Expected Credit Loss Based on PSAK 71: A Systematic Literature Review

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Abstract. In this research, we examine the empirical literature on accounting for financial instruments IFRS 9 which was converged by Indonesia into PSAK 71 on financial instruments. We focus on three things, namely transition, impairment, and parameters in calculating expected credit loss (ECL). This research uses literature study method. This study aims to discuss the implementation of IFRS 9 or PSAK 71 on financial instruments in Indonesia from various literatures. We conclude that the ECL provisions affect how financial instruments are valued and how the income statement affects the value of shares. In good economic conditions, the impact of impairment on profit or loss should be less than when it is not, when there is a need to determine the lifetime ECL of a financial instrument rather than only a 12-month ECL due to high credit risk.

Keywords: IFRS 9; PSAK 71; Expected Credit Loss.

I. Introduction

Als al coluny thalt hals aldopted Internaltionall Finalnciall Reporting Stalndalrdrs (IFRS), Indolenial palricipaltes in alnd supportrs the aldoption olf al single alcounling stalndalrd als palr olf the globallizaltioln olf alcounling thaltlfolows the “alll size” principle. Since 2012, IFRS hals been used by stale-owld colmpalnies alnd alll othcr entitlies wth al significalt almoltnt olf public rsponsibility thalt alre supervisd by BAIPEPAM-LK. The Finalnciall Alcoolning Stalndalrdrs Boladr olf the Indolenialn Institute olf Alcoolntaltnts (DASK IAI) hals raltified the Stalmntent olf Finalnciall Alcoolning Stalndalrdrs 71 (PSAK 71) colncerning Finalnciall Instruments wth al rncovrgerce olf IFRS 9 Finalnciall Instruments issued by the Internaltionall Alcoolning Stalndalrd Boladr (IAISB) als al malrnestaltioln olf the commlntment tol rncovrgerce olf IFRS 9 (Halmidah, 2013).

The new regulatoory stalndalrd IFRS 9 olr the converged PSAK 71 intorduces new alcounling rules forl finalnciall asssets, finalnciall liabililies,tmpliment metholdollogies, falir value oltplions, alnd hedge alcounling. This new regulaltioln lrngely rplacels the IAIS 39 stalndalrd. PSAK 71 intorduces al new mdel forl impalirment llosss oln finalnciall instruments. Orlginalzaltiolns must culculalte the expected credit llos (ECL) alnd rclonogize it in the incolme stalmntent. Finalnciall instruments wth lovw credit risk, the orlginalzaltioln culculalttes al 12 molnth ECL. If credit risk consdrably wlsens between the rampilnt dnte alnd the purchals, the orlginalzaltioln sholuld culcumte al ltimelime ECL wth an alllowlvalnce thalt is severals tmes hgher thanl the 12-molnth ECL.

ECL is al risk falctolr thalt olriginalted from the balnkng sectolr where the expected llosss is used als palr olf the risk prernium alnd chrged tol the deblor (Bluhm et al., 2010, p. 2). The ECL is culculateld using the nltent prsent vlue olf the probablility olf defult (PD), llosss given defult (LGD) alnd expsure alt defult (EAD). Fdlr risk alnalysis alnd mnlageent, crdlt lenders use PD als olnf olf the molst crulclal risk falcotrs tol assess alnd dfine (Vnlck & Halmpl, 2017). This study alims tol discuss the implementaltion olf IFRS 9 olr PSAK 71 oln fionalnciall instruments in Indolenias fromalrual literatures.

II. Literature Review

PSAK 71 Fnnancial Instruments

Alcoldring tol Saldbun, et. all. (2020) PSAK policilys are very helpful forl deblors alnd bnlks in rurning their business. PSAK 71 pventrs bnlkns frolh falcing NPLs (nqn-perfoorming lolsals) alnd mntaltins crdlt qulility. Lending institutilns must mkalve reserves alt the stalt olf the lolan perioold balsed oln prolvisilns forl anticipalted futur credit llossses, alcoldring tol PSAK 71 (folrwalrd loloiking) balsed oln vrliolus falcotrs, olnf olf which is throuh folrecaists oln malcr lcolnolmy vrlsblles. Balsed oln this new alcounling stalndalrd, colmpalnies alre required to provide alllowlvalnce forl impalirment llossses (CKPN) forl alll types olf crdlt oln lolsals alnd divide it intol 3 stadium (stalges).
III. Research Methods

This study is an research with a literature review method where the data is obtained from the review of several articles.

IV. Discussion

Translation from IAIS 39 to IFRS 9

Default risk in IAIS 39 is considered “too little, too late” (de Halân & van Oordt, 2018). The resulting loss model in IAIS 39 mentions the possibility that the borrower in this case the debtor will be declared bankrupt and losses that may occur as a result of future events are not recognized. IAIS 39 prohibits reporting entities from including the consequences of future events that occur after the balance sheet date (Nilvoltny-Falkas, 2016, p. 201) and in other words, loan losses are only taken into account when they are very near to 100%.

The new IFRS 9 combines stochastic algorithms to calculate the expected credit loss (ECL) and the probability of PD, LGD, and EAD with the forward-looking approach to calculate the measurement and valuation in the financial instruments. The default risk off financial instruments is the main emphasis off the IFRS 9 ECL model. The probability is required to look at the significant increase in credit risk (SICR) since initial recognition at each reporting date. Changes in credit risk since initial recognition were the main driver in placing financial instruments into the three-stage impairment model within the scope of IFRS 9.

All financial instruments are subject to the ECL model, and the ECL is computed for financial instrument contracts. In the default phase, there is no difference in the computations of the financial impairment, as shown by the assumption that the model removes from IAIS 39 and the ECL model from IFRS 9. All significant difference in IFRS 9 or PSAK 71 is the presence of stage 1 to stage 3.

In the first stage (stage 1), the significant increase in credit risk cannot be measured since initial recognition. The 12-month ECL is caused by a default event that may occur within 12 months after the reporting date or at the loss on the asset as measured by the probability that the loss will occur within the next 12 months. (Beerbalum and Alhmald, 2015).

Impairment

H. Vollalrevi (2018) explains that credit risk can be explained as the risk that the borrower or debtor is unable to repay the loan, so that the lender may lose the loan principal and/or interest on the loan. The impairment model in IFRS 9 or PSAK 71 is more forward-looking which is also major for change at the loss model in IAIS 39 which only recognizes losses arising from past...
events. Impairment of IAIS 39 was criticized for generating tolol little and tolol late an allallowance for loss (H. Vollaurevic, M. Valrolvic, 2018).

The lack of a specific measurement method for determining the ECL model in IFRS 9 or PSAIK 71 creates a challenge in the actual use of the new impairment model. Instead, organizational losses are expected to create internal models using collateral real solvency that can be supported by historical information and future risk forecasts.

By combining the risk of default and the reporting date with the risk of the initial recognition of the asset and using realizable and alvalilable data, the risk of default is assessed. However, if there is no appreciable change in the credit risk, the colmpalny must record an 12-month ECL at the reporting date. All al allowance for losses, the entity acknowledges an impairment in profit or loss. (IAIS Plus, 2016)

Schutte, et all. (2020, p. 4) explains that for ECL computational models using the PD and LGD models, IFRS 9 calls for the substantial amount of data and time. After the standard is based on principles, not precise techniques have been provided for ECL life time estimation. Instead of determining whether the financial instrument's credit risk has significantly increased since the initial recognition, all using different approaches for valuing financial instruments.

It is recommended that the features of the financial instrument (or set of financial instruments) and prior (historical) data are comparable financial instruments be taken into consideration in the methodology used to assess the considerable rise in credit risk on initial recognition. In order to assess changes in credit risk, organizational losses should only be used in the assessment basis on the credit risk analysis. (IAIS Plus, 2016).

When assessing whether the financial instrument meets the criteria for impairment and the calculation of the ECL, which is calculated as the credit loss assessment probability represents the present value of all cash deficits in the anticipated period of the financial instrument, sometimes only qualitative information and non-statistical qualitative information must be used. (IAIS Plus, 2016)

All allowances for losses is calculated for all debt financial instruments measured at fair value, through other comprehensive income, or at amortized cost. ECL is recognized upon initial recognition of the debt instrument as an allowance for ECL in the income statement. If the debt instrument is measured at fair value through other comprehensive income, the change in fair value or other caluring almomult is recognized in other comprehensive income. On derecognition, all gains or losses in other comprehensive income are included in the income statement. This means that all 12-month or lifetime ECL is charged to income and all other non-credit related changes are recognized in other comprehensive income (Novotny-Farkals, 2016, p. 204).
Palralyeters in ECL Calculaltions
The key components of the ECL estimation framework are the structure of PD, LGD, EAD, and the dynamic state of the credit rating variable (e.g., macroeconomic indicators). Although historically information is an important basis for measuring ECL, entities must adjust their historical data such as credit loss experience based on currently observable data to reflect the effect of current conditions and future forecasts (Durovic, 2019).

Forward-looking calculations must be based on accurate estimates of current and future cash flows as well as macroeconomic data for financial instruments (Adaln, 2018). PSAIK 71 provides for the use of macroeconomic factors and probability-weighted results in calculating impairment or allowance for loan losses. ECL calculation is based on the net present value of PD, LGD, and EAD products, where PD is an important factor for calculating expected credit losses estimated for risk analysis at maturity (Valnek & Halmpel, 2017).

The ECL model is used for all financial instruments that are recognized at amortized cost or fair value through other comprehensive income, such as loans, securities, other loans, trade receivables, lease receivables, loan commitments, financial guarantees, guarantees, and contracts (Golnjak, 2019, p. 34; Nolvotny-Falks, 2016; Valnek & Halmpel, 2017).

The new ECL model in PSAIK 71 should result in earlier and larger recognition of loan losses (Nolvotny Falks, 2015) that exceeds IAIS 39 reserve levels (Seitz et al., 2018). All loans/advances for loan losses is highly volatile and may change the parameters used, and differs between troubled and non-performing loans (Seitz et al., 2018). Research shows that the high volatility of ECL depends on the PD model used by the entity with examples such as the PD model based on long-term and rating agencies such as Moody's. As proposed in IFRS 9 there should be a qualitative and quantitative assessment of the future cash flows derived solely from interest and principal payments.

V. Conclusion
IFRS 9 and PSAIK 71 which were introduced after the financial crisis and allow for principles with a forward-looking apportionment to IFRS 9 and PSAIK 71 do not regulate how to allocate loan losses for financial instruments and how entities should present their allocations and views in each entity's internal accounting policies.

In calculating impairment losses, ECL takes into account the lower allocatable loan loss provisions growth and the significantly larger all loss because in an economic crisis by considering the PDI as an key parameter, then calculates into account the components of LGD, EAD, and the macroeconomic scenario set by the entity.

Credit losses are estimated in the macroeconomic scenario and recognized at an earlier time which means that the entity must reserve additional capital to the allocated time to prepare for a potential increase in defaults when macroeconomic indicators deteriorate. Early recognition of credit losses can encourage entities to adopt more prudent and less cyclically lenient strategies and strengthen credit risk monitoring (Frykström & Jieying, 2018).

We conclude that the ECL provisions halve the impact on the valuation of financial instruments and income statements and affect the value of other shares. In unfavorable economic conditions, the impact of impairment on profit and loss should be less than at the time of a decline, when the significant reduction in credit risk requires the calculation of the lifetime ECL rather than at 12 months ECL. Further qualitative or quantitative research should analyze the impact of reimbursement on final financial statements and shareholder value.

References


