisions required under IRACP and impairment allowances made under Ind AS 109 should be disclosed by NBFCs/ARCs in the notes to their financial statements to provide a benchmark to their Boards, RBI supervisors and other stakeholders, on the adequacy of provisioning for credit losses.

Template for Disclosure in Notes to Financial Statements

Asset Classification asper RBINonns	Asset classifica lion as per Ind AS 109	Gross Carrying Amount as per Ind AS	Loss Allowances (Provisions) as required under IndAS 109	Net Carrying Amount	Provisions required as per IRACP norms	Difference between Ind AS109 provisions and IRACP norms
(1)	(2)	(3)	(4)	(5)=(3)-(4)	(6)	(7) =(4)-(6)
Performing **Assets**						
Standard	Stage1					
Subtotal	Stage 2					
Non-PerformingAssets (NPA)						
Substandard	Stage 3					
Doubtful • up to1 year	Stage 3					
1 to 3years	Stage 3					
More than3 years	Stage 3					
Subtotal fordoubtful						
Loss	Stage 3					
Subtotal for NPA						
Other items such as guarantees, loancommitments,etc. whichare inthescope ofInd AS109but not covered under current Income Recognition, Asset Classification andProvisioning (IRACP) norms	Stage1					
	Stage 2					
	Stage 3					
Subtotal						
Total	**Stage1**					
	Stage 2					
	Stage 3					
	Total					

Data Sources, Governance and Controls

The implementation of Ind AS 109 introduces a forward-looking approach to estimating expected credit losses for financial assets. This approach necessitates a robust framework of data and controls to ensure accurate and reliable ECL estimates. The quality and integrity of data, alongside the strength of internal controls, play a crucial role in meeting the standard's requirements.

a) Quality of Data:

- o Comprehensive Data Collection: Accurate ECL estimates rely on comprehensive and relevant historical data, including past credit losses, repayment behaviors, and macroeconomic indicators. Collecting high-quality data helps in identifying patterns and trends critical for predicting future credit losses.
- o Forward-Looking Information: Ind AS 109 requires the incorporation of forward-looking information. This includes economic forecasts, market trends, and industry-specific data, which are essential for developing realistic and responsive ECL models.
- o Granularity and Segmentation: Detailed data at a granular level allows for better segmentation of financial assets. This enables entities to tailor ECL models to specific asset classes, improving the precision of loss estimates.

b) Robust Governance & Controls:

- o Governance and Oversight: Strong governance frameworks ensure that the processes for developing and validating ECL models are subject to rigorous oversight. This includes the establishment of committees or working groups responsible for reviewing and approving ECL methodologies.
- o Validation and Back-Testing: Regular validation and back-testing of ECL models are critical to ensure their accuracy and reliability. This involves comparing predicted losses against actual outcomes and making necessary adjustments to the models.
- o Multiple Sources of data: In practice, this is quite detailed exercise as this involves use of multiple sources / source systems (LMS, LOS, Credit rating systems, CBS, NPA system, forward looking data inputs, manual input of assumptions etc.) and hence ensuring appropriate controls over data is implemented is of prime importance.
- o Audit Trails and Documentation: Maintaining thorough documentation and audit trails for all data sources, assumptions, and model changes enhances transparency and accountability. This is crucial for internal reviews and external audits.

c) Data Integrity and Consistency:

- o Data Accuracy: Ensuring data accuracy is fundamental to the reliability of ECL estimates. This involves regular data quality checks, reconciliation processes, and addressing any discrepancies promptly.
- o Consistency: Consistent application of data definitions, methodologies, and assumptions across different reporting periods and asset classes ensures comparability and reduces the risk of errors.

- Systems and Technology: Leveraging advanced systems and technology for data management and processing enhances the efficiency and accuracy of ECL calculations. Automated data integration and processing tools can minimize manual errors and streamline the ECL estimation process.

The importance of data and controls in developing ECL estimates under IFRS 9 cannot be overstated. Quality data forms the backbone of accurate ECL models, while robust controls ensure the integrity and reliability of the estimates. Together, they enhance the transparency, compliance, and risk management capabilities of entities, ultimately contributing to more resilient financial systems.

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Western India Regional Council

(Set up by an Act of Parliament)

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