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# The application of the expected losses model under the IFRS9 standard and its impact on the provision of loan losses in Iraqi banks

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**Abstract :** Credit activity is the backbone of banks, so it is important to analyze and study credit risks in order to hedge against possible losses as they affect the future performance of banks, and in this research we will use the International Financial Reporting Standard IFRS9 in measuring potential credit risks by applying the expected losses model (ECL (contained within IFRS9 according to scientific foundations).the research problem was represented in the questions(Does banks adoption of the expected loss model contained in IFRS9 in treating realized losses lead to misleading the financial statements? Does applying the expected loss model contained in IFRS9 affect the quality bank profits according to their total assets?

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 (Iraqi Trade Bank ) 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.

While the most important recommendations were that banks should develop plans and procedures to face problems by 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 and within international financial reporting standards, to In addition to the importance of setting a unified ratio for the provision for loan losses for the purpose of narrowing the gap in front of accounting policies that ultimately lead to a decrease in the quality of profits and moving away from managing profits

**Introduction**: Earnings are a critical indicator of the performance of companies, as all parties dealing with commercial banks rely on them for the purposes of making various investment decisions, and therefore the management has a strong motive to manipulate profits to influence the decisions of investors, so the need to provide more accurate information and the ability to determine the extent of potential borrowers To pay, and to confirm the quality of performance and the soundness of the financial position, and in the absence of approved mechanisms for calculating the risks related to future losses, this will lead to a failure to achieve the required transparency in order to manage risks, which leads to improper decisions. 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, to measure 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, 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..

## I. 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.

1. Applying the expected losses model according to IFRS9 on a sample of banks.
2. Determine the effect of applying the expected losses model according to IFRS9 on a sample of banks.

**I.3 Research Objectives**

The objectives of the research can be crystallized through the points it seeks to achieve :

1.Presentation of the requirements of the International Financial Reporting Standard IFRS9 .

2.Statement of the extent to which Iraqi banks comply with the requirements of the International Financial Reporting .
.Standard IFRS9.

.3.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 .

1. 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**

**I.5.1 Research Community**

The research community is represented by local Iraqi banks listed in the Iraq Stock Exchange .

**I.5.2 Research Sample**

The sample was selected from the research community, in which non-performing loans are available, as the research sample included the Iraqi Trade Bank.

**I.6 Research limits**

**I.6.1 partial Boundaries**

The applied side of the research was limited to the local environment, especially the Iraqi banking sector, by choosing (Trade Bank of Iraq)

**I.6.2 temporal limits**

The researcher relied on the data and information contained in the financial statements, the report of the auditor and the board of directors of the Trade Bank of Iraq for the years ranging from 2014 to 2021

**I.7 Sources of data and information collection**

The researcher relied on several means to obtain the necessary data and information to complete the research in both its theoretical and applied aspects, as follows:

**I.7.1 heoretical aspect**

The researcher adopted the deductive approach in supplementing the theoretical side by making use of the availability of Arabic and foreign references and literature, such as books, theses, university theses, and studies related to the subject of the research, including periodicals, articles, and research published on the Internet.

**I.7.1 he applied side**

The researcher relied on a number of means in achieving the applied side, as follows

1.The financial statements, board of directors reports, and auditors' reports for the selected bank, the research sample, for several years.

Information related to the bank, the research sample, which is issued by the Iraq Stock Exchange .

**8 -1previous studies**

**1-8-1 Local studies:**

| **I- 1- Study: (Yacob and Jasim, 2018)** | |
|---|---|
| Study Title | **Examining the impact of the transition to International Financial Reporting Standards (IFRS) on the banking sector in the Iraqi environment from a (qualitative and evaluative) perspective.** |
| Research problem | Examining the impact of the transition to International Financial Reporting Standards (IFRS) on the banking sector in the Iraqi environment from a (qualitative and evaluative) perspective |
| Purpose of the study | The study aimed to test the annual financial statements in the private banking sector listed in the Iraq Stock Exchange after the shift from accounting practices in accordance with the unified accounting system for banks and insurance companies to accounting practices in accordance with international financial reporting standards. Eh |
| The most important conclusions | The Iraqi environment is promising for development. It has taken upon itself the mandatory adoption of financial reporting standards in the private banking sector and in accordance with the instructions issued by the Central Bank of Iraq to keep abreast of developments in the international economic environment, which makes the outputs of financial reports prepared in the aforementioned sector capable of providing accounting information of high quality |
| The most important recommendations | Serious call by the authorities, associations and professional bodies in the Iraqi environment to compulsory adoption of international financial reporting standards for all sectors (companies) listed in the Iraq Stock Exchange |

## 1-8-2 Arabic studies:

| **1-(Study: (Suzy Abu Ali et al., 2011)** | |
|---|---|
| Study Title | **The impact of the quality of accounting profits on the cost of borrowing according to international financial reporting standards: an applied study on industrial and service public shareholding companies listed on the Amman Stock Exchange** |
| The research sample | The study population consists of Jordanian industrial and service public shareholding companies listed on the Amman Stock Exchange during 2007. The number of listed companies has reached (92) industrial companies and (110) service companies |
| Purpose of the study | It aims to identify the impact of the quality of accounting profits on the cost of borrowing for industrial and .service companies listed on the Amman Stock Exchange |
| The most important conclusions | There is an effect of the quality of accounting profits on the cost of borrowing, and the results indicated that there is an effect of the characteristics of accounting profits individually on the cost of borrowing, with the exception of smoothing accounting profits. |
| The most important recommendations | The results of the study revealed, however, that the quality of accounting profits differs according to the measurement method used, as the estimators of the quality of accounting profits must use more than one characteristic in accounting profits to judge the relevance and reliability of accounting information. |

## 3-8-1
## foreign studies

| **1- Study (Ormazabal, et al. 2020)** | |
|---|---|
| Study Title | **SWITCHING FROM INCURRED TO EXPECTED LOAN LOSS PROVISIONING: EARLY EVIDENCE**<br>**Conversion from provision for incurred to expected loan losses: early evidence** |
| Search target | This paper provides early evidence of the impact of global regulation mandating a shift from a loan loss allowance (LLP) based on incurred credit losses (ICL) to an LLP based on expected credit losses (ECL ). |
| The most important conclusions | We found that the greater effect on loan loss provisions results in lower equity returns, higher changes in CDS spreads, and higher changes in bid and ask spreads. Crucially, these patterns are most pronounced when credit conditions deteriorate. Finally, we also find evidence that as credit conditions deteriorate, a rule change causes provisions to increase and credit to contract. Our study contributes to the debate on the effect of the ECL model on procyclical activity, which is a particularly pressing issue in the context of the current pandemic. |

## II. The conceptual framework of the study
## II.1 The concept of international financial reporting standards IFRSs

International Financial Reporting Standards have gained general acceptance around the world, considering that their application is one of the most important indicators that enhance the quality and transparency of financial statements

and reports through their qualitative characteristics of accounting information, and this would maximize the benefit of users of accounting information. (Rashwan and Shaqfa, 2022, 350).
The International Financial Reporting Standards (IFRSs) are referred to as "guiding rules that professionals consider as a source of support for their judgments and inspiration for their wisdom, although they are rules that do not cancel wisdom and diligence, and the IFRSs are a professional description of generally accepted professional practices and their aim is to reduce the degree of difference in expression and practice in Similar circumstances as well as being adopted as a general framework for evaluating the efficiency and quality of professional work to determine the nature and depth of professional responsibility. (Muhammad and Bejay, 2021, 27)
The International Accounting Standards Board has indicated in its publication regarding the considerations that must be taken into account when accounting for expected credit losses in accordance with the requirements of the International Standard for Financial Instruments (IFRS9) under conditions of uncertainty, as the Board confirmed that the standard requires pre-calculation and recognition of expected credit losses when an increase occurs. In the level of credit risk on financial instruments instead of calculating it at the time of incurring it or at the time of financial default (Beerbaum & Ahmad, 2015: 5), but it did not explain specifically when it is necessary to recognize losses over a lifetime, nor did it stipulate the basis on which future estimates should be determined When forecasting expected credit losses. (Muhammad and Bejay, 2021, 27)

The IASB indicated that expected credit losses should be recognized based on information about past and current economic events, taking into account expected future events when measuring credit losses on the basis of probability of occurrence, and the IFRS9 standard requires banks to follow an approach by which expected credit losses are determined under different circumstances. Nor should it continue to automatically apply its current approach to calculating expected credit losses. (Rashwan and Shaqfa, 2022, 346-347)

**II.2 Requirements for applying the International Financial Reporting Standard IFRS9**

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 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: (Mohsen, 2022:5158)
Most of the requirements of International Accounting Standard 39IAS related to the classification and measurement of financial liabilities are transferred to IFRS9 without any changes, as most of the obligations in Standard 39IAS are measured at amortized cost, or are divided into the basis of contracts that are measured at amortized cost, and embedded derivatives that are measured in terms of value For obligations held for trading purposes, and all derivative obligations are measured at fair value, hence it can be said that the International Financial Reporting Standard IFRS9 did not cancel all classification and measurement requirements of International Accounting Standard 39 IAS, especially those related to financial liabilities, instead the financial reporting standard was based on the International Financial Reporting Standard IFRS9 has become part of it, and it is certain that the International Financial Reporting Standard IFRS9 did not start from scratch, but is rather an evolution and modernization of the International Accounting Standard 39IAS
For unquoted equity investments consistent with the requirements set out in the standard for an unquoted equity instrument, which are settled by such delivery under IAS 39, these derivatives are measurable and should be measured at cost, while IFRS9 has replaced them with a measurement of fair value

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-Sayed and Al-Shuraidi, 2019: 57)
(Sayed and Al-Rashidi) indicated that 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 fair value principle from Through profits and losses for a classification

prepared according to the amortized cost principle (Al-Sayed and Al-Rashidi, 2019: 63)

**II.3 <u>The objective and scope of the International Financial Reporting Standard IFRS9</u>**

The IFRS9 standard was issued entitled - Financial Instruments: Measurement and Recognition in response to the criticism directed at the IAS39 standard, which was the cause of the occurrence of the global financial crisis as a result of its delay in recognizing loan losses until after verification and the actual occurrence of credit losses, while IFRS9 tended towards calculating loss provisions according to expectations of a financial default or Inability to pay (Abdrashitova, 2022: 9)

The objective of the International Financial Reporting Standard IFRS9 is to reduce the problems and criticisms that accompanied the application of IAS39 by setting principles for preparing financial reports related to financial assets and liabilities with the aim of providing appropriate information for users of financial statements to assess doubts related to estimating the amounts, timing and extent of certainty of future cash flows achieved on assets Financial and in line with the needs of different users of financial reports (Fatlawi, 2022: 5652), as the most comprehensive change according to IFRS9 represented the replacement of the incurred credit losses model according to IAS39, which was severely criticized as it is moving towards measuring and recognizing credit losses after their occurrence with the expected losses model, which Under which credit default provisions are created upon initial recognition of financial assets (or when credit or guarantee is first committed) based on current expectations of potential (future) credit defaults (Beerbaum & Piechock, 2016: 6)

IFRS9 has strengthened the principle of financial hedging, credit risk management, and how accounting treatments for financial assets and liabilities are disclosed in financial reports through the following: (Badri & Badri, 2022: 6)

1-Classifying and measuring financial assets at fair value, which is the original, or at amortized cost in cases of exception, according to the business model of the establishment for managing financial assets

2-Requirements for reclassifying financial assets and how to recognize and derecognise financial assets and liabilities

3-How to measure financial instruments upon initial recognition at fair value

4-Measurement of assets in subsequent periods according to the fair value method through other comprehensive income and fair value through profit and loss in addition to the amortized cost

5-Accounting for expected credit losses as a result of the decline in the value of financial instruments

6-Hedge accounting requirements and the conditions and mechanisms for calculating them, whether for financial assets or liabilities, with an indication of the types of hedging relationships, such as fair value hedging, cash flow hedging, and net investment in foreign operations

7-Requirements for measuring derivatives incorporated in contracts

With regard to the scope of IFRS9, what distinguishes it most is that it is available for application to all economic units and various financial instruments, except for what is required to apply another standard to it, as IFRS9 covered all items that came within IAS39 “Financial Instruments Measurement and Recognition” and exceeded that to include fixed assets in addition to financial liabilities And the IASB confirmed that IFRS9 includes the following: (Al-Saeed, 2020: 145-146)

1-Loans and various credit facilities

2-All financial instruments recognized at amortized cost

3-Debt instruments recorded at fair value through other comprehensive income

4-Financial guarantee contracts

5-Loan linkage

6-Debit balances that are not measured at fair value

7-Acceptance bills and confirmed import credits included in the contingent liabilities

Excluded from the scope of IFRS9 are deposits with banks that mature within a month or less from the date of the financial position, current accounts with banks, and balances with the Central Bank in local currency

**First**: The accounting treatment of financial assets according to IFRS 9: Any contract that leads to the emergence of a financial asset for the economic unit leads at the same time to the emergence of a financial liability or an equity instrument, and the economic unit must recognize the financial asset in its statement of financial position when the economic unit becomes a party to the texts. contractual transactions of the financial instrument, provided that purchases and sales are recorded using the transaction history.

)Represents the date on which the economic unit is committed to buying or selling a financial asset) (Ihab and Yaqoub, 2020: 127) and accounting for the transaction date includes recognition of an asset that will be received or a liability that will be paid in exchange for that asset, or the settlement date as a basis for recognition and evidence in the books where it represents ( The date on which the asset will be transferred to the economic unit or on which the economic unit will transfer a specific asset to others, and a specific asset will be recognized on the date it is received by the economic unit). (Tariq, 2017: 104-105) (

- Financial assets that are measured later when preparing the financial statements at amortized cost. To clarify, these assets must meet two conditions.

✓ To keep the financial asset within a business model that aims at financial assets in order to collect the contractual cash flows.

✓ Contractual cash flows represent specific cash flows on certain dates.

- Financial assets that are measured at fair value, which are: (Ehab and Jacob, 2020: 126)

✓ Either through profit and loss: it represents assets that are not measured at amortized cost or through other comprehensive income such as financial assets held for trading purposes and financial assets that the unit evaluates on the basis of fair value to maximize cash flows when sold and financial assets that do not collect cash flows an integral part of achieving the goal of the business model،

✓ Or through other comprehensive income: It consists of indebtedness investments that meet the contractual cash flow test and that the business model of the economic unit maintains for collection or for sale.

As the above categories are classified upon acquisition and when the economic unit becomes a party to the contract, IASB has developed two approaches to determine the classification and measurement of financial assets, according to the following: (Ihab and Yaqoub, 2020: 127)

•The establishment's business model for managing financial assets: that is, the method in which the economic unit manages its assets in order to generate cash flows to preserve the time value of money and avoid credit risks, including borrowing risks. (Faiza, 2021: 145)

•The contractual cash flow characteristics model of the financial asset: where the financial asset generates cash flows on specific or identifiable dates, such as bonds, and with regard to canceling the classification of assets, IFRS 9 adopted this method and according to the two conditions below:

✓ Testing the business model when the objective of acquiring a debt instrument is to obtain its nominal value

✓ Test cash flow characteristics: When a debt instrument is given a contractual right to receive cash flows

After the initial recognition of the financial assets and the preparation of the financial statements, the subsequent measurement of the financial assets is carried out in accordance with IFRS9, either at fair value or at amortized cost, according to the initial classification of the asset, as follows: (Barnoussi et. al., 2020, 181)

A- Recognizing the differences in the evaluation of financial assets when preparing the financial statements:

✓ Financial assets that are measured at fair value: they must be measured at fair value when preparing the financial statements, showing the evaluation differences within the profits and losses (income statement.(

✓ Financial assets measured at amortized cost: They are measured at cost with amortization of the premium or discount according to the effective (real) interest method, and then the profits or losses of the financial asset measured at amortized cost are recognized in the profit and loss account when the financial asset is derecognised or decreased.

B- Investing in equity instruments (stocks) and recognizing valuation differences: Financial investments in equity should be measured at fair value through profit and loss when preparing financial statements, as follows: (Al-Dulaimi et al., 2022: 181)

✓ Financial assets at fair value through profit and loss: These include investment in shares held for trading purposes or any investments in shares for non-trading purposes.

✓ Financial assets at fair value through other comprehensive income: These include investment in shares that are not held for trading purposes and the economic unit decided, since its acquisition, to address the fair value valuation differences for them.

**II.4The concept of the expected losses model**

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.2019:2)

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). 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, an increase in the provision is made by increasing the loan loss provision for the specified period. When loan loss provisions increase, they reduce net income, which means that an expected credit loss is recognized in the period in which it occurred. On the income statement, the loan loss allowance is a non-cash expense account, which reduces reported income. In the statement of balance, loan loss provisions are aggregated and presented as loan loss allowance with a deduction for net amounts written off and others. (El Diri et al, 2021: 3)

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 Generally Accepted Accounting Principles in the United States is also having an impact. Changing or replacing a standard is very laborious and therefore not quick. This adaptation requires professional accountants qualified in accounting by standards. The reason for this is that there is a fact that must be recognized, which is that there are international financial reporting standards that require the evaluation of certain events related to the financial statements, while trained accounting staff in countries with economies based on planning and detailed regulations do not have experience in evaluating accounting events. (Dosmanbetova) et al.2020:206(

The financial sector is considered one of the most important sectors worldwide because of its impact on national economic growth and the development of public business by providing financial facilities to all economic institutions and individual investors, and creating a more stable financial system. Therefore, credit losses play a central role in assessing risks and stability in banks and have great economic importance because credit loss is often the main cause of bank failure. (Al-Hanandeh et al. 2020:95)

The mandatory implementation of international financial reporting standards depends on the fact that they are of high quality and contribute to a more quality and reliable representation of the financial position of companies and economic units. One of the main contributions is to reduce corporate profit manipulation, which is a widespread phenomenon that distorts the true financial position of companies and leads to wrong decisions by stakeholders, such as investors. (Eriotis et al, 2019:30)

Financial stability is very important for all countries because it is linked to the effective functioning of the market economy. A stable situation in the financial system becomes mandatory to make rational decisions to allocate resources and improve the investment climate for any country, as indicated (Crockett, 1997) that the proposed financial stability refers to the smooth functioning of the markets that create the financial system. MacFarlane (1999) added financial stability as avoiding financial crisis, which financial crisis is a more modern term to describe bank panics, bank runs, and bank collapses. It defines and can define financial stability as the ability to facilitate and improve economic operations and risk risks. It considers and absorbs shocks. Financial stability is a continuum that may change over time and correspond to a set of constituent elements of finance. (Nugroho et al. 2021:99) In general, it is likely that The IFRS9 expected credit loss approach significantly improves the timing and scale of credit loss recognition, which brings important benefits from a financial stability point of view. (Sánchez.2018:83)

Many previous studies such as (Loew et al., 2019) and (Ernst & Young, 2018) confirmed that the application of the IFRS9 standard will lead to a significant increase in bank credit loss provisions, and the study (Abad and Suarez.2017) also confirmed that the IFRS9 model The expected credit loss (ECL) defined in IFRS9 is more responsive to changing economic conditions, compared to the model (IAS 39IAS). Therefore, the application of the IFRS9 standard will contribute to increasing capital more during periods of economic expansion, and less during periods of contraction due to the impact of expectations on expected losses and thus on provisions. (Al-Sakini & Qatewneh, 2021:1902)

The size of loan loss provisions included in the banks' financial statements can have indicative effects on the quality of the banks' assets. (Ozili.2019:2), and (Beatty & Liao, 2011) considered in their study that loan loss provisions are one of the most important receivables in banks, and they mainly arise from expected loan losses and the great appreciation enjoyed by bank managers in determining the size of loan loss provisions estimates if Understanding how banks' loan-loss provisions interact with uncertainty in economic policy is important because banks have a critical role in providing credit to the domestic economy and any over-provisioning can dampen bank lending, profitability, and economic growth. (Öztürk & Ozili.2012:924)

Accounting estimates and their widespread use when preparing financial statements is not new, but what is new is their increased use due to the tendency of standards setters towards accounting on the basis of fair value when preparing financial statements, which are based on accounting assessment. One of the aspects of accounting estimates is the delay in recognizing expected losses, which is a manifestation of Manifestations of opportunistic behavior of loan allocations that lose the transparency of banks and increase the uncertainty of investors about the banking foundations, which makes the financial statements misleading. (Abdul Dayem, 2021: 553)

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. (Alhadab & Alsahawneh, 2016:243)

a- Expected credit loss (ECL) can be referred to as the calculation of the present value of the amount expected to be lost on a financial asset, for financial reporting purposes. Implementing the IFRS9 expected loss model is a challenge for many companies. It provides a model for measuring the new impairment under IFRS9 Provisions for Expected Credit Losses and that the implementation of the equation if it is necessary to collect economic unit data related to customers and details of receivables and guarantees, group them into appropriate risk groups (if possible) and supplement them with external data on ratings and probability default, all information is present to measure expected losses. To do this, the formula is then applied which is: ECL = EAD * PD * LGD . (Loew et al., 2019), and expected credit losses are measured according to the following equation:

ECL = %PD × EAD × LGD

Where the terms included in the above equation refer to the following:

- Expected Credit Losses (ECL)
- Probability of default (PD): It is a credit risk that gives a measure of the probability that the borrower's will and identity will not be fit to fulfill his obligations.
- یExposure At Default (EAD): It represents the total value to which the bank is exposed when the loan defaults.
- Losses given default: The estimated amount of money that a bank or other financial institution loses when a borrower defaults on a loan. LGD is depicted as a percentage of total exposure at the time of default or a $1 value of potential loss. Total debt risk to a financial institution is calculated after reviewing all outstanding loans using accumulated losses and exposure.

**II.5 The main objectives of loan loss provisions**

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. Loan Loss Provisions (Alhadab & Alsahawneh, 2016:243) 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 (Gebhardt & Novotny, 2018:10)

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)

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 in Stages 2 and 3 in the event of a deterioration. Large expected credit quality tool.( 453 Witzany.& Pastiranová 2021)

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 )

**II.6 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. (Sy&Petitjean, 2016:80) 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. (Ellisson & Fredriksson.2014:6) 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: (Elnahass & Steele.2018:8)

•Reliance on management's judgment to estimate future cash flows.

• Being less transparent, which allows concealing whether there is a deteriorating loan portfolio.

**III- <u>The practical side</u>**

**III- 1<u>Trade Bank of Iraq</u>**

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.

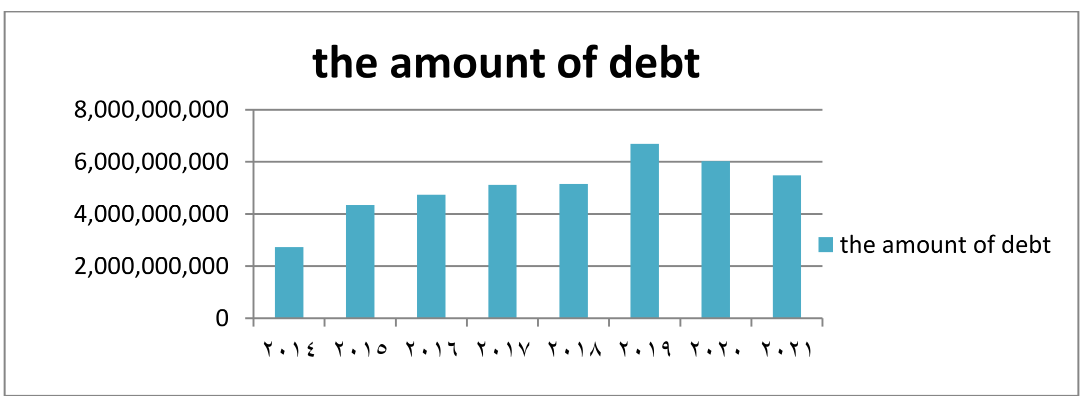
The Iraqi Trade Bank achieved early successes, such as signing framework agreements with 26 international institutions to guarantee exports, in addition to that it was one of the first Iraqi banks to obtain credit lines from solid international banks with an excellent reputation, despite the lack of 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.

III-3 **<u>Bank credit analysis</u>**

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 (the bank) and the credit recipient (The customer) It is necessary to know that the role of credit is important in the process of developing the national economy, and the following is a chart showing the amount of credit granted during the selected period 2014/2021

1) The amount of credit granted by the Trade Bank of Iraq for the period from 2014 to 2021

Figure No. (1)
Loans granted by the Trade Bank of Iraq for the period from 2014-2021



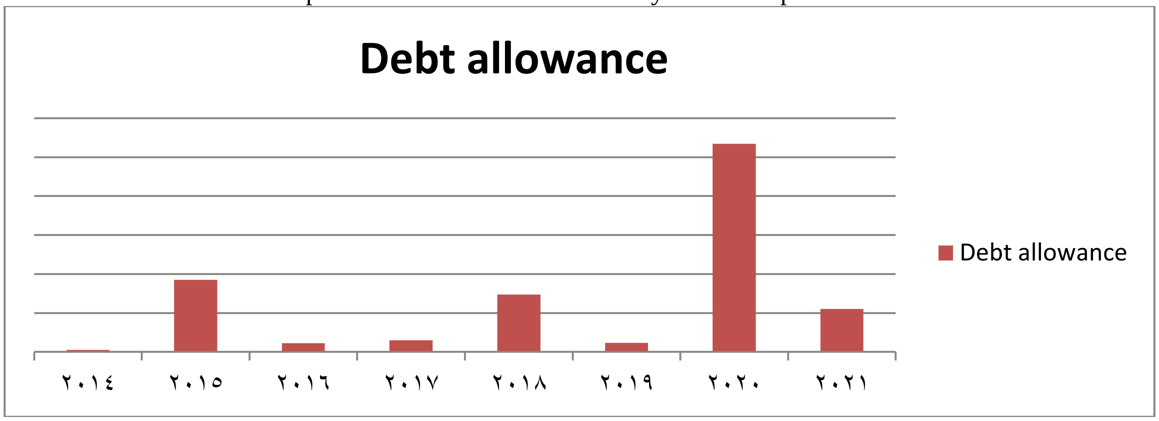

Source: Prepared by the researcher based on the financial statements from 2014 to 2021 for the above bank.

From the above figure, we note that the majority of the granted loans are similar in terms of the amounts granted, except for the year 2016, when it reached (47,365,280,000) billion dollars. Here we note that the bank enjoys high liquidity compared to previous years, which were within the range of six billion and five billion. This indicates that this bank has a political Credit and high quality in granting credit.

2) The allocation of loans granted to the Trade Bank of Iraq for the period from 2014 to 2021

Figure (2)

The amount of the provision for debt losses for the year for the period from 2014 to 2021




Source: prepared by the researcher based on the financial statements for the period 2014 to 2021 for the above bank

Through the above figure, we note that the amount of the loan provision did not change except in the year 2020 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.

-3-3Measuring 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

Loans and provisions for loan losses for the Trade Bank of Iraq TBI

**Schedule (1)**

| the years | (Loans (from statement of financial position (Dinar) | (Loan provision (from the income statement (Dinar) |
|---|---|---|
| 2014 | 2,721,658,000 | 10,547,000 |
| 2015 | 4,336,761,000 | 370,605,000 |
| 2016 | 4,736,528,000 | 45,000,000 |
| 2017 | 5,117,138,000 | 59,114,000 |
| 2018 | 5,157,252,000 | 295,055,000 |
| 2019 | 6,695,654,000 | 45,991,000 |
| 2020 | 6,015,014,000 | 1,068,034,000 |
| 2021 | 5,483,087,000 | 220,230,000 |

- 4-3Measuring the credit losses of the Trade Bank of Iraq

Expected credit losses are measured by applying the following formula:

ECL = %PD × EAD × LGD

1) ECL: expected credit loss

2) PD: Probability of default

3) EAD: credit exposure at default

4)LGD:: Loss Given Default Ratio

A- 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)

| the years | Loan amount | credit period* | Customer Expectation**(1) | Economic forecast***(2) | Probability of Default (PD) pd=1+2/12 |
|---|---|---|---|---|---|
| 2014 | 2,721,658,000 | 5 | 0.65 | 0.60 | 0.7 |
| 2015 | 4,336,761,000 | 4 | 0.65 | 0.60 | 0.7 |
| 2016 | 4,736,528,000 | 15 | 1 | 0.95 | 1.08 |
| 2017 | 5,117,138,000 | 5 | 0.65 | 0.60 | 0.7 |
| 2018 | 5,157,252,000 | 5 | 0.65 | 0.60 | 0.70 |
| 2019 | 6,695,654,000 | 5 | 0.65 | 0.60 | 0.7 |
| 2020 | 6,015,014,000 | 10 | 0.85 | 0.80 | 0.92 |
| 2021 | 5,483,087,000 | 5 | 0.65 | 0.60 | 0.7 |

*Credit term: from the bank's management data above.
**Customer expectation: It is estimated by the senior managements of banks and related departments
***Economic forecast: It is estimated by the senior management of banks and related departments

**Schedule (3)**

Schedule for calculating the provision for credit losses according to the instructions of the Central Bank of Iraq

| credit rating | approved ratio |
|---|---|
| Good | %2 |
| Middle | %10 |
| Mediocre | %25 |
| Poor | %50 |
| Loser | %100 |

B - Measuring the credit exposure at default (EAD) Exposure At Default of the Trade Bank of Iraq for the period from 2014 to 2021.

**Schedule (4)**

credit exposure at default (EAD(

Iraqi Trade Bank

Exposure At Default for the period from 2014 to 2021

| the years | loans | good 2% | average 10% | below average 25% | poor50% | Loser 100% |
|---|---|---|---|---|---|---|
| 2014 | 2,721,658,000 | 54,433,160 | 272,165,800 | 680,414,500 | 1,360,829,000 | 2,721,658,000 |
| 2015 | 4,336,761,000 | 86,735,220 | 433,676,100 | 1,084,190,250 | 2,168,380,500 | 4,336,761,000 |
| 2016 | 4736528000 | 94,730,560 | 47,365,280 | 1,184,132,000 | 2,368,264,000 | 4,736,528,000 |
| 2017 | 5,117,138,000 | 102,342,760 | 511,713,800 | 1,279,284,500 | 2,558,569,000 | 5,117,138,000 |
| 2018 | 5,157,252,000 | 103,145,040 | 515,725,200 | 1,289,313,000 | 2,578,626,000 | 5,157,252,000 |
| 2019 | 6,695,654,000 | 133,913,080 | 669,565,400 | 1,673,913,500 | 3,347,827,000 | 6,695,654,000 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **2020** | **6,015,014,000** | **120,300,280** | **601,501,400** | **1,503,753,500** | **3,007,507,000** | **6,015,014,000** |
| **2021** | **5,483,087,000** | **109,661,740** | **548,308,700** | **1,370,771,750** | **2,741,543,500** | **5,483,087,000** |

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 and shown in Table No. (8) above.

The credit analysis shown in Table No. (4) of 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.

**Schedule (5)**

Comparison table of the provision for credit losses under the instructions of the Central Bank of Iraq for the period From 2014 to 2021

| Years | Good | Average | **mediocre** | **poor** | **Loser** | **Evaluation** | **The allocation according to the Iraqi Bank** |
|---|---|---|---|---|---|---|---|
| 2014 | 54433160 | 272165800 | 680414500 | 1360829000 | 2721658000 | Good | 10,547,000 |
| 2015 | 86735220 | 433676100 | 1084190250 | 2168380500 | 4336761000 | middle | 370,605,000 |
| 2016 | 94730560 | 473652800 | 1184132000 | 2368264000 | 4736528000 | Good | 45,000,000 |
| 2017 | 102342760 | 511713800 | 1279284500 | 2558569000 | 5117138000 | Good | 59,114,000 |
| 2018 | 103145040 | 515725200 | 1289313000 | 2578626000 | 5157252000 | middle | 295,055,000 |
| 2019 | 133913080 | 669565400 | 1673913500 | 3347827000 | 6695654000 | Good | 45,991,000 |
| 2020 | 120300280 | 601501400 | 1503753500 | 3007507000 | 6015014000 | middle | 1,068,034,000 |
| 2021 | 109661740 | 548308700 | 1370771750 | 2741543500 | 5483087000 | middle | 220,230,000 |

For a table prepared by the researcher based on the data of the Trade Bank of Iraq, where the amounts represent the percentage of loans granted multiplied by the percentages specified by the Central Bank of Iraq and shown in Table No. (5) above.

**-Case Analysis**:

Through Table No. (5), 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. 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.

**C**- Calculating the percentage of loss given default LGD for the period from 2014 to 2021 for the Iraqi Bank

**Schedule (6)**

Losses given default (LGD) for the period from 2014 to 2021

| **the years** | **loans** | **credit term** | **Paid installments** | **remaining installments** | **LGD=1-(1/2)** | **Percentage/12 months** |
|---|---|---|---|---|---|---|
| 2014 | **2,721,658,000** | **5** | **544,331,600** | **2,177,326,400** | **75%** | **6.25%** |
| 2015 | **4,336,761,000** | **4** | **1,084,190,250** | **3,252,570,750** | **67%** | **5.56%** |

| | | | | | | |
|---|---|---|---|---|---|---|
| 2016 | **4,736,528,000** | **15** | **315,768,533** | **4,420,759,467** | **93%** | **7.74%** |
| 2017 | **5,117,138,000** | **5** | **1,023,427,600** | **4,093,710,400** | **75%** | **6.25%** |
| 2018 | **5,157,252,000** | **5** | **1,031,450,400** | **4,125,801,600** | **75%** | **6.25%** |
| 2019 | **6,695,654,000** | **5** | **1,339,130,800** | **5,356,523,200** | **75%** | **6.25%** |
| 2020 | **6,015,014,000** | **10** | **601,501,400** | **5,413,512,600** | **89%** | **7.41%** |
| 2021 | **5,483,087,000** | **5** | **1,096,617,400** | **4,386,469,600** | **75%** | **6.25%** |

The table was prepared by the researcher based on the data of the Trade Bank of Iraq and the application of the LGD equation parties by dividing the paid premiums on the remaining sections and according to the equation.

Case Analysis: Through Table (6), we note that theoretically, LGD is defined as the main component of the expected loss of the credit portfolio, which is essential for credit risk management and that the loss in case of default (LGD) for bank loans as a function of Loan guarantee. Collateral values is that collateral values can be negative, resulting in LGD values greater than one and further complicating the determination of portfolio losses. Here we find that all the loss percentage assuming default did not exceed 10%, and this is evidence that the financial statements were prepared in accordance with the requirements of international financial reporting standards

H- Applying the equation ECL = PD % × EAD × LGD for the purpose of measuring the expected credit losses of the Iraqi Trade Bank for the period from 2014-2021, and this is done through table (7)

**Schedule (7)**

Apply the equation ECL = PD % x EAD x LGD

| ECL | LGD | EAD | PD % | السنوات |
|---|---|---|---|---|
| 28,577,409 | **75%** | 54433160 | **0.7** | 2014 |
| 203,394,091 | **67%** | 433676100 | **0.7** | 2015 |
| 95,147,374 | **93%** | 94730560 | **1.08** | 2016 |
| 53,729,949 | **75%** | 102342760 | **0.7** | 2017 |
| 270,755,730 | **75%** | 515725200 | **0.7** | 2018 |
| 70,304,367 | **75%** | 133913080 | **0.7** | 2019 |
| 492,509,346 | **89%** | **601,501,400** | **0.92** | 2020 |
| 287,862,068 | **75%** | 548308700 | **0.7** | 2021 |

The table was prepared by the researcher based on the data of the Trade Bank of Iraq and the application of the sides of the equation ECL by multiplying the outputs of the sections of the equation.

**- Case Analysis:**

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 gives a positive picture of the work of this bank above in the event of granting external or international credit.

**Schedule (8)**

Comparison of allocations according to the Central Bank of Iraq and the EC

| the year | The allocation is according to the percentage of the Central Bank of Iraq | allocated according to IFRS9 | the difference | |
|---|---|---|---|---|
| 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

**- Case Analysis**:

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, 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.

**conclusions**

1. 11The Iraqi Trade Bank has not made any adjustments in the value of losses since the actual application in 2019.
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.

3 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 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.

**Recommendations**

1. The need for banks, including the Iraqi Trade Bank, to make adjustments in the value of losses since the actual application in 2019.
2. 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.
3. 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..
4. -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.

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