



GUIDANCE ON ACCOUNTING FOR EXPECTED CREDIT LOSSES

ICAEW welcomes the opportunity to comment on the Consultation Document (CD) *Guidance on accounting for expected credit losses* published by Basel Committee for Banking Supervision on 2 February 2015, a copy of which is available from this [link](#).

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MAJOR POINTS

Welcoming the initiative

1. We welcome the opportunity to comment on the Consultative Document (CD), *Guidance on accounting for expected credit losses*. The introduction of accounting for expected credit losses in IFRS 9 *Financial Instruments* and the forthcoming *Accounting Standards Update* in US GAAP represent a significant change and challenge for preparers, investors, securities regulators and the auditors of lending institutions. We recognise that prudential supervisors and the wider regulatory community have expressed significant interest throughout the course of the development of these standards. Following the finalisation of the IFRS standard we acknowledge that prudential supervisors have opinions on how they expect it to be implemented and wish to make those views clear especially as they relate to the interaction between credit risk management principles and expected loss accounting.
2. We welcome the initiative taken by the Basel Committee to provide guidance on where supervisory principles for sound credit risk practices affect the accounting for expected credit losses (ECL). We consider that a single set of authoritative guidance that is applicable to banks across geographies is more likely to be effective in encouraging consistent implementation of IFRS 9 than similar efforts made at a national level.

More clarity needed between credit risk management and accounting guidance

3. We support the 11 principles setting out the 'Supervisory requirements for sound credit risk practices that interact with expected credit loss management'. However, the document in fact includes guidance on both credit risk management and accounting. It is important that the Committee makes clear which aspects of the guidance relate to which topic in order to avoid confusion especially given the differing objectives of each framework.
4. Effective guidance in this area should encourage more consistent and higher quality implementation of IFRS 9 through alignment of credit risk practices and expected credit loss accounting where this is appropriate. Whilst we believe that producing guidance with these aims was and remains the Committee's intention we urge the Committee to take note of our detailed comments which we believe will improve the effectiveness of the guidance in achieving its stated objective. Further clarity on aspects of scope, the Committee's expectations regarding proportionality, materiality, consistency with IFRS 9 and the interpretation of modelling and segmentation will, in our opinion, lead to the guidance being considerably more effective than currently it is. Such drafting improvements are not merely cosmetic.

Guidance can only limit measurement differences so far

5. Whilst we believe guidance of this type can be of assistance in narrowing certain approaches to the standard, our firm view is that, due to the inherent judgement and uncertainty associated with expected loss, accounting guidance of this nature will not achieve conformity of measurement outcome across financial institutions. Whilst it may in many (but by no means all) cases be possible to source reliable and supportable forecasts of economic factors and accurate historical data sets that can be used in expected loss calculation, these calculations will nevertheless require very considerable expert judgement and we therefore expect the range of reasonable and supportable expected loss outcomes to be wide in many cases. This is partially acknowledged in paragraph 71 which states that "the guidance seeks to narrow different interpretations and practices in these areas of the accounting requirements, *to the extent possible*, through the application of consistent and sound credit risk practices" (our italics). It would be helpful if the Committee would acknowledge that - given the differences in accounting requirements between IFRS and the US and the fundamental concept of expected loss - it is not realistic to suggest that outcomes between banks can be aligned.

Bank supervisors are not accounting standard setters

6. We support the concept of a single set of high quality, global financial reporting standards for banks, other financial institutions and all listed companies. In order to promote this goal, it is important to avoid the creation of multiple interpretations of international standards for different purposes as this could, over time, seriously undermine the consistency of financial reporting between different jurisdictions or industries. IFRS 9 was developed after extensive consultation, due process and deliberation. We believe that if it is necessary to create further authoritative financial reporting guidance, it should be done through the IASB and its Interpretations Committee.

7. At the same time, we recognise the legitimate interests of banking supervisors in this area and support the use of their powers, to use different measurement bases for regulatory purposes and/or to provide more specific guidance for regulatory purposes. We also recognise that if prudential supervisors do require banks to use a narrower approach than IFRS 9 (but within the range of the standard) for the purposes of, for example, calculating regulatory capital, then the banks are likely to apply this in their financial statements when it does not create a conflict with the standard. This is an important distinction and the guidance should be clear that it is intended to cover regulatory reporting rather than necessarily providing authoritative interpretations of IFRS, which in our view could set a worrying precedent.
8. We do not object to the Committee indicating a preference for limited use of particular simplifications and practical expedients offered in IFRS 9, especially in circumstances where it believes that more extensive use would result in a lower quality implementation of the standard. But should such an approach be pursued we urge strongly that it should be applied only where there is a clear consensus amongst stakeholders that discouraging the use of options is very likely to improve the usefulness of information to investors resulting from applying the impairment requirements of IFRS 9. We suggest that the Committee also considers whether limiting the use of practical expedients will improve consistency of application across banks when they are, in practice, likely to develop their own policies rather than rely on the thresholds used in practical expedients.
9. We appreciate the efforts that have been made by the Committee not to introduce guidance that might conflict with IFRS 9. As detailed later in this letter, however, there are areas where the guidance might be read as being inconsistent with IFRS 9. We urge the Committee to make suggested changes so as to avoid such implications and to be as clear as possible about the interaction with IFRS 9. We would also encourage the Committee to ensure that in finalising the guidance the IASB is consulted, including signing off the end result to ensure that any changes do not undermine the Committee's efforts made so far to preserve the integrity of the standard.
10. As detailed in paragraph 12 below in addition to timely finalisation we recommend that the Committee also be explicit about the timely revision of the guidance. After the initial implementation review will be crucial to ensure that difficulties and inconsistencies are ironed out as soon as practicable. Going forward regular updates to the guidance will help financial institutions to follow best practice.

Guidance needs to be sufficient clear that it is verifiable

11. We note that the guidance was not written with the objective that the 11 principles are subject to external audit. However, we are aware some prudential supervisors (including the Bank of England) may choose to require such an approach or indirectly seek comfort from auditors as to a bank's compliance with the guidance. There is a separate debate to be had as whether requiring external assurance is likely to be beneficial or at least to consider whether audit may be more desirable in a few years' time after implementation issues have been ironed out. We consider auditability to be a secondary concern given it is not a focus for the Committee, but *verifiability* is important for preparers, particularly for boards of directors who are responsible for signing off the accounts and who need their own assurance over the information. Some of our observations and proposed changes to the guidance are therefore driven by a belief that if the resulting information is not verifiable (and hence auditable) then it is difficult for management and supervisors to be confident over whether the guidance has been followed properly (as well as compliance achieved with the standard).

Timely finalisation is important

12. Finally, notwithstanding our observations and proposed drafting changes we understand and appreciate the efforts made by the Committee to produce this guidance quickly in order to allow preparers time to take it into account in their implementation planning. We believe that its expedient finalisation remains important and suggest that the aim should be to deliver a final text as soon as practically possible. This is most likely to be achieved where it is clear that it represents best/good practice rather than defining required minimum standards. We have offered separate drafting amendments, discussed below, as a potential means to speed up the process.

Supplementary drafting comments are also provided

13. Our response to the guidance sets out high level major points, detailed above, together with more specific comments and proposed amendments that the Committee may find helpful in finalising their guidance. Together with our response we also submit a separate document for the Committee's

attention which is a collection of comments provided by members of our working party. The working party includes representatives of large audit firms as well as major banks. We request that the Committee carefully considers the detailed drafting suggestions included in that document as they are intended to improve the clarity and effectiveness of the guidance, not to undermine it. Clarity of drafting will make the guidance much more successful in practice.

14. We have also added additional audit related points at the end of this response in the Appendix.

DETAILED COMMENTS

Objective and scope

15. The objective of the guidance as stated is to 'set out supervisory requirements on sound credit risk practices associated with the implementation and ongoing application of expected credit loss (ECL) accounting models', with the scope of the paper is stated as being limited to "those practices affecting the assessment and measurement of allowances under the applicable accounting framework." The second section of the document refers to "practices that interact with expected credit loss measurement" and contains guidance that does not relate to assessment and measurement of allowances. We believe that as currently constructed the guidance duplicates and in some cases provides alternative requirements in areas where guidance already exists elsewhere in regulation relating to topics beyond the scope of the paper. An example of this is paragraphs 56-58 setting out the requirements of principle 5 in relation 'internal credit risk assessment models' where new requirements around model validation and independent review of such activity are apparently being introduced. We would question whether models for accounting purposes should be subject to different requirements than for regulatory reporting, but if this is the intention it would be preferable to highlight the differences. If the intention is for the guidance to be consistent with the existing requirements, then cross referencing would be preferable. This will help ensure that the guidance is focused on the areas relating to expected credit losses and avoid falling out of date if other requirements are updated.
16. The guidance is intended to cover the credit risk practices for lending exposures only, with an acknowledgement that for other exposures "credit risk is properly considered in developing ECL estimates". It is not clear to what extent the Committee expects the application of those principles in managing credit risk exposures from non-lending exposures such as debt securities, lease receivables and unfunded lending exposures such as written loan commitments and written financial guarantee contracts. Our response is based upon the assumption that it should apply to all assets that meet the amortised cost definition within IFRS 9 with the exception of debt securities. We draw the Committee's attention to the fact that 'lending exposures' and 'debt securities' are not terms that are readily defined in existing Basel literature or IFRS and as a result there is the potential for significant confusion if the Committee is unable to clarify scope in this regard.
17. We note that the omission of 'debt securities' from the scope of the paper presents certain dilemmas for preparers, particularly as it relates to certain (often higher rated) assets such as sovereign debt. For example, were the 'low credit risk' threshold not to be used by a bank (including for example a central bank) on the basis that it represented a 'lower quality' implementation of the standard, then in many circumstances holdings in sovereign debt (issued either by the banks, host country or another country) would now or could in the future be transferred to lifetime loss measurement were a bank to apply the 'significance' test created for other lending exposures. We believe that by differentiating between different classes of credit exposure that require amortised cost measurement by reference to where the Committee's guidance applied, banks could run the risk of preparing financial statements that did not serve the needs of the users and/or were inconsistent with other banks where policy decisions in this area differed. Whilst we do not propose that the Committee draw 'debt securities' as defined within the scope of the paper (due to the additional work that would be required elsewhere in the paper), we encourage the Committee to consider this issue carefully, particularly in the finalisation of the guidance as it relates to the use of the 'low credit risk threshold'.
18. We note that the guidance when finalised is intended for banks applying ECL accounting models, which currently includes IFRS and US GAAP accounting frameworks. Given that the US GAAP ECL accounting requirements are not yet finalised, it is not clear whether it is the intention of the Committee to include an equivalent to Appendix A on IFRS 9 for the US GAAP requirements in the future. However, we note that Paragraph 15 of the guidance states that it expects internationally active banks to "limit their use of practical simplifications and/or practical expedients included in the relevant

accounting standards”, which can be read as being applicable to the US GAAP ECL accounting requirements before they are published. We also note that any intended interaction between this guidance and any guidance issued by US authorities on the US GAAP ECL accounting requirements when finalised are unclear and therefore it is not possible for us to comment further in this area at this stage, bearing in mind that a number of UK banking institutions and their auditors may need to consider this guidance in the context of the requirements of both IFRS and US GAAP expected loss frameworks. Whilst it may not be the intention of the Committee to deal with these issues in this paper we believe that the Committee should give further consideration in this area as the US framework is finalised in order to ensure that any finalised guidance remains relevant and useful for practitioners dealing with both IFRS and US GAAP reporting.

Proportionality vs Consistency: quality of implementation

19. We agree with the Committee that internationally active banks and banks with more sophisticated lending businesses should strive for the highest quality implementation. We also support a ‘proportionate approach’ where the sophistication of credit risk management reflects the relative size and complexity of lending exposures, which we do not believe conflicts with such an implementation. Indeed, a high quality implementation will appropriately balance cost, time and quality to ensure that the resulting financial reporting meets the accounting requirements effectively and efficiently without introducing undue operational risks.
20. This view appears to be included in certain aspects of the guidance. For example, the Committee considers that supervisors may adopt a ‘proportionate approach’ for less complex banks and in particular Principle 1 refers to credit risk practices being commensurate with the size, nature and complexity of lending exposures. However, as currently drafted, we are concerned that certain aspects of the guidance could be read as requiring highly sophisticated credit risk management and measurement techniques for all lending exposures irrespective of their size and complexity.
21. We note that the Committee makes the distinction between internationally active banks (those banks more sophisticated in the business of lending) and less complex banks. Whilst we understand that National Competent Authorities (NCAs) will form their own judgements when undertaking supervision activities, we believe that a lack of clarity on this area may lead to significant inconsistencies in practice both within and across geographies in the way that the guidance is applied. If the Committee does indeed have a higher expectation of compliance with the proposed guidelines for internationally active banks it would be beneficial if the Committee (or NCAs) could consider further what additional guidance could be provided to NCAs in order to help identify such banks. This will remove ambiguity for banks as to what kind of implementation and oversight is expected. Alternatively, broader acceptance of a proportional approach being taken in the application of the guidance would provide preparers, auditors and supervisors more latitude to apply the guidance appropriately regardless of the size and complexity of any institution that must be mindful of the Committee’s guidance.
22. Even the largest, most complex and internationally active banks have lending portfolios for which full implementation of the guidance as drafted will not be appropriate due to data or modelling limitations similar to those faced in the context of assessing capital adequacy, for example on portfolios where A-IRB approaches are not permitted or required. Given that the appropriate expected loss accounting estimate will be required on a timely basis at least at every reporting date, we believe that the Committee should acknowledge that approaches commensurate with the size, nature and complexity of the lending exposures, as set out in Principle 1, applicable for all banks regardless of their size.
23. Additionally, whilst we agree with the objective of a high quality implementation of the accounting requirements and that costs should not be a key consideration, higher costs may not necessarily result in a higher quality implementation. For example, the use of complex models will not result in a better outcome when reliable and supportable data is limited. We are concerned that as currently drafted the guidance appears to require work to be undertaken in a number of areas that may represent ‘undue cost and effort’ and we would urge the Committee to take account of the suggestions made in that regard. Whilst we understand the Committee may wish to reinforce the principles by providing examples of good practices in a number of areas, we would ask that the Committee clearly acknowledges that whilst it is incumbent on preparers to select methodologies and modelling approaches that represent a high quality implementation of the standard, there will be circumstances where application of all aspects of the guidance will not be appropriate (or in some circumstances possible) and that this does not in and of itself imply a lower quality implementation of the standard. (For example, a very complex, data-

intensive modelling approach for a high quality mortgage portfolio that has experienced only immaterial defaults over the last 20 years would not result in a materially different outcome to a simpler approach and is likely to require many unsubstantiated estimates that could actually reduce the quality of the output.)

24. The Committee expects processes for both credit risk practices and financial reporting to be integrated and for improvements in one area to facilitate improvements in the other. According to the Committee, common processes, systems, tools and data that are used in the accounting and capital frameworks include credit risk systems, estimated PDs (with adjustment), past due status, loan-to-value ratios, historical loss rates, product type, amortisation schedule, down payments requirements, market segment, geographical location, vintage and collateral type along with information of a forward-looking nature. We doubt that this integrated process can be achieved if measurement principles of risk estimates differ for regulatory and accounting purposes (for instance if a one year PD for a given counterparty is not the same under the regulatory and accounting frameworks). Potential changes of measurement of risk estimates for regulatory purposes are not part of this guidance. Further, we note that both supervisors and auditors review the credit risk models implemented by banks but with reference to different frameworks and objectives. To make the process more efficient we encourage the Committee to consider the question of convergence and acknowledge that to the extent that convergence is not desirable or possible it should not be sought.

Consistency with IFRS 9

25. We note that representatives of the IASB are satisfied in general that the application of the Appendix A would not prevent a bank from meeting the impairment requirements of IFRS 9 *Financial Instruments*. Given that the Committee will receive comments from constituents and may choose to make changes to the guidance we encourage the Committee to seek sufficient input from the IASB on the guidance before it is finalised.
26. Whilst we appreciate the time invested by the Committee in creating this guidance to an expedited timetable, we are concerned that some of terminology used in this guidance is inconsistent as between paragraphs and may be interpreted to be inconsistent with IFRS 9 terminology. Particular attention should be given to terms such as “robust” and “adequate” and their meaning as that is likely to differ from interpretation of terminology used in IFRS 9. Certain concepts and requirements are also discussed in different ways in a number of paragraphs which may lead to ambiguity as to what this guidance requires. These are not merely cosmetic issues; clarity of drafting will ensure the guidance is followed appropriately and efficiently by reference to terminology used in IFRS 9.
27. We have highlighted below a number of comments and proposed changes to language which would more closely align the guidance with IFRS 9.
 - Paragraph 63 of the guidance states that “[i]n estimating ECL, banks may determine either a single amount or a range of possible amounts” and yet paragraph A2 states the estimate should “take into account the range of possible future scenarios.” Our understanding of IFRS 9 B5.5.41 is that a range of possible scenarios must always be performed (even if those scenarios are limited only to two, being a possibility that a credit loss occurs and the possibility that no credit loss occurs). We propose that the wording in paragraph 63 is refined so as to not give the impression that a bank can determine the loss allowance based on a single cash flow forecast, which could be construed as being based on the most likely recoverable cash flows, which would fail to recognise the risk of non-payment even when it is remote. We also note that paragraph A2 could be read as implying that a full probability weighted approach reflecting all possible scenarios is required in all cases which is not a requirement of IFRS 9. We would recommend that paragraph A2 is redrafted so it is aligned with IFRS 9.
 - The guidance in paragraph A6 states that a bank should not undertake an exhaustive search for information that may affect the estimate of ECL but should use utilise information that is ‘reasonably available’. We note IFRS 9:5.5.17(c) clarifies what is reasonable by considering whether obtaining the information would lead to ‘undue cost or effort’. This appears to be in conflict with paragraph 60 of the guidance that states the costs for collecting data should not be avoided on the basis that a bank considers them to be excessive or unnecessary. Given our views on materiality expressed below, we consider that where exposures are immaterial, or in the case where obtaining the

additional information leads to an immaterial marginal difference in the estimate of expected credit losses, the approach taken in IFRS 9 should prevail.

- In paragraph A8 the guidance uses the term 'high credit risk' when referring to certain originated exposures. Such a term is not used in IFRS 9 and raises the question as to what 'high' means given the different lending practices and risk appetites of banks. We believe the guidance was trying to highlight that higher credit risk on origination may be consistent with the expectation of greater volatility in credit risk over time and therefore a heightened risk that the loan could move from 12-month expected losses to lifetime expected losses, thus greater care being needed in monitoring changes in credit risk. If that is the case, we recommend that the Committee clarifies this in the guidance rather than introduce a new 'high credit risk' term that is not defined.
28. IFRS 9 does not define 'significant increases in credit risk' and given the wide range of institutions and an even wider range of products and jurisdictions for which IFRS 9 is applicable, we are pleased that the Committee has not sought to define 'significant increases in credit risk'. However, we have a number of observations relating to the Committee's guidance on the assessment of 'significant increases in credit risk' which we feel would benefit from further consideration and clarification, examples of these are detailed below.
 29. Paragraph A3 states that in working out whether there has been a significant increase in credit risk PDs should be based on the risk of default over the expected life of the financial instrument (not just the next 12-months although IFRS 9 B5.5.13 acknowledges this may be a reasonable approximation of the change in the lifetime risk of a default occurring in limited circumstances). However, it is worth including or referencing the guidance in IFRS 9:B5.5.11 that consideration should be given to the remaining time to maturity when assessing whether there has been an increase in credit risk (given that all other things being equal, PDs reduce with the passage of time and thus a constant PD could imply a significant increase in credit risk).
 30. Changes in pricing may in some circumstances be related to increased credit risk but that link is overstated in paragraph A15 which states that "any post-origination increase in credit risk is unlikely to be fully compensated by the interest rate charged". Pricing methodologies generally take into account other factors such as strategic business considerations, funding costs and capital requirements. Additionally, the pricing for some products is not as sensitive as other products to movements in credit risk. We are also concerned that changes in pricing that do result from credit deterioration are often a lagging indicator (e.g. as a result of an observed uplift in defaults) and would encourage the committee to acknowledge this so as not to dilute the importance of the application of other credit risk management activities in the measurement of expected credit losses.
 31. Footnote 33 to factor (a) of A27 seeks to add an additional rebuttable presumption around the ability to distinguish the reasons for changes in the credit spread within pricing. Given that other factors are included in pricing it would be difficult if not impossible to rebut the presumption. Therefore we are concerned that the footnote would result in lifetime expected loss being recognised where there may not be a significant increase in credit risk contrary to IFRS 9 5.5.3.
 32. Paragraph A27 gives emphasis to seven other factors to be considered in addition to those factors that are included in IFRS 9:B5.5.17 (a)-(p) noting that "the presence of any of conditions (...) would suggest that there has potentially been a significant increase in credit risk" albeit some of the seven appear to overlap to some extent with those in IFRS 9. IFRS 9 lists factors that "may be relevant in assessing changes in credit risk". We consider the guidance places weight that such factors are presumptively an indicator of an increase in credit risk which is not the approach for the comparable guidance in IFRS 9. We also note that some of the additional factors included in paragraph A27 contain phrases which are ambiguous. For example, the meaning of "an internal credit assessment summary indicator" and "deterioration of relevant factors" is unclear and thus subject to different interpretations. It would be helpful if the Committee could clarify the intentions in this paragraph and where possible align with the words in the standard to the greatest extent possible as this would assist both preparers and auditors as they seek to apply and audit compliance with the guidance.

Prescriptive modelling requirements and segmentation

33. The guidance specifies a series of expectations surrounding model validation that may be inconsistent with the organisational design within a bank. By prescribing an approach in this area, the paper does not appear to allow organisations to establish effective approaches that meet basic "principle"

requirements which may lead some organisations to dismantle existing effective structures to accommodate the requirements of the guidance.

34. IFRS 9 already anticipates a greater level of segmentation in determining ECL calculations. The guidance has extended this by suggesting that it anticipates frequent re-segmentation, and also that collective portfolios cannot straddle stage one and stage two – with the premise that if the assets are genuinely homogenous then a sign of deterioration would impact all assets in the pool. While we anticipate seeing banks create a number of pools to undertake the calculation taking account of geography (including region), industry grouping etc, we do not expect that frequent re-segmentation should be necessary.
35. The principle for segmentation is well expressed in paragraph 44 and 45 of the guidance, which explain that lending exposures should be grouped so that they share similar risk characteristics and are expected to react to changing risk parameters in a similar way. Such groupings should be sufficiently granular that changes in credit quality will lead to migration that effects the measurement of ECL.
36. ECL measurement should be based on credit risk management processes and it is also necessary for credit risk management that loan portfolios are segmented during model development into groups that share common main risk characteristics and these characteristics are used to differentiate loans accordingly. Therefore it should be expected that risk management models represent a good starting point for developing ECL measurement models, since they will differentiate loans based on the previously identified risk drivers.
37. While models will never be able to capture all risk drivers, they focus on ones that have proven to be relevant and predictive as well as reasonably stable over time. As a result, frequent changes in the segmentation should not be expected and could result in driving unnecessary differences between risk management and regulatory capital calculations and ECL measurement, losing the benefit of the model development and review process, including the benefit of historical data series, resulting in a lower quality implementation. Frequent re-segmentation will also hinder comparability of numbers from period to period impairing management's ability to understand and explain the resulting financial reporting.
38. However there may be risk drivers and risk events that are not captured in models. In some cases, a specific change of risks affecting a portfolio would be better dealt with by a management overlay, which may involve ad hoc segmentation based on the information available in relation to the new risk driver or event, or by refinement of the model without re-segmentation, rather than by re-segmentation. For example, the effect of a natural disaster or a material unexpected economic event may require the determination of which loans or portfolios are impacted and the expected impact through a management overlay process (top down) rather than re-segmenting existing modelled portfolios (bottom up).

The need to apply materiality

39. We understand that the guidance does not aim to override the concept of materiality as applied to financial reporting. The guidance would benefit if this was clarified and the notion of a "proportionate approach" expanded to recognise that the concept of materiality is also important and applies to all banks and not just less complex ones.
40. Financial reporting frameworks often discuss the concept of materiality in the context of preparation and presentation of financial statements. Materiality is considered at both the overall financial statement level and in relation to individual account balances, classes of transactions and disclosures. Materiality may be influenced by considerations such as legal and regulatory requirements and considerations relating to individual financial statement account balances and relationships. This process may result in different materiality considerations being applied depending on the aspect of the financial statements being considered. For example, the expected degree of accuracy of certain statutory disclosures, such as directors' emoluments, may make normal materiality considerations irrelevant.

Prudence and neutrality in financial reporting

41. The guidance notes in paragraph 63 that "the Committee expects that banks will exercise prudence, defined as exercising appropriate care and caution with determining the level of ECL and the allowances to be recognised for accounting purposes". The guidance also refers to "prudent policies" in

paragraph 10 and in paragraph 14 where it states that “supervisors having a natural interest in promoting the use of sound and prudent credit risk practices”. Although the Committee refers to the exercise of prudence and neutrality we are concerned that the use of the term prudence in the guidance may be interpreted as a practice of over-cautious estimation of the downside which would be in conflict with the financial reporting objective of neutrality. The ECL model in IFRS 9 is designed with prudence in mind given it results in the recognition of a provision for expected losses at initial recognition. Therefore, including references to prudent practices and prudence in determining the level of ECL is redundant particularly given that IFRS 9 does not refer to prudence and the risk of the term being interpreted in a way that would be in conflict with the principle of neutrality.

Uncertainty over disclosures

42. Principle 8 states that disclosures beyond those required by accounting standards may be needed. It is not clear whether the Committee expects these disclosures to be included in the financial statements (and hence subject to audit) or not. Given the current objective of the IASB and securities regulators to streamline disclosures and the fact that many international active banks participate in the Enhanced Disclosure Task Force. We would encourage these agencies and groups to work together to ensure a consistent and measured approach taken by banks in providing credit risk disclosures beyond those required by accounting standards.

APPENDIX

Audit specific points

1. In addition to the comments above that relate to both preparers and auditors we make the following comments in relation to auditing specifically. As part of the audit approach for banks auditors review the design, implementation and operative effectiveness of a bank's risk management and internal control framework and assess whether they can rely on it to determine the audit procedures. We therefore welcome guidance for banks that will foster sound risk management practices and an effective internal control system for credit risk assessment and measurement. In addition auditors would support any guidance that assists them making an assessment of credit risk management practices as they relate to expected credit losses. However, we note that statutory audit opinions are expressed by reference to an accounting framework set out in international standards (local GAAP, IFRS or US GAAP) and therefore non-compliance with this guidance, not being part of those accounting frameworks, will not of itself lead to a qualified audit opinion being issued.

2. We note the Committee's initiative to introduce requirements for the validation of the banks' internal credit assessment models and the recommendations for the banks' regulators and their task to ensure that the proper policies and internal controls are in place for validation of the internal credit risk assessments models. We believe that an independent review of the model for ECL falls within the scope of audit services. When this review is performed by another auditor (external or internal) the statutory auditor will still need to review these findings in the course of the audit of ECL model for accounting purposes. Therefore we disagree with the footnote 22 on page 16 of the paper, stating that the independent review of the model validation process by the statutory auditor is a "non-audit service".

3. An effective implementation of expected loss accounting standards requires a consistent approach within banks supported by a consistent approach from auditors, prudential supervisors and securities regulators across multiple geographies. Where NCAs take different views on what they consider an effective high quality implementation, and/or require different levels of assurance from a banks' auditors on compliance with the guidelines, this runs the risk of creating geographical differences in interpretation that puts pressure on banks trying to apply a consistent approach throughout their organisation. We acknowledge that auditors across geographies must play their part in trying to minimise these differences, but our success with this will depend on NCAs taking as much of a consistent approach as they can. Following the finalisation of the guidelines we would hope national supervisors work together with the Committee to promote a consistent supervisory approach. We would welcome being part of that dialogue.