**RESEARCH ARTICLE**

# The impact of the application of the International Accounting Standard (IFARS 9) on the financial reporting of Iraqi private commercial banks

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## Abstract

The problem of recognizing credit losses is one of the most important contemporary problems in accounting thought, as the process of creating a provision for credit losses is one of the most important bases of measurement in hedging against these losses and mitigating their impact. Studies and research in the field of accounting show that the accounting treatment used in accordance with the international standard (IFRS 39) is one of the fundamental reasons for the exacerbation of the global financial crisis in 2008, which is the delay in the recognition of credit losses until they are achieved, which is the so-called model of actual credit losses, as the treatment is based on recognizing the loss on the actual basis, i.e. after its occurrence, and not on the expected basis, i.e. before it occurs. In light of the criticisms leveled at the international standard (IAS 39) entitled Financial Instruments, the International Accounting Standards Board issued a standard for financial instruments, which is the International Financial Reporting Standard (IFRS 9). The new standard includes a proposed accounting framework for recognizing expected losses. According to the requirements of this standard, banks create provisions to face risks on an expected or estimated basis with the aim of early recognition of credit risks. As a result of the effects that this application will have on credit risks. It was necessary to shed light on the impact of the application of this standard on reducing credit risk, and thus the financial reporting of Iraqi commercial banks will be affected.

Keywords: IFRS 9; financial instruments; Iraqi commercial banks

## INTRODUCTION

The International Monetary Fund clarified that countries adopt the application of international accounting standards for reporting Financial System (IFRS) contributes to upgrading the financial and economic system to enhance the facility's ability to Develop and diversify the scope of its operations, and contribute to increasing the reliability of information and providing more information Transparency in a timely manner as it contributes to unifying the language of money and business and enhancing confidence in the global economy .

The International Accounting Standards for Financial Reporting represent a guiding framework for achieving standardization of accounting treatments, measuring operations and events that affect the financial position of the economic unit and the results of its work, and communicating this information to the methods that benefit from it to take the appropriate decision.

Implemented in financial statements from the 1st January 2018, the IFRS 9 aims to remedy to the IFRS 39 weaknesses by:

1) Classifying financial instruments according their business model,
2) Recognizing loan loss provisions on an expected-losses basis, and
3) Aligning the hedge accounting treatment with risk management activities.

While the revision of financial instruments classification and hedge accounting have generated relatively few meaningful discussions during the IFRS 9 drafting, the development of the expected credit-losses model prompted many reactions from debate participants.

### Research problem:

It is a result of the application of the International Financial Reporting Standard 9 (IFRS) titled Financial Instruments–recognition and measurement, the way financial institutions recognize losses will change.

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IFRS 9 (Financial Instruments - Recognition and Measurement by Banks) Create provisions for expected debts before they occur, which limits credit losses, but On the other hand, it causes a significant increase in the amount of provisions, and thus the banks will face financial institutions have some challenges and obstacles in the application of this standard, as well as the requirements of For Iraqi banks. The application of this criterion is a challenge, the main question of the research is :-There are some financial challenges and obstacles in this direction For Iraqi banks, The application of this is a challenge the main challenge to compete in:

What is the impact of applying the International Financial Reporting Standard (IFRS 9) titled Financial Instruments-Recognition and measurement of loan risk reduction to the financial reporting of Iraqi commercial banks ?

### The following sub-questions arise from it:

1) Does applying the expected credit loss model in accordance with IFRS lead to Financial Instruments (IFRS9) Financial Instruments – Recognition and Measurement to Reduce Risk Loans in Iraqi commercial banks?
2) Does disclosure of allowances for expected credit losses reduce the risk of loans In the Iraqi commercial banks?

### Research aims:

In light of the research problem and its concepts, the main objective of the research is: According to the International Financial Reporting Standard 9 (IFRS) entitled Expected Credit Loss Model, Financial Instruments – Recognition and Measurement, in Reducing Loan Risk to Improve Financial reporting in Iraqi commercial banks.

### Research hypotheses:

In light of the research problem, objectives and importance, the research hypotheses are as follows:

1. The application of the expected credit loss model does not perform according to Financial Reporting (IFRS 9) Financial Instruments - Recognition and Measurement of the risks of loans in Iraqi commercial banks.
2. Disclosure of allowances for expected credit losses does not reduce the risk Loans in Iraqi commercial banks.
3. The application of the expected credit loss model does not lead to Financial Reporting (IFRS 9) Financial Instruments - Recognition and Measurement to Improving the financial reporting of Iraqi commercial banks.

### Description of the IFRS 9:

The IFRS 9 presents substantial changes compared to IAS 39. Comparing the financial assets classification and measurement, IAS 39 required classification according the nature of the asset; classification according which depends on its measure. In accordance with the last version of IAS 39 issued on 13th October 2008, unless the bank voluntarily opts for the assessment at fair value through profit and loss, financial assets could be classified: (Febriani & Dwi, 2020: 32)

1. As trading asset, and thus be measured at fair value through profit and loss (FVTPL);

2. As available-for-sale asset, and be measured at fair value through other comprehensive income (FVTOCI);
3. As loans and receivables, for which a measure at amortized cost is required, and;
4. As held-to-maturity asset, also measure data mortised cost.

IFRS 9 now amends the IAS 39 classification by requiring measures of financial assets based on the business model of the entity, and no longer on the asset nature. Consequently, underIFRS9 financial asset for which the objective is achieved: (Mojca, 2017: 5)

1) By selling, shall be designed at FVTPL;
2) By collecting cash-flows and selling, shall be designed at FVTOCI, and;
3) By collecting cash-flows only, shall be designed at amortized cost.

Likewise, the FVTPL option remains possible in order to reduce a potential accounting mismatch. (Mojca, 2020: 321)

In addition, IFRS 9 requires financial instruments shall present additional cash-flow characteristics to be designed at amortized cost or FVTOCI. The cash-flow characteristics test implies contractual terms of the financial asset give rise on specifies dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding. Precisely, interests shall only consider the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time and other basic lending isks and costs, as well as a profit margin. Basically, financial instruments for which contractual terms introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement are considerate as failing SPPI test and shall be designed at FVTPL. (Julien, 2019:21)

### Recognition of expected credit losses:

Regarding the loan loss provisioning, the main weakness addressed to the IAS 39 was the delayed loss recognition due to the incurred losses basis. Indeed, delayed loss recognition plainly affected bank earnings during the financial crisis, as banks recorded at once foreseeable losses. Thus, IFRS 9 presents a major change by requiring to record loan loss provisions on an expected losses basis, which aims to smooth credit losses by a provisioning as soon as the financial asset is recorded on the financial statements. This expected losses-based provisioning applied for assets measured at amortized cost or at FVTOCI and process according three following steps (also called the three "buckets"): (Novotny, 2016: 200)

1. At initial recognition, the entity shall measure the loss allowance for that financial instrument at an amount equal to12-month expected credit losses;
2. The entity shall measure the loss allowance for a financial instrument at an amount equal to the life time expected credit losses if the credit risk on that financial instrument has increased significantly since initial recognition. (Stefania et al, 2016: 6)
3. For incurred credit loss, the entity shall measure the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses and shall calculate the interest revenue based on the gross carrying amount adjusted for the loss all owance.

Expected losses described in 1 and 2 above are assessed on a historical basis related to previous banks losses losses and refer to general (portfolio-based) provisions. Credit losses mentioned in 3) above represent individually assessed provisions related to incurred losses, similarly than in IAS 39.(O′ Hanlon et al, 2015:98)

### The expected effects of IFRS 9 on banks′ capital:

Impact of business model reclassifications As mentioned above, IFRS 9 requires banks classify and assess their financial assets according their business model. This change from IAS 39 to IFRS 9 classification implies potential differences in recognition of financial asset. Regarding IAS 39 loans and receivables category for which assets are assessed at their amortized cost, whether such assets do not meet a hold-to-collect business model they shall be assessed at FVTPL (when meeting hold-to-sell business model) or FVTOCI (when meeting hold to collect-and-sell model) under IFRS 9. In addition, an asset which fails to meet SPPI requirement is necessarily assessed at FVTPL. Thus, new recognition at fair value directly impacts, favorably or not, the banks: (David, 2011: 54)

1. Retained earnings when loans and receivables are reclassified at FVTPL or fail at SPPI test and,
2. Other reserves when reclassified at FVTOCI. That is especially true when the amount assessed at fair value differs greatly from the amortized cost value. Assets recognized in other IAS 39 categories–as held to maturity, available for sale and trading –are expected to be subject to minor changes in their value reassessment. This expectation is justified by the fact that those categories suggest assets included in are relatively closer than the business model they are assigned. For example, IAS 39′s held-tomaturity assets – assessed at amortized cost – should be IFRS 9′s hold-to-collect assets. Similarly, IAS 39′s trading assets should meet IFRS 9′s hold-to-sell category. (Jesus, 2012: 21) As well, IAS 39′s available for sale category suggests similarities with IFRS 9 hold to collect-and-sell category. Finally, it appears relatively difficult to evaluate the potential impact on shareholder′s equity induced by assets reclassifications. Multiple scenarios

may be raised and this issue shall be considered as bank-specific. Impact of expected-losses-based provisions While IAS 39 required provisioning on an incurred-losses basis, i.e. impaired provisions assessed on an individually basis, IFRS 9 now implements provision based on expected losses. Basically, provision on an expected losses basis implies banks allocate general loss allowance to financial assets at their initial recognition –, based on their 12-month expected credit losses. (Albert, 2015: 11)

Whether credit risk increase significantly, this general loss allowance shall be raised in order to reflect the lifetime expected credit losses. When credit losses incurred, a loss provision shall be recorded on an individual basis. Consequently, now provisioning performing assets (or non-loss incurred assets) in addition to those for which incurred loss has been recorded would mechanically impact the net income unfavorably (the so-called Day-one losses). Thus, the transition to IFRS 9 implies banks assess their financial assets in accordance with expected-losses model on the 1er January 2018. (Khan & jain, 2008: 23)

### Applied study of a sample of banks

### Characteristics of the research sample members:

It is clear from the analysis of the questionnaire answers presented in Table No. (1) that about 36% of the sample members hold a master′s degree, and this indicates the bank′s dependence on holders of higher degrees in most aspects of its work, and that the majority of them specialize in accounting, where they constituted a percentage (57%), and the reason is due to the degree of the subject's relationship and its connection with that specialization.

Through the previous data, it is clear that the research sample has sufficient knowledge and experience, which makes it able to understand the axes of the questionnaire and answer them objectively. The following table shows the demographic variables of the research:

**Table (1)**
**Characteristics of the sample members**

| Details | Items | F | % |
|---|---|---|---|
| Qualification | PhD | 4 | 14 |
| | Master's | 10 | 36 |
| | BA | 8 | 29 |
| | diploma | 6 | 21 |
| | Total | 28 | 100% |
| Scientific specialization | Accounting | 16 | 57 |
| | Finance | 2 | 7 |
| | Management | 5 | 18 |
| | Economic | 5 | 18 |
| | Total | 28 | 100% |

### Analysis and discussion of the results of the study:

The data in Table (2) regarding the arithmetic mean and standard deviation, as the highest mean of the sample members agree that IFRS 9 seeks to increase the use of fair

value in the accounting measurement, as it reached (4.031). It has an impact on many paragraphs, whether by recognition or measurement, and the arithmetic ranges between (3.746 - 3.365) and the lowest paragraph with an arithmetic mean (3.190). It is a heterogeneous mixture.

Table (2)
Analysis of Results

| Items | Stand. Dev. | Mean |
|---|---|---|
| The application of IFRS 9 Financial Instruments has no effect on net income | 1.015 | 3.746 |
| There is an impact of applying International Financial Reporting Standard No. 9 Financial Instruments on the opening balances of the retained earnings of banks listed on the Amman Stock Exchange. | 0.895 | 3.476 |
| Accounting for financial instruments under the standard is complex and difficult to implement. | 0.921 | 3.634 |
| The classification of financial assets contained in the standard depends on the intention of the management, which leads to the classification being based on the personal judgment of the management, which makes it difficult to achieve comparability, whether at the level of the bank itself across financial periods or between banks and each other. | 1.053 | 3.619 |
| Relying on mixed measurement in measuring the value of financial instruments, which makes it difficult to achieve compilation, as the financial statements under the standard will become a heterogeneous mixture. | 1.105 | 3.190 |
| The standard changed the categories of classification and measurement of financial assets, as it made the classification categories into two categories only. | 1.052 | 3.365 |
| The standard also specifies the basis for applying the business model and cash flow characteristics to financial assets to determine whether they are measured at depreciable cost or at fair value. | 1.162 | 3.492 |
| Standard No. 9 indicated that the embedded derivatives should not be separated if the host is an asset within the scope of the Standard, in addition to evaluating hybrid contracts that include one or more embedded derivatives as a single unit according to the terms specified by the Standard. | 0.927 | 3.413 |
| According to the standard, the impairment requirements were changed as the standard replaced the actual credit losses model, which existed under IAS 39, with the expected credit losses model. | 1.035 | 3.730 |
| It seeks to increase the use of fair value in the accounting measurement. | 3.943 | 4.031 |

To complete the study and test the hypothesis of the study variables, as shown in the table below:

Finally, the data of Table (3) shows the influence relationship between susceptibility, security, privacy and organizational effectiveness, and the data of this table indicate that the f-value of these variables is significant at the level (P<0.05) of 35.976, which indicates acceptance of the study hypothesis.

Table (3)
Hypothesis Testing

| | Model | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| Hypothesis | Regression | 7.446 | 1 | 7.446 | 35.976 | .000 |
| | Resi dual | 12.626 | 61 | .207 | - | - |

## CONCLUSION

Bank credit affects the level of the economy through its impact on the dimensions of growth. The prosperity of the economy depends on the growth achieved by the financial institutions operating in the country, and due to Iraq's adoption of the application of international accounting standards, so it became clear that there is an impact of the application of International Financial Reporting Standard 9 on the financial statements. Loan losses are one of the most important mechanisms used to reduce credit risk and preserve the bank's financial resources. The problem of recognizing expected credit losses, measuring them and accurately disclosing them is one of the most important accounting problems at the present time. In light of this, the International Accounting Standards Board issued the International Financial Reporting Standard (IFRS 9)., which is considered a fundamental accounting transfer in recognition, and there is no doubt that the application of this standard affects the financial performance of the banks, so it was necessary to shed light on the impact of the application of the standard and indicate its impact on the financial statements, recognition and indicators of the financial performance of the banks.

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