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EFFECT OF EXPECTED LOSSES MODEL IN BANKS' PERFORMANCE UNDER INTERNATIONAL FINANCIAL REPORTING STANDARD IN IRAQI BANKS (APPLIED STUDY)

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Abstract:

The research aimed to present the requirements of the International Financial Reporting Standard IFRS9, as well as to indicate the extent to which private Iraqi banks, the research sample adhere to the requirements of the content of the International Financial Reporting Standard IFRS9. In light of this, the research reached a set of conclusions, the most prominent of which is the need to apply the International Financial Reporting Standard IFRS9 financial instruments in the banks selected as the research sample, as well as the presence of great challenges facing banks in particular and economic units in general with regard to the substantial increases in credit risks with regard to the initial recognition of the application of expected credit losses According to the IFRS 9 standard, and that the application of the International Financial Reporting Standard IFRS9 achieves an increase in loan loss provisions that result in more useful provisions, especially when credit conditions deteriorate.

Keywords: Ecosystem Accounting, Environmental Costs, Reducing Environmental Costs

INTRODUCTION:

The provision for loan losses is also one of the most important mechanisms used to reduce credit risks and preserve the financial resources of banks. The problem of recognizing expected credit losses, measuring them and disclosing them accurately is one of the most important accounting problems that must be taken into consideration. Therefore, the International Accounting Standards Board headed towards issuing the standard. International Financial Reporting (IFRS9), which in turn is an essential accounting transfer in the recognition and measurement of expected credit losses by providing a methodology for recognizing expected losses under a new model based on future expectations, which is the expected credit losses model, and the purpose of loan loss provisions in financial reporting standards International Bank provides a guarantee to cover expected loan losses in the future, such as bankruptcy of debtors or other scenarios in which banks are unable to collect the full amount of the loan granted, of great challenges facing banks in particular and economic units in general with regard to the substantial increases in credit risks with regard to the initial recognition of the application of expected credit losses and the accumulated loan loss provisions must be reflected in the statement of financial position, which is called the loan loss provision, or future loan losses. estimated.

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THE FIRST TOPIC: RESEARCH METHODOLOGY:

1.1-Research Problem:

The research problem emerges from the weak commitment of the banks listed in the Iraq Stock Exchange to the requirements of the International Financial Reporting Standard IFRS9 and what it includes of the expected losses model, which reflects negatively on the quality of profits, and accordingly the research problem can be formulated by asking the following: Does banks' adoption of the expected losses model contained in IFRS9 in dealing with realized losses mislead the financial statements?, Does the application of the expected losses model contained in IFRS9 affect the quality of banks' receivables according to their total assets?

1-2 Research Importance:

The research derives its importance from studying the effect of applying the expected losses model according to IFRS9 on the allocation of loans in commercial banks due to the importance of this sector and its role in local economic life, as well as taking into account the importance of adopting the IFRS9 standard in general in the banking sector as one of the financial tools. Global profits for the purpose of achieving research hypotheses, as the financial statements will be for two different periods, and accordingly, the research objectives can be crystallized through the points that it seeks to achieve.

I.3 Research Objectives:

The objectives of the research can be crystallized through the points it seeks to achieve to Presentation of the requirements of the International Financial Reporting Standard IFRS9, Statement of the extent to which Iraqi banks comply with the requirements of the International Financial Reporting Standard IFRS9. And Measuring the effect of applying the expected losses model on the quality of profits in Iraqi private banks.

1.4 - Research Hypothesis

To achieve the research objectives, the following hypothesis was formulated: The application of the International Financial Reporting Standard IFRS9 in Iraqi banks contributes to increasing their ability to manage credit risks and to enhance the confidence of shareholders and depositors in a greater way.

I.5 Research population and sample:

The research community is represented by local Iraqi banks listed in the Iraq Stock Exchange and the sample was selected from the research community, in which non-performing loans are available, as the research sample included the Iraqi Trade Bank.

THE SECOND TOPIC: THE CONCEPTUAL FRAMEWORK OF THE STUDY

2-1 The concept of the expected losses model:

One of the main causes of global financial crises is the unjustified increase and inappropriate development of the financial instruments market. Most investors, due to incorrect evaluation and failure to disclose risks in a timely manner when dealing with financial instruments, these investors do not have real information about the true financial position of the invested companies. Since international financial reporting standards are in a state of constant change and updating. Besides, for example, the emerging adaptation of International Financial Reporting Standards to GAAP in the United States is also having an impact. (Dosmanbetova, et al.2020:206).

The management of the bank must take this into account when estimating the future loan loss. On the other hand, if the company is declared bankrupt a day after the submission of the final accounts to the bank, but before the issuance of the financial statements, the managers are not allowed to take the expected credit losses into account even if they are sure. of its existence. If the expected loan losses exceed the loan loss provision account of the bank, (El Diri et al, 2021: 3).

The purpose of loan loss provisions in the International Financial Reporting Standards IFRS is to provide a guarantee to cover expected loan losses in the future, such as bankruptcy of debtors or other scenarios in which the bank is unable to collect the full amount of the loan contract, such as sudden economic crises. Therefore, the accumulated loan loss provisions are supposed to reflect in the statement of financial position, which is called the estimated future loan loss provision. Here, banks must take the incurred loss model (Ozili.2019:5) .

As for what is the incurred loss model and loan loss provisions, it can be explained through the following example: If a large company with employees in a small town goes bankrupt a few weeks before submitting the final accounts to the bank, there may not be any defaulted loans yet, but the bank knows that A large part of them will default in the near future due to bankruptcy (Olszak & Świtała.2020:385).

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The concept of loan loss provisions does not exceed the fact that it is a relatively large accumulation of commercial banks, and these provisions have an important impact on the income and organizational capital of banks. The aim of these provisions is to adjust the loss of loans to bank savings in order to reflect an expected future loss on loan bonds. (Al-Hindi, 2015: 4).
While it was defined as a policy followed by commercial banks by allocating some funds (reserves) to face any possible default in loans, which in turn would help protect banks' positions in terms of profitability and capital (Nugroho,et.al,, 2021:102).

2-2 The main objectives of loan loss provisions:

Bank loan loss provisions have traditionally been estimated based on the ICL (incurred credit loss) model, according to which a loan loss allowance is created if there is objective evidence of impairment. (for example, as a result of one or more events that occur after the initial recognition of the asset with a negative impact on the expected future cash flows of the loans). However, the financial crisis generated a perception that the ICL model used in bank accounting standards often resulted in inadequate and timely provisioning (Ormazabal & Sakasai, 2020:10).
Loan loss provisions are an important component of the banking sector because they provide sensitive information to a wider audience. (Maphosa.2020:82) It consists in providing special information about the bank's future and tax reduction through profit management, organizational capital management, income and profit volatility level management, and avoiding fluctuations in risk-weighted assets, which in turn affect the bank's risks and profitability (Nugroho,et.al,, 2021:102).
Loan Loss Provisions Regulators and bank supervisors rely heavily on reported accounting amounts when calculating and monitoring the adequacy of banks' regulatory capital. In their view, loan loss provisions should cover expected credit losses in the future while regulatory capital should protect banks from unexpected losses (Jakubíková, 2022:10).
The recognition of loan loss provisions is based on expected credit losses. It went through two stages, the first within the International Accounting Standard 39IAS, so the provisions for loan losses are recognized only in the event that there is evidence of a decrease in the value of financial assets and after proving the existence of this decrease in value. By contrast, IFRS 9IFRS requires early recognition of credit losses that are expected to occur, without evidence, expressed as 12-month expected credit losses in Stage 1, or lifetime expected credit losses (Ozili & Adamu 2021:453).
Banks must provide sufficient loan loss provisions to cover expected losses in order to maintain the most important function of regulatory capital, which is to absorb unexpected losses from a possible range of loan loss estimates. Banks must record loan loss at the upper end of the estimates in their financial statements. If the bank loan loss provision is less than the expected losses, it will eventually reduce the bank's capital when realized. (Ejike, 2018:7).
The loan loss provision is also an important indicator of the safety of banks from a prudential regulatory perspective. The size of non-performing loans and the maintenance of sufficient loan loss provisions to mitigate their exposure to credit risk. (Ozili & Adamu, 2021: 2).

2-3 The expected loss model derived from the International Financial Reporting Standard IFRS9 :

Provisions for loan losses under IFRS 9 increase in a timely manner as the probability of default rises when the credit situation deteriorates. US GAAP and IFRS "incurred loss model" are used to determine provisions Loan losses. In short, the model states that an impairment of loans should be recognized when there is objective evidence of impairment due to an event occurring. When applying the E-LLM model, banks should evaluate their loan portfolios based on the expectation of cash flows for the following period and the goal is to build loan loss reserves during the period of economic growth in order to absorb losses in the economic downturn. However, E-LLM is criticized for these reasons: (Ellisson & Fredriksson.2014:6)

1. Reliance on management's judgment to estimate future cash flows.
2. Being less transparent, which allows concealing whether there is a deteriorating loan portfolio.

IFRS9 is applied retrospectively in accordance with International Accounting Standard IAS8 "Accounting Policies, Changes in Accounting Estimates and Errors" where the new requirements must be applied to economic operations and events as if these requirements were always in effect. The International Financial Reporting Standard IFRS9 includes specific requirements based on the impracticality of evaluation at the date of

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initial application, so the economic unit must use reasonable and supportive information available without undue cost or effort to determine credit risk at the date of initial recognition of the financial instrument. (Volarević & Varović 2018:272).

It should be noted that the IFRS9 International Financial Reporting Standard can be applied to all financial instruments that fall within the scope of the International Accounting Standard IAS39 "Financial Instruments: Recognition and Measurement", and there is no change with regard to the initial recognition, and the most important requirements for the application of the International Financial Reporting Standard IFRS9 can be summarized, so what The following: (Sánchez, 2018:78) .

All the efforts made by the International Accounting Standards Board and the American Financial Accounting Standards Board remain their commitment to achieving more comparability at the international level, especially in the field of accounting for financial instruments, and the application of IFRS9 requires the formation of much higher provisions than what is formed according to IAS39 as a result of relying on the estimation of losses Expected and not actual loans (Jakubíková, 2022: 4), which is expected to affect the level of profits, capital, capital adequacy index, and then the ability to lend. (Al Faiza, 2021: 57).

The application of IFRS9 requires the economic unit to evaluate all its financial instruments that will be affected by the measurement alternatives according to the new standard, which requires making adjustments to the accounting systems used in the economic unit, as well as the need to reclassify the financial assets that were prepared according to the FV principle from Through P&L for a classification prepared according to the amortized cost principle (Beerbaum, & Piechocki, 2016: 63).

THE THIRD TOPIC: APPLICATION SIDE FOR SEARCH:

3-1 Introduction to the research sample:

The Iraqi Trade Bank was established in July 2003 as an independent governmental entity for the purpose of facilitating the import and export of goods and services to and from Iraq to serve the national economy and rehabilitate the country after the end of the United Nations oil-for-food program and to meet the humanitarian needs of Iraq and rebuild the Iraqi economy and repair infrastructure and for other purposes related to For the benefit of the Iraqi people, taking into account the economic importance of trade in revitalizing the Iraqi economy and stimulating it to achieve long-term growth. In November of 2003, the bank began its work as an independent government bank with a capital of 1,100,000 million and one hundred thousand US dollars, and its paid-up capital increased as on 6/30/2016 to become 26,475,845,000,000 (twenty-six trillion, four hundred and seventy-five billion, eight hundred and forty-five Iraqi dinars). Al Iraqi Trading is one of the leading banks in the Middle East in the commercial and investment finance sectors. The Iraqi Trade Bank is the most experienced and trusted bank in the field of banking in Iraq, as it has achieved rapid growth since its inception to become one of the leading and active institutions in the banking sector. The bank has established a wide network of correspondent banks in the world and built strong relationships with international banks with an excellent reputation and according to the requirements of the banking process, as the number of correspondent banks reached more than.

From (428) banks located in (108) cities and covering (95) countries in the world, which provided it with real opportunities for global presence and competitive capabilities in providing various banking services.

The Iraqi Trade Bank achieved early successes, such as signing framework agreements with 26 international institutions to guarantee exports, in addition to that it was one of the first Iraqi banks to obtain credit lines from solid international banks with an excellent reputation, despite the lack of a credit rating for the State of Iraq, as this achievement is considered A great achievement in itself for the bank added to the list of important and strategic achievements.

3-2 Bank credit analysis:

Bank credit is considered an important stage of the most important stages of development of services provided by banks, and it is one of the most important revenues that are based on a study of the case of the credit applicant and ensuring the existence of sufficient guarantees in exchange for obtaining financing, as the credit process expresses the trust that arises between the credit payer and the credit recipient. It is necessary to know that the role of credit is important in the process of developing the national economy, we note that the amount of the loan provision did not change except in the year 2020

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above. We note that there has been no noticeable change compared to the previous years and the subsequent year of 2020, and this is an indication that the bank has adopted a credit policy that differs from the previous period.

Measuring bank credit risks: a reference to the instructions of the Central Bank, which stipulate the preparation of financial statements in accordance with the requirements of the International Financial Reporting Standard IFRS/IAS.

Schedule (1): Loans and provisions for loan losses for the Trade Bank of Iraq TBI research sample

Years	Loans (from statement of financial position) (Dinar)	Loan provision (from the income statement) (Dinar)
2014	2721658000	10547000
2015	4336761000	370605000
2016	4736528000	45000000
2017	5117138000	59114000
2018	5,157,252,000	295055000
2019	6695654000	45991000
2020	6015014000	1068034000
2021	5483087000	220230000

3-3 Measuring the credit losses of the Trade Bank of Iraq:

Expected credit losses are measured by applying the following formula:

ECL = %PD × EAD × LGD . Then: ECL: expected credit loss, PD: Probability of default, LGD: Loss Given Default Ratio

Measuring the probability of default (PD) probability of Default (Trade Bank of Iraq) for the period from 2014 to 2021:

Schedule (2): Measuring the probability of defaulting Trade Bank of Iraq)

Years	Loan amount	credit period*	Customer Expectation**(1)	Economic forecast***(2)	Probability of Default (PD) pd=1+2/12
2014	2721658000	5	0.65	0.60	0.7
2015	4336761000	4	0.65	0.60	0.7
2016	4736528000	15	1	0.95	1.08
2017	5117138000	5	0.65	0.60	0.7
2018	5,157,252,000	5	0.65	0.60	0.70
2019	6695654000	5	0.65	0.60	0.7
2020	6015014000	10	0.85	0.80	0.92
2021	5483087000	5	0.65	0.60	0.7

The table was prepared by the researcher based on the data of the Trade Bank of Iraq, where it represents the amount of loans granted multiplied by the percentages specified by the Central Bank of Iraq.The credit analysis shown in the Iraqi Trade Bank indicates that the rating grades, which start with a good rating on credit quality, and here the risk is very low according to the above table. As for the other ratings, they are average, below average, bad and losing, as they indicate a change in credit, that is, there is Fluctuations in credit risks may be medium or high risk, i.e. variable, or very high and lead to large losses.

For a table prepared by the researcher based on the data of the Trade Bank of Iraq, where the amounts

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represent the percentage of loans granted multiplied by the percentages specified by the Central Bank of Iraq and shown in Table No. (5) above. Through Table No. (2), we note that loan allocations according to the IFRS9 standard model of the Trade Bank of Iraq were within the percentages allowed by the Central Bank of Iraq, and they ranged between good and average during a period of eight years starting from the fiscal year 2014, and this indicates the bank's commitment to what it stated. in particular, and economic units in general, with regard to the significant increases in credit risk with regard to the initial recognition of the application of expected credit losses according to the IFRS 9 standard. The table for calculating the provision for credit losses according to the instructions of the Central Bank of Iraq, and this is a positive indicator that proves that the application of the standard IFRS9 is only a means to verify the ability of loan allocations that are allocated by banks.

And by applying the expected credit losses equation, which is ECL = PD % × EAD × LGD, the results showed that all years indicate that loan allocations were within the limits allowed by the Central Bank of Iraq and consistent with international financial reporting standards compared to the results of the equation, and this indicates that there is a great agreement between Local standards and international standards, and this indicates the bank's commitment to what it stated. in particular, and economic units in general, with regard to the significant increases in credit risk with regard to the initial recognition of the application of expected credit losses according to the IFRS 9 standard. The table for calculating the provision for credit losses according to the instructions of the Central Bank of Iraq and this gives a positive picture of the work of this bank above in the event of granting external or international credit.

Schedule (3): Comparison of allocations according to the Central Bank of Iraq and the EC

Year	The allocation is according to the percentage of the Central Bank of Iraq	allocated according to IFRS9	the difference	Increase (+) Decrease (-)
2014	10547000	28577409	-18030409	-
2015	370605000	203394091	167210909	+
2016	45000000	95147374	-50147374	_
2017	59114000	53729949	5384051	+
2018	295055000	270755730	24299270	+
2019	45991000	70304367	-24313367	_
2020	1068034000	492509346	575524654	+
2021	220230000	287862068	-67632068	_

The table was prepared by the researcher based on the data of the Trade Bank of Iraq and the application of the parties to the ECL equation for the purpose of making comparisons between loan loss provisions according to the Central Bank and IFRS7. When applying the expected credit loss model, it is clear from the above table that this bank has complied somewhat with the instructions of the Central Bank of Iraq, in particular, and economic units in general, with regard to the significant increases in credit risk with regard to the initial recognition of the application of expected credit losses according to the IFRS 9 standard which are generally consistent with international financial reporting standards, despite the discrepancy between the results of the years, and this does not mean that the bank is far from those standards, but because of the economic and political conditions that It has an important role in influencing the financial and banking environment because of the global complex financial links." From it, we can say that the goal of moving from accounting for incurred losses model to expected losses through IFRS9 financial reporting standard and bringing the accounting logic closer to the precautionary logic in order to minimize risks Possible, this principle provides the aspect of safety and enhances the confidence of depositors and shareholders more, and this proves the validity of the research hypothesis: (The application of the International Financial Reporting Standard IFRS9 in Iraqi banks contributes to increasing their ability to manage credit risks and enhance the confidence of shareholders and depositors more.

THE FOURTH TOPIC : CONCLUSIONS AND RECOMMENDATIONS:

4-1 Conclusions:

1. The Iraqi Trade Bank has not made any adjustments in the value of losses since the actual application in 2019.
3 The possibility of using the expected credit losses model by Iraqi banks due to the availability of all the information required for its application, provided that the disclosure of that information is in accordance with international financial reporting standards.
2. There are major challenges facing banks, in particular, and economic units in general, with regard to the significant increases in credit risk with regard to the initial recognition of the application of expected credit losses according to the IFRS 9 standard.
4 There are problems faced by Iraqi banks in applying expected credit losses according to IFRS 9 standard with regard to unstable economic conditions, especially those related to deflation and inflation, as there will be differences between provisions and depreciation of money.

4-2 Recommendations:

1. The need for banks, including the Iraqi Trade Bank and the Ashur International Bank (a private contribution), to develop and train human resources to use the expected credit losses model and to provide all the information required for its application.
2. The need for banks, including the Iraqi Trade Bank, to develop plans and procedures to face problems by applying expected credit losses in accordance with IFRS 9 standard with regard to unstable economic conditions, especially those related to deflation and inflation, as there will be differences between allocations and depreciation of money and within international financial reporting standards..
3. The need for banks, including the Iraqi Trade Bank, to make adjustments in the value of losses since the actual application in 2019.
4. The need for banks, including the Trade Bank of Iraq, to confront with regard to the substantial increases in credit risks regarding Initial recognition relates to the application of expected credit losses in accordance with the standard IFRS9.

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