STAFF PAPER

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IASB® meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs*® Standard**
Paper topic	**Towards an Exposure Draft—IFRS 9 *Financial Instruments* (Impairment of Financial Assets)**
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Introduction

1. This paper discusses whether to incorporate an expected credit loss model in Section 11 *Basic Financial Instruments* of the *IFRS for SMEs* Standard to align with IFRS 9 *Financial Instruments.*

2. In this paper, the term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Standard.

Purpose of the paper

3. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to continue its discussion from December 2021 on whether, and if so how, to incorporate an expected credit loss model in Section 11 of the *IFRS for SMEs* Standard to align with the simplified approach in IFRS 9.

Summary of the staff recommendations

4. The staff recommend the IASB:

   (a) retain unchanged the incurred loss model in Section 11 of the *IFRS for SMEs* Standard for trade receivables and contract assets within the scope of Section 23 *Revenue* of the *IFRS for SMEs* Standard;

   (b) propose amendments to Section 11 to require an SME to use an expected credit loss model for all other financial assets measured at amortised cost; and

   (c) retain unchanged the requirements in Section 11 for impairment of equity instruments measured at cost.

Structure of the paper

5. This paper is structured as follows:

   (a) background (paragraphs 7–22 of this paper);

   (b) staff analysis (paragraphs 23–46 of this paper);

   (c) staff recommendation and question for the IASB (paragraph 47 of this paper); and

   (d) next steps (paragraph 48 of this paper).

6. Appendices to this paper include:

   (a) Appendix A—extract from the Request for Information *Comprehensive Review of the IFRS for SMEs Standard* (Request for Information), published in January 2020, on aligning the *IFRS for SMEs* Standard with the simplified approach in IFRS 9; and

   (b) Appendix B—staff draft of an expected credit loss model for SMEs.

Background[1]

7. This section covers the following background information from the December 2021 IASB meeting:

   (a) feedback on the Request for Information;

   (b) feedback from preparer interviews;

   (c) alternatives presented by the staff; and

   (d) IASB discussion.

Feedback on the Request for Information

8. Question S3B of the Request for Information asked for views on aligning the *IFRS for SMEs* Standard with the simplified approach that applies to trade receivables, contract assets and lease receivables in IFRS 9. The simplified approach in IFRS 9 requires the loss allowance to be measured at an amount equal to lifetime expected credit losses. Appendix A to this paper explains the IASB's reasons for asking this question.

9. At the December 2021 IASB meeting, the staff presented the feedback on Question S3B. Overall, respondents expressed mixed views. While there was some support for alignment with the simplified approach in IFRS 9, there were also calls for the simplified approach in IFRS 9 to be further simplified. Some respondents suggested that SMEs measure expected credit losses based on management's 'best estimate' of contractual cash flows less expected cash flows (best estimate approach) instead of considering a weighted probability of a range of possible outcomes. In addition, some respondents suggested including illustrative examples in the *IFRS for SMEs* Standard. However, other respondents disagreed with alignment, and expressed concerns that an expected credit loss model would be difficult for SMEs to apply and would impose undue cost or effort on them.

10. Based on the feedback on the Request for Information, the staff's preliminary thoughts were the IASB should undertake additional work to understand the practical challenges associated with implementing or applying the simplified approach to

[1] For more detail see Agenda Paper 30D *Towards an Exposure Draft—IFRS 9* Financial Instruments *(impairment of financial assets)* for the December 2021 IASB meeting and the IASB discussion on that paper.

decide whether further simplifications should be considered. SMEIG members also supported this action.

Feedback from preparer interviews

11. The staff interviewed four global preparers about their application of the expected credit loss model in IFRS 9, including the simplified approach.[2] Overall, these preparers said implementation of the expected credit loss model was challenging but ongoing application is straightforward. However, they observed that smaller, less sophisticated SMEs might find it difficult to incorporate forward-looking information into their existing impairment model.

Alternatives presented by the staff

12. Given that this is a specialised area, the staff asked SMEIG members for volunteers with practical experience or expertise in application of IFRS 9's expected credit loss model to help staff develop proposals. All SMEIG members were given the opportunity to comment on the staff proposals once developed, and these were presented to the IASB in December 2021.

13. Based on the feedback on the Request for Information, preparer interviews, and the assistance of the subgroup of SMEIG members the staff identified two possible alternatives to the simplified approach in IFRS 9:

    (a) *Alternative 1*—measure impairment losses at each reporting date as contractual cash flows less expected cash flows using the SME's best estimate of the expected cash flows instead of evaluating a range of possible outcomes, and allow the use of a provision matrix as a practical expedient.

    (b) *Alternative 2*—for trade receivables and contract assets arising from transactions within the scope of Section 23 *Revenue* of the *IFRS for SMEs* Standard,[3] measure impairment losses at each reporting date as described in Alternative 1. For other debt instruments, measure impairment losses at each

[2] Preparers included finance officers and accountants preparing general purpose financial statements.
[3] In its October 2021 meeting, the IASB tentatively decided to develop amendments to the *IFRS for SMEs* Standard to align it with IFRS 15 *Revenue from Contracts with Customers*.

reporting date applying the simplified approach in IFRS 9; and allow the use of a provision matrix as a practical expedient for all debt instruments.

Under both alternatives, the other inputs used to measure impairment losses would be aligned with the simplified approach in IFRS 9 (consideration of the time value of money, and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions).

14. The subgroup of SMEIG members generally supported Alternative 1. In addition, some members suggested that instead of using forward-looking information, an SME could use historical loss experience as the main basis to measure expected credit losses.

15. The staff and the SMEIG subgroup also recommended retaining unchanged the measurement requirements in Section 11 for impairment of equity instruments measured at cost.

IASB discussion

16. At its December 2021 meeting, the IASB was asked to consider the staff analysis of the IASB's three 'alignment principles' (relevance to SMEs, simplicity and faithful representation—see Agenda Paper 30 *Cover paper* of this meeting) and based on that analysis to provide direction on whether:

   (a) to propose amendments to Section 11 of the *IFRS for SMEs* Standard to replace the incurred loss model with one of the two alternatives in paragraph 13 of this paper; or

   (b) to retain the incurred loss model in Section 11 of the *IFRS for SMEs* Standard, if the IASB disagrees with those two alternatives.

17. At its December 2021 meeting, the IASB generally agreed that that the *relevance* principle is met because SMEs would be affected by alignment with an expected credit loss model, and alignment would affect the decisions of some users of financial statements prepared applying the *IFRS for SMEs* Standard.

18. However, IASB members were generally not supportive of the two alternatives in paragraph 13 of this paper. Some IASB members expressed concern that the

simplifications to the requirements in IFRS 9 (use of the SME's best estimate of expected credit losses) would not lead to a faithful representation.

19. Some IASB members observed that it is not clear what is meant by the SME's best estimate. Some members raised concerns that an SME's best estimate might be interpreted as the most likely outcome, meaning an SME could conclude its best estimate of expected credit losses is nil. Such an interpretation would not be consistent with the IFRS 9 expected credit loss model, which requires consideration of the possibility that a credit loss occurs even if the possibility is very low.

20. Further, some IASB members also expressed concern about introducing a new model (for example, a best estimate approach under Alternative 1 or 2) and implying it would provide an outcome aligned with the expected credit loss model in IFRS 9.

21. An IASB member noted that the expected credit loss model in IFRS 9 contains several expedients and was designed to be proportionate for different types of entities, since the focus is on reasonable and supportable information that is available without undue cost or effort (see paragraph 5.5.17(c) of IFRS 9). Therefore, the IASB directed the staff to explore developing an expected credit loss model aligned with the simplified approach in IFRS 9, with further simplifications for SMEs if necessary. The IASB would consider the expected credit loss model developed by the staff at a future meeting and decide whether to incorporate that model in the *IFRS for SMEs* Standard or retain the current incurred loss model.

22. The IASB generally agreed that the measurement requirements in Section 11 for impairment of equity instruments measured at cost should be retained unchanged.

Staff analysis

23. The staff analysis is set out as follows:

    (a) staff draft of an expected credit loss model for SMEs;

    (b) application of the IASB's alignment principles;

    (c) possible approaches for impairment of financial assets; and

    (d) impairment of equity instruments measured at cost.

Staff draft of an expected credit loss model for SMEs

24. Appendix B to this paper sets out the staff draft of an expected credit loss model for SMEs that is aligned with the simplified approach in IFRS 9 (see paragraph 21 of this paper).

25. The staff draft incorporates the main principles of the simplified approach in IFRS 9 and the guidance in IFRS 9 applicable to transactions of SMEs. Consistent with the drafting of the *IFRS for SMEs* Standard, the staff draft also reflects minor drafting changes to assist understanding and refer to those transactions SMEs typically undertake.

Application of the IASB's alignment principles

26. In considering whether and, if so, how to align the *IFRS for SMEs* Standard with new and amended IFRS Accounting Standards, the IASB agreed to apply three 'alignment principles' (relevance to SMEs, simplicity and faithful representation—see Agenda Paper 30 of this meeting), including the assessment of costs and benefits.

27. As mentioned in paragraph 17 of this paper, at its December 2021 meeting, the IASB generally agreed that the *relevance* principles is met. Consequently, the staff analysis in this paper only considers whether an expected loss model for SMEs, based on the staff draft in Appendix B to this paper, would satisfy the principles of simplicity and faithful representation, and the assessment of costs and benefits.

Simplicity and faithful representation

28. At the December 2021 meeting, the IASB:

    (a) observed that the simplified approach in IFRS 9 was designed to be proportionate for different types of entities since the focus is on reasonable and supportable information that is available without undue cost or effort; and

    (b) expressed concern about introducing a new model for SMEs (for example, requiring an SME's best estimate of expected credit losses) and implying it would provide an outcome aligned with the simplified approach in IFRS 9.

29. Given the IASB's direction in paragraph 28 of this paper, the staff have retained the underlying principles of the simplified approach in IFRS 9 when developing an expected credit loss model for SMEs. Simplifications have been restricted to excluding guidance that is not relevant to typical SMEs and minor drafting simplifications, as explained in paragraph 25 of this paper. Retaining the underlying principles in IFRS 9 would ensure an expected credit loss model in the *IFRS for SMEs* Standard would meet the IASB's alignment principle of faithful representation.

Assessment of costs and benefits

30. The IASB's alignment approach includes an assessment of whether the benefits of moving to an expected credit loss model justify the costs to SMEs of applying it.

31. Feedback on the Request for Information and from the interviews with preparers provides evidence that implementing the simplified approach in IFRS 9 is complex. If the IASB replaces the incurred loss model in Section 11 of the *IFRS for SMEs* Standard with an expected credit loss model, SMEs would incur implementation costs. These costs include potential changes to systems and processes, training costs and increases in audit costs, at least in the year of implementation. Aspects of an expected credit loss model that could be challenging to SMEs include understanding the new requirements, evaluating possible outcomes and forecasting future conditions.

32. The main criticism of the incurred loss model is that an impairment test is not required until there is objective evidence of impairment, meaning impairment is recognised 'too little, too late'. Users of financial statements can better predict future cash flows using information based on the expected loss model as the information incorporates an entity's expectations about current and forecast information. Therefore, moving to the expected cost model is expected to provide more relevant information to users of SME financial statements.

33. Nevertheless, the main benefits for users would relate to information about longer term financial assets, rather than those settled shortly after the entity's year end. The IASB developed the expected credit loss model in IFRS 9 predominately to respond to concerns identified during the financial crisis about delayed recognition of credit losses on loans. SMEs do not include financial institutions, and do not typically have significant long-term loan receivables or investments in bonds. Many SMEs only hold

short-term, non-interest bearing financial assets, specifically trade receivables. Furthermore, feedback from our user survey and user interviews did not indicate demand for the more sophisticated information provided under an expected credit loss model for SMEs.

34. Some feedback on the Request for Information and from interviews with preparers indicates that, due to the short time horizon, SMEs already consider future information when assessing the impairment of trade receivables and many already apply a collective impairment approach using a provision matrix. The IASB received similar feedback during its outreach when developing IFRS 9.[4] Furthermore, SMEs usually prepare less timely financial statements, meaning they will capture events after the reporting period over a longer period. For many SMEs, by the time their financial statements are issued, most of the financial assets outstanding at the reporting date will have been settled.

35. The feedback above indicates that moving to an expected credit loss model may involve significant implementation costs for SMEs (see paragraph 31 of this paper) without a significant change in impairment information or benefits for users of their financial statements.

Possible approaches for impairment of financial assets

36. Given the above analysis, the staff have identified three possible approaches for the IASB to consider:

Approach 1: Incurred loss model

37. Under Approach 1 the IASB would retain the incurred loss model in Section 11 of the *IFRS for SMEs* Standard for all financial assets at amortised cost.

38. Many SMEs only hold short-term, non-interest bearing financial assets, specifically trade receivables. Approach 1 is supported by the assessment of costs and benefits above for those SMEs.

[4] Paragraph 26 of Agenda Paper 5E *Simplified approach for trade receivables and lease receivables* of the November 2013 IASB meeting.

Approach 2: Expected credit loss model

39. Under Approach 2, the IASB would propose amendments to Section 11 of the *IFRS for SMEs* Standard to require an SME to use an expected credit loss model for all financial assets at amortised cost.

40. Approach 2 may result in better information for users of financial statements when SMEs hold longer term financial assets, such as related party loan receivables. However, it would involve significant implementation costs for all SMEs.

41. A staff draft of an expected credit loss model for SMEs is set out in Appendix B to this paper. Alternatively, Appendix B might be restructured as follows (with the aim of making it more user-friendly for SMEs that only have trade receivables and contract assets within the scope of Section 23 of the *IFRS for SMEs* Standard):

    (a) require an SME to use a provision matrix approach to determine the expected credit losses for trade receivables and contract assets (based on paragraph 11.X4 and 11.X11 of Appendix B and Illustrative Example 12 in IFRS 9, which illustrates use of a provision matrix for trade receivables); and

    (b) require an SME to use the expected credit loss model as drafted in Appendix B for all other financial assets measured at amortised cost.

    This alternative would provide a similar outcome to the staff draft in Appendix B, but might be viewed as a simplification. This is because SMEs that only have trade receivables would only need to refer to paragraph 11.X4 and 11.X11 of Appendix B (and the illustrative example), which could be presented upfront, rather than understand and apply the staff draft in Appendix B in full.

Approach 3: Incurred loss model for trade receivables and contract assets. Expected credit loss model for other financial assets

42. Under Approach 3, the IASB would:

    (a) retain the incurred loss model in Section 11 of the *IFRS for SMEs* Standard for trade receivables and contract assets within the scope of Section 23 of the *IFRS for SMEs* Standard; and

(b) propose amendments to Section 11 of the *IFRS for SMEs* Standard to require an SME to use an expected credit loss model for all other financial assets measured at amortised cost, for example as drafted in Appendix B.

43. Approach 3 seems to be the approach that is best supported by the assessment of costs and benefits in paragraphs 30–35 of this paper. In particular, Approach 3 would reduce implementation costs because most SMEs would continue to apply the incurred loss model. Only those SMEs that hold financial assets other than trade receivables and contract assets would be required to apply an expected credit loss model. However, Approach 3 would lead to the incorporation of two impairment models for financial assets in Section 11 of the *IFRS for SMEs* Standard, which arguably adds complexity to the *IFRS for SMEs* Standard. Two impairment models may also be confusing for users of SME financial statements—however, as noted in paragraph 34 of this paper, feedback indicates that SMEs that hold trade receivables and contract assets are already incorporating future looking information in their impairment assessments.

Other considerations

44. The following considerations are also important when assessing the three approaches:

(a) under Approach 2 or 3 the IASB's proposals for a simplified expected loss model would be included in the Exposure Draft. This would enable respondents to comment on those proposals. If the IASB applies Approach 1 in the Exposure Draft, it may not be able to change to Approach 2 or 3 without re-exposure.[5]

(b) the staff have not considered an optional or required fallback to the simplified model in IFRS 9. The *IFRS for SMEs* Standard is intended to be a self-contained, standalone Standard and the IASB has tentatively decided to remove the only fallback to IFRS Accounting Standards during this comprehensive review.[6] Therefore, any options or requirements considered

[5] If the IASB makes fundamental changes to the proposals in an Exposure Draft, on which respondents have not had the opportunity to comment, this would probably result in the need to re-expose the proposals.

[6] In October 2021, the IASB tentatively decided to propose an amendment to the *IFRS for SMEs* Standard to remove an entity's option to apply the recognition and measurement requirements for financial instruments in IFRS Accounting Standards.

appropriate for SMEs should be incorporated in the *IFRS for SMEs* Standard, not via a cross-reference to IFRS Accounting Standards.

(c) the post-implementation review of the impairment requirements in IFRS 9 has not yet been performed. The findings from this review may provide additional information about the costs and benefits of introducing an expected credit loss model in the *IFRS for SMEs* Standard, and assurance that the simplified approach in IFRS 9 is working as intended and will not be amended. However, the main objective of a post-implementation review is to assess if the objective of the standard-setting project has been met. Therefore, the IASB may not hear significant additional information relevant to making a decision on which of the approaches to follow for SMEs on top of that already heard from preparer interviews and respondents to the Request for Information.

(d) paragraph BC264(b) of the Basis for Conclusions on the *IFRS for SMEs* Standard explains that between comprehensive reviews, the IASB, with input from the SMEIG, decides whether there is a need for an interim review to consider any new and revised IFRS Accounting Standard not yet incorporated or any urgent amendments identified. Therefore, the IASB could consider alignment with the simplified model in IFRS 9 (and IFRS 16 *Leases*[7]) in three years' time,[8] rather than wait for the next comprehensive review. Nevertheless, the benefits of an interim review would need to be weighed against the benefits of providing a stable platform between comprehensive reviews.

Staff conclusion

45. The staff recommend Approach 3 because it is supported by the staff assessment of costs and benefits in paragraphs 30–35 of this paper. Approach 3 would result in a similar outcome to Approach 2 (as explained in paragraphs 33–34 of this paper), without requiring SMEs to change their existing processes for trade receivables and contract assets. Furthermore, Approach 3 would enable the IASB's proposals for a simplified expected loss model to be included in the Exposure Draft and provide

[7] In November 2021, the IASB tentatively decided to consider amending the *IFRS for SMEs* Standard to align with IFRS 16 *Leases* in a future review of the Standard.

[8] Paragraph BC264(c) of the Basis for Conclusions accompanying the *IFRS for SMEs* Standard notes that amendments to the *IFRS for SMEs* Standard would not typically be expected to be more frequent than approximately once every three years to provide SMEs with a stable platform.

flexibility for the IASB to redeliberate this approach based on the feedback on the Exposure Draft.

Impairment of equity instruments measured at cost

46. At its December 2021 meeting, the IASB generally agreed that the measurement requirements in Section 11 of the *IFRS for SMEs* Standard for impairment of equity instruments measured at cost should be retained unchanged. Section 11 requires an SME to measure equity instruments whose fair value cannot be measured reliably without undue cost or effort at cost less impairment. If there is objective evidence of impairment, the SME recognises an impairment loss as the difference between the asset's carrying amount and the best estimate of the amount received if the asset were to be sold at the reporting date. IFRS 9 requires entities to measure all equity instruments at fair value, and so the expected credit loss model does not apply to equity instruments.

Staff recommendation and question for the IASB

47. The staff recommend the IASB:

    (a) retain unchanged the incurred loss model in Section 11 of the *IFRS for SMEs* Standard for trade receivables and contract assets within the scope of Section 23 *Revenue* of the *IFRS for SMEs* Standard;

    (b) propose amendments to Section 11 to require an SME to use an expected credit loss model for all other financial assets measured at amortised cost, for example as drafted in Appendix B to this paper; and

    (c) retain unchanged the requirements in Section 11 for impairment of equity instruments measured at cost.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 47 of this paper?

Next steps

48. At its December 2021 meeting, the IASB decided to defer its discussion on measurement of issued financial guarantee contracts pending its decision on incorporating an expected credit loss model into the *IFRS for SMEs* Standard. The staff plan to bring our analysis on the measurement of issued financial guarantee contracts to a future IASB meeting. This analysis will depend on the IASB's decision about incorporating an expected credit loss model versus retaining the incurred loss model in Section 11 of the *IFRS for SMEs* Standard.

Appendix A—Extract from the Request for Information on aligning the *IFRS for SMEs* Standard with IFRS 9[9]

Impairment of financial assets

A1. In considering aligning the requirements for impairment of financial assets in Section 11 with IFRS 9, the [IASB] Board noted that the scope of the *IFRS for SMEs* Standard excludes any entity that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Most banks, credit unions, insurance companies, securities brokers, securities dealers, mutual funds and investment banks satisfy this criterion. Therefore, the general approach to impairment in IFRS 9 would not be relevant to many entities applying the *IFRS for SMEs* Standard.

A2. IFRS 9 includes a simplified approach that applies to trade receivables, contract assets and lease receivables. It requires the loss allowance to be measured at an amount equal to lifetime expected credit losses. The simplified approach reduces the need to track separately increases in credit risk. Therefore, the simplified approach alleviates the practical concerns about using the general approach for tracking changes in credit risk to determine whether there has been a significant increase in credit risk.

A3. The Board decided to seek views on replacing the incurred loss model in Section 11 for the impairment of financial assets with the simplified approach in IFRS 9. It did so because the expected credit loss model is widely regarded as an improvement on the approach in IAS 39 *Financial Instruments: Recognition and Measurement*. Furthermore, if Section 11 were amended to include the simplified approach in IFRS 9, users would be better able to predict future cash flows than they can using the incurred loss model in Section 11.

[9] See paragraphs B35-B37 of the Request for Information.

Appendix B—Staff draft of an expected credit loss model for SMEs

Measurement of expected credit losses

11.X1 An entity shall measure expected credit losses of a financial instrument in a way that reflects:

(a) an unbiased and probability-weighted amount that is determined by evaluating alternative possible outcomes;

(b) the time value of money; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.[10]

11.X2 Expected credit losses are a probability-weighted estimate of credit losses (ie the present value of all cash shortfalls) over the expected life of the financial instrument. The maximum period to consider when measuring expected credit losses is the maximum period over which the entity is exposed to credit risk. Because expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due.

11.X3 A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. The estimate of expected cash shortfalls considers the probability of a foreclosure and the cash flows that would result from it, for example, cash flows from collateralised assets.

11.X4 An entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 11.X1. For example, an entity may use a provision matrix as a practical expedient for the calculation of the expected credit losses on trade receivables. The entity would use its historical credit loss experience (adjusted as appropriate in accordance with paragraph 11.X11) for trade receivables to estimate the expected credit losses on the financial assets as relevant. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 per cent if not past due, 2 per cent if less than 30 days past due, 3 per cent if more than 30 days but less than 90 days past due, 20 per cent if 90–180 days past due etc).

11.X5 Expected credit losses on lease receivables shall be measured consistently with the cash flows and the discount rate used in the measurement of the lease receivable in accordance with Section 20 *Leases*.

Financial guarantee contracts[11]

11.X6 For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

Probability-weighted outcome

11.X7 When measuring expected credit losses, an entity need not identify every possible scenario. However, that measurement shall reflect at least two outcomes, the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.

11.X8 The average credit losses of a group of financial instruments with shared risk characteristics (eg trade receivables of customers with shared characteristics) may be a reasonable estimate of the probability-weighted amount. In other situations when financial assets are individually significant, for example a loan to a related party, the identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probability of those outcomes will probably be needed.

[10] For the purposes of paragraph 11.X1 of the *IFRS for SMEs* Standard only, use of 'undue cost or effort' refers to the extent of gathering of information. It is not an undue cost or effort exemption from applying a requirement as discussed in paragraph 2.14A-2.14D of the *IFRS for SMEs* Standard.

[11] The requirements for financial guarantee contracts are included for completeness. However, as noted in paragraph 48 of this paper, the staff plan to bring our analysis on the measurement of issued financial guarantee contracts to a future IASB meeting.

Time value of money

11.X9 Expected credit losses shall be discounted to the reporting date, using the effective interest rate determined at initial recognition. If a financial instrument has a variable interest rate, expected credit losses shall be discounted using the current effective interest rate determined in accordance with paragraph 11.19.

Reasonable and supportable information

11.X10 An entity shall use reasonable and supportable information to estimate expected credit losses. An entity may use various sources of data, that may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings, credit loss experience of other entities and external ratings, reports and statistics. Entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument (or groups of financial instruments).

11.X11 Historical information is an important anchor or base from which to measure expected credit losses. However, an entity shall adjust historical data, such as credit loss experience, to reflect, and be directionally consistent with, changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses). In some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered.

New definition in IFRS for SMEs *Glossary of terms*

credit loss	The difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls), discounted at the original effective interest rate.

Appendix to Section 11

The staff suggest to include Example 12 from IFRS 9 Illustrative Examples illustrating use of a provision matrix for trade receivables, possibly with some additional explanations to assist understanding for SMEs.