



IFRS 9 for financial institutions - the case for IFRS and FinRep-taxonomies – a conceptual gap analysis

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Abstract

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Main topic: A tsunami of regulations since the 2013 financial crisis is steering toward's Europe's financial service sector. At the same time the accounting standard for financial institutions' core products the financial instruments will be changing.

As disclosures according to IFRS 9 become mandatory by 2018, the existing IFRS Taxonomy for IFRS 9 already developed by the IFRS Foundation, represents a suitable and objective framework to assess IFRS 9 impact on disclosures. The specific goal of this paper is to perform a conceptual gap analysis considering the IFRS 9 taxonomy issued by the IASB and the Financial Reporting (FinRep) taxonomy on IFRS 9 issued by the European Banking Authority (EBA).

In general, the IFRS Taxonomy is not used very much in practice. This is not understandable as several advantages relate to the IFRS taxonomy: as it is not the objective of a principle-based accounting standard to define specific rules for each and every disclosure, this is the reason why to derive reporting elements would be very difficult to accomplish. The IASB started to perform a review process of the XBRL Due Process in 2013. As a result the development of the IFRS taxonomy should become part of the general due process of the financial reporting standards. Due to these changes it is expected that the importance of the IFRS taxonomy will be growing. The FinRep-taxonomy has become mandatory since 2014 for all banks within Europe, to fulfill the regulatory reporting requirements according to the Capital Requirements Directive (CRR) IV.

Results: Even though the disclosures for external reporting and for regulatory reporting are based on the same accounting framework International Financial Reporting Standards Boards (IFRS), differences can be observed with regard to disclosures, which are partly material. These differences become transparent when analysing IFRS- and FinRep-taxonomy reporting elements. This is caused by the principle-based IFRS, which enable scope of interpretation and the different objectives of the IASB and the banking supervision. Whereas the IASB follows the objective to develop industry non-specific international financial reporting standards, the banking supervision core focus lies on the banking industry. The EBA follows specific information requests with the FinRep-taxonomy in the role as banking supervisory. The IASB intends to provide decision useful information for investors. Nevertheless these two taxonomies provide the possibility for a starting point for the harmonization and the development of common practice disclosures, which could counteract against heterogeneous financial reporting and the issue of "information overload".

Method: Analytical

Practical Implications: This paper is relevant for managers who are responsible for external and regulatory reporting.

Introduction

Whenever new reporting standards are issued by the IASB (International Accounting Standards Board) that concern the notes to the financial statement, the disclosures become increasingly relevant. The notes constitute an important source for the firms' analysis.¹

Modifications to previous standards become clear to investors when the new standards are first used. This is also true for the International Financial Reporting Standard 9 (IFRS 9), the new measurement standard for financial instruments and for the latest IFRS 7, which, as a reaction to the financial crisis, changes the requirements with respect to the notes for financial years from 1 January 2018. One of the main criticisms of IAS 39 was that it augmented procyclical effects for financial institutions.

According to a study published by Moody's Analytics, based on a qualitative questionnaire filled in by international banks in 2015, IFRS 9 will have significant effects on the provision for loan loss provisions of financial institutions.² Thus it will have significant implications for the financial industry.³

The IFRS taxonomy of 2016, which contains the respective modifications according to IFRS 9 and 7, is not yet at the center of public attention. The lack of public attention is difficult to understand since the IFRS taxonomy overrides the room for interpretation of principle-based accounting standards with its de facto reporting elements. There are several reasons, including the fact that the IASB does not play an important role in the further development of the IFRS taxonomy. In the following, we will show that during the last months the IASB has implemented a few changes. A principle-based standard setting faces several conflicts regarding the taxonomy development, since the taxonomy development is not geared by principles, but rather by single reporting requirements. Moreover the IFRS taxonomy has faced international criticism that it is not sufficiently detailed. Thus it is not comparable and does not fulfil the requirements of a globally approved standard.⁴

However, evidence suggests that the IFRS taxonomy will be integrated into a new European standard. The European Securities and Markets Authority (ESMA) started implementing the new EU transparency guidelines from 2013. The guidelines should help issuers facilitate submissions and make the submitted information easier accessible for investors and regulators, providing better analysis and comparability.

One of the rules of the new guide-line requires issuers who are traded in a regulated EU

market to prepare their annual reports in a common European electronic format (Europe-an Single Electronic Format, ESEF) as of 1 January 2020. ESMA held a public consultation, which ended on 18 January 2016, on the technical implementation standards.

IFRS Taxonomy Consultative Group (ITCG)

The IFRS Taxonomy Consultative Group (ITCG) was established with the goal of consulting the IASB with respect to the characteristics and implementation of the IFRS taxonomy.

The IFRS taxonomy is based on XBRL (eXtensible Business Reporting Language), a language, which makes it possible to exchange automatically and process electronic financial information and other firm data along the financial reporting supply chain.⁵ Taxonomies should standardize and structure reporting elements but also decrease complexity and increase the quality of corporate governance.⁶

According to the IASB charter, the ITCG consists of 16 to 20 members, including a chairman and a vice chairman with different geographical and professional backgrounds. The members are expected to support the development of the IFRS taxonomies with their expertise and practical and theoretical experience in XBRL, for example with expertise in taxonomy domains or with a membership in respective working- or stakeholder groups. A complete summary of the current members of the ITCG can be found on the web-site of the IASB (www.ifrs.org). The members of the ITCG are appointed for three years. Requirements for the appointment are the proof of expert knowledge, abilities or practical experience in the area of XBRL.

Changes for the IASB Taxonomy Due Process

The IASB has recently announced changes to the consultation process for the IFRS taxonomy. The IASB will be more extensively integrated in the further development and support of the IFRS taxonomy. In the future, IASB members must approve changes in reporting content and in common practice elements.

Hence the importance and pervasiveness of the IFRS taxonomy will undeniable increase. Critics argue that stronger integration of the IASB could lead to the taxonomy influencing the standard setting and therefore a reversion to a rules-based approach.⁷ The question is if this apprehension is reasonable, as the IFRS taxonomy has many different reporting elements compared to US GAAP and thus does not aim to provide a unilateral interpretation of the standards. The IFRS taxonomy counters this criticism through the integration of common practice elements⁸, which are only possible because of the

principle-based approach. Therefore, with the envisaged changes, the IASB further supports the development of the IFRS taxonomy as the basis for the digitalization of financial reporting.

Conceptual Framework: Taxonomy

The increasing digitalization of society has reached internal accounting and external reporting. It is in this respect not surprising that the digitalization also affects financial reporting.⁹ Instead of the paper-based annual reports electronic structured-financial reporting are issued by corporations, which, in contrast to a unstructured Word or PDF document, can be processed electronically and automatically. This is only possible with a taxonomy that specifies the structure of the financial information.

The differentiation between quantitative data, such as tables or numbers, and qualitative data such as text disclosures, whose standardization still causes extensive problems, is considered as essential structural element in the notes reporting elements of the taxonomy. Particularly, metadata plays an important role in the structured electronic reporting, as it describes how the financial information is presented. Thereby not only the “how”, but also the “what” is specified, as the taxonomy describes the framework of all expected financial information. In general, legal standards on the one hand are distinguished from established common practice on the other hand. In the last years XBRL as electronic reporting language has emerged as the de-facto standard, on which regulators, tax authorities and non-profit organizations rely on.

XBRL enables firms to prepare their data in a standardized way and to use it several times. Examples of receivers and purposes of use are the publication in the “Bundesanzeiger” (German Federal Gazette) of information about business partners, loan creditors, investors and regulatory authorities. XBRL specifies the data format to share firm information, but it is not a software to create firm reports. The language XML (Extensible Markup Language) is the technical basis of XBRL. The reporting firm can still choose for themselves which extent the amount of transmitted data should be. XBRL does not determine reporting obligations and does not influence the reporting standards a firm uses – but XBRL provides an instrument to describe the generated and passed-on information in an appropriate and structured way and processes the information automatically.

XBRL dominates the market for taxonomies for external financial reporting and regulatory reporting. The delivery of a taxonomy can be open or closed¹⁰. The FinRep-taxonomy was selected to be a closed taxonomy, which means that all report elements that are included in the taxonomy must be delivered by the reporting firm. If this is not applicable, it has to be noted accordingly. In contrast, an open taxonomy is only a reference, eventually the firm has to create its own firm-specific taxonomy with firm-specific deviations. Hence there is no enforcement of following the guidelines of the taxonomy. In the case of an open taxonomy, deviations are called extensions¹¹.

Background for IFRS 9 and FinRep-taxonomy

As declarations under IFRS 9 do not have to be disclosed for financial years before 1 January 2018 and since the IFRS taxonomy is already available, this taxonomy enables the early examination of the impact of IFRS 9 on disclosures. Moreover, the EBA has published a consultation concerning the influence of IFRS 9 on FinRep¹². In particular, notes about financial instruments under IFRS 9 and 7 are compared with respect to the differences between accounting standards and regulatory reporting. The main focus lies on analysing the IFRS taxonomy-my of the IASB and the Financial Reporting (FinRep) taxonomy of the EBA. At this point, it is important to mention that until 2011 the Committee of European Banking Supervisors (CEBS) (the predecessor of the EBA) developed the FinRep-taxonomy as an extension of the IASB taxonomy. That guaranteed the unambiguity and reutilization of the relevant and overlapping disclosures. With the launch of the FinRep-taxonomy based on Basel III, this approach was not further pursued, which led to even more differences between the two taxonomies but also between the reporting approaches.

IAS 39 vs. IFRS 9: Incurred loss model vs. Expected credit loss model

We will now examine the reasons that IAS 39 came under criticism and will be replaced by IFRS 9:

- **Complex Framework:** a very complex framework of accounting leading to inconsistent application
- **Optionality:** various options under IAS 39 imply that comparability between companies is difficult.
- **Decision Making:** for example, in the case of loan loss provisioning, IAS 39 appeared to not provide the right solution (“Too late – too little”).
- **Not reflective of business activities:** accounting outcomes can appear

disconnected from business activities.

- IFRS 9 became the answer:
- Simple and comprehensive framework: clear framework of classification and measurement requirements for financial instruments
- Reduced Optionality: simpler option based on the purpose of holding the assets as opposed to the intention of holding the individual asset
- Decision Making: reflect the effect of an entity's risk management activities in the financial statements with more principle-based requirements
- Picturing Business activities: reflects how an entity manages its financial instruments and the contractual cash-flow characteristics of the financial assets.

In July 2014 the IASB issued IFRS "Financial Instruments" ("IFRS 9"). The standard substitutes IAS 39 "Financial Instruments: Recognition and Measurement" ("IAS 39"). Summarized IFRS 9 implicates the following significant changes: new regulations for the classification and measurement of financial assets for firms, the fair-value accounting of financial liabilities (taking into account credit risk), new requirements for impairments, and hedge accounting.

IFRS 9 requires that the company's business model for managing financial assets and the contractual cash-flow characteristics of the financial asset determine the classification and measurement of financial assets. Each financial asset is either classified as "fair value through profit or loss", "amortized cost" or "fair value through other comprehensive income". As the rules for the classification differ from the existing regulations according to IAS 39, it is necessary to analyse all financial assets with regard to a possible re-classification. Dependent on the business model's degree of heterogeneity, changes in the classification and measurement of financial assets according to IAS 39 are expected.

The impairment regulations according to IFRS 9 concern the financial assets that are either set as amortized cost or as fair value through other comprehensive income. Moreover, the new impairment requirements must also be applied to leasing receivables and off-balance sheet credit commitments such as loan commitments and financial guarantees.

The most extensive changes according to IFRS 9 are induced by the new impairment model causing a paradigm shift. The existing incurred loss model, in which credit losses are captured when a triggering event occurs, is replaced by the expected loss model. In

the expected loss model, provisions for credit defaults are made at the initial recognition of financial assets (or when the credit or guarantee is first committed) based on the current expectation of potential (future) credit defaults.

With IFRS 9, the IASB has introduced a two-stage process to determine loan loss provisions. The first step of the impairment model requires that for each financial asset loan loss provisions are calculated at initial recognition based on expected credit defaults within 12 months. Before each interim report, the firm evaluates whether there has been a significant increase in the credit risk: in which case, the loan loss provisions must reflect the lifetime expected loss. The big four audit companies have not yet released final comments for IFRS 9, but the authors of existing literature agree that due to the change of impairment rules, the subjectivity, when setting loan loss provisions, will increase. The reason for this is that loan loss provisions are based on future-oriented and probability-weighted information that are continuously monitored and updated over the full lifetime of the financial asset. On the contrary, IAS 39 recognizes impairments in the form of loan loss provisions only after a triggering event of one or several loss events.

It is expected that IFRS 9 will lead to an increase in loan loss provisions. This conclusion is based on the requirement that provisions for expected losses within the next 12 months must be adjusted for all instruments, even for those for which the credit risk did not significantly increase. This means that contrary to the incurred loss model of IAS 39, the transactions that have to be included in the provisions increase. Furthermore, it is based on the assumption that the holdings of financial assets that have to be considered for the lifetime expected loss are greater than those, for which the loss event according to IAS 39 already occurred.

Comparison of IFRS taxonomy and FinRep-taxonomy regarding the notes for financial instruments

According to different authors, the IFRS 7 change of notes displays the main aspects of IFRS 9 changes, as more detailed notes are required by IFRS 7.1.3. Not only quantitative but also qualitative aspects have to be considered. This increases especially the requirements of the internal data warehouses of the banks to provide multiple data with a high granularity for aggregation in financial reporting.

In the following, the notes related to IFRS taxonomy and FinRep-taxonomy will be compared. The main focus will be on the notes according to IFRS 7, corresponding to IFRS 9.

The investigation classifies the differences in the notes with respect to IFRS and FinRep-taxonomy on the basis of different characteristics:

- Quantitative differences
- Qualitative differences

The main focus of the investigation lies on the movement schedule for loan loss provisions. Only small differences between the two taxonomies can be detected when comparing the single positions of the movement schedule.

Table 1.1: IFRS 9 semantics in IFRS and FinRep- taxonomies

IFRS Taxonomy Reference	IFRS Taxonomy	FinRep	FinRep Reference
Effective 2018-01-01 IFRS 7.35I d Example, Effective 2018-01-01 IFRS 7.IG20B Example	Increase (decrease) through transfers, financial assets	Impairment or reversal of impairment (net) with transfer between stages	Annex V.Part 2.77; IFRS 7.35B(b); IFRS 7.35J; IAS1.82(ba); Annex V.Part 2.129
Effective 2018-01-01 IFRS 7.35I c Example, Effective 2018-01-01 IFRS 7.IG20B Example	Decrease through derecognition, financial assets	Changes due to repayments and disposals	IFRS 7.35I; Annex V.Part 2.132
Effective 2018-01-01 IFRS 7.35I a Example, Effective 2018-01-01 IFRS 7.IG20B Example	Increase through origination or purchase, financial assets	Changes due to origination and acquisition	IFRS 7.35I; IFRS 9.B5.5.25; Annex V.Part 2.131
Effective 2018-01-01 IFRS 7.35I c Example, Effective 2018-01-01 IFRS 7.IG20B Example	Decrease through write-off, financial assets	Write-off through decrease in allowance account	Annex V.Part 2.78;IFRS 9.5.4.4;IFRS 7.35L; Annex V.Part 2.133
Effective 2018-01-01 IFRS 7.IG20B Example	Increase (decrease) through changes in models or risk parameters, financial assets	Changes due to update in the institution's methodology for estimation (net)	IFRS 7.35I; IFRS 7.35B(b); Annex V.Part 2.130
Effective 2018-01-01 IFRS 7.35I b Example	Increase (decrease) through modification of contractual cash flows, financial assets	Impairment or reversal of impairment (net) without transfer between stages	Annex V.Part 2.77; IFRS 7.35B(b); IFRS 7.35J; IAS1.82(ba); Annex V.Part 2.129
Effective 2018-01-01 IFRS 7.IG20B Example	Increase (decrease) through foreign exchange, financial assets	Amounts partially written-off directly to the statement of profit or loss	IFRS 9.5.4.4; Annex V.133, 134
Effective 2018-01-01 IFRS 7.IG20B Example	Increase (decrease) through other movements, financial assets	Other adjustments	IFRS 7.35B(b)
Effective 2018-01-01 IFRS 7.35H Disclosure, Effective 2018-01-01 IFRS 7.35I Disclosure	Total increase (decrease) in financial assets	Closing Balance	n/a

The movement schedule positions of provisions with respect to the IFRS taxonomy opposed to the FinRep-taxonomy are shown in the table above. Although the positions are described in detail in IFRS 7, the terms are very different. Moreover, FinRep provides its own description or recommendation for filling in the positions. Since the IFRS taxonomy and the FinRep-taxonomy have different main headings, the challenge is to integrate the data to reconcile the taxonomies. This can be illustrated by the fact that some positions in the movement schedule of the provision do not exist in the IFRS taxonomy. For example, according to FinRep, partial or total write-offs have to be shown. And in the IFRS taxonomy, changes due to foreign-currency effects have to be shown separately, one of the

standard statements in the movement schedules. Another characteristic of FinRep is that details about itemized valuation allowances and general provisions have to be provided as shown in Table 12.1. According to IFRS 9 or rather IFRS 7 an itemized valuation allowance takes place in the third step when the default already took place. Classes 1 and 2 are subject to a general loan loss provision as standard models are used.

The biggest quantitative differences arise from the fact that according to FinRep additional information to the movement schedule has to be provided. All transfers between the single classes have to be disclosed according to Table 12.2 (FinRep). This contrasts to the requirements of the IFRS taxonomy, as according to IFRS 7 such disclosures are not required, leading to a tremendous additional effort to collect data for the credit institutions. There are examples for qualitative disclosures according to the IFRS taxonomy that are completely converted to quantitative disclosures in the FinRep-taxonomy. According to IFRS 7, only significant changes in the customer balances have to be shown, whereas according to the FinRep-taxonomy a complete quantitative reconciliation has to occur.

Table 7.1 of the FinRep-taxonomy distinguishes between overdue periods, which have to be disclosed for different time periods. IFRS 7 replaces these with risk classes and thus does not require such a differentiation.

These figures demonstrate that FinRep was developed taking into account bank-specific disclosure requirements, as this form of time-specific classification is typical for banking supervision and for disclosure requirements in the notes to the financial statement for banks. This would contradict the IFRS principle of industry-agnostic treatment.

Also the requirements for the notes concerning the changes of the credit risk of financial assets according to Table 4.2.2 (FinRep), which are set as fair-value changes in value in Other Comprehensive Income (OCI), go beyond the disclosure requirements of IFRS 9 and IFRS 7.

Conclusion

Even if the notes in accounting and regulatory reporting are based on a common basis of IFRS accounting standards, there are differences, some significant, in the reporting. The differences become obvious when analyzing the characteristics of the IFRS and FinRep taxonomies. This is due to a certain latitude in interpretation of the principle-based accounting standards of the IASB and the different objectives of the IASB and regulatory reporting. Moreover there is a deficiency in common practice elements, as they provide only partly detailed reporting elements, since they are only included in the IFRS taxonomy

when they are reported by the majority of firms. On the other hand, this means that there are reporting elements, which are due to its frequency not considered in the IFRS taxonomy. In addition, the common industry elements are always analyzed from the point of view of the industry's independence so that in the end it could be decided not to adopt the IFRS taxonomy.

While the IASB aims to develop industry independent global standards, the focus of regulatory reporting lies on credit institutions. The EBA uses the FinRep-taxonomy to gather specific information in their role as banking supervisor. The IASB wants to provide investors with decision-supporting information. The IFRS follows the principle of the industry-agnostic treatment, whereas FinRep should fulfil banking-specific regulatory requirements.

Nevertheless, the taxonomies offer a starting point for harmonization and the development of industry standards (common practices), which could help to overcome heterogeneous reporting and information overload. Moreover, the question arises whether the FinRep-taxonomy should not be revised, or even based architecturally on the IFRS taxonomy, as was the case before 2011, in order to guarantee the unambiguousness and reutilization of the elements.

Footnotes

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