IFRS Accounting

Staff paper

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Topic	**Impairment of financial assets**
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Purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:

   (a) consider feedback on the proposals for impairment of financial assets in the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft); and

   (b) provide direction on alternative approaches to address that feedback.

2. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard (the Standard).

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Structure of this paper

3. This paper is structured as follows:

   (a) development of the proposals (paragraphs 4–11);

   (b) feedback on the proposals (Question 4 of the Exposure Draft, paragraphs 12–16);

   (c) feedback from the SME Implementation Group (paragraphs 17–20);

   (d) staff analysis (paragraphs 21–55);

   (e) questions for the IASB (paragraph 56);

   (f) next steps (paragraph 57); and

   (g) Appendix—extract from the Basis for Conclusions on the Exposure Draft.

Development of the proposals

Current requirements for impairment of financial assets

4. Section 11 *Basic Financial Instruments* of the Standard sets out the requirements for recognising and measuring impairment of financial assets measured at cost or amortised cost. The requirements are based on IAS 39 *Financial Instruments: Recognition and Measurement*. The impairment model in Section 11 and IAS 39 is an incurred loss model. The IASB developed the expected credit loss (ECL) model in IFRS 9 *Financial Instruments* to respond to concerns that the incurred loss model may delay the recognition of credit losses.

5. IFRS 9 includes a simplified approach to provide for lifetime expected credit losses for 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 removes the need to track separately increases in credit risk. Therefore, the simplified approach alleviates the practical concerns about using the

general approach, which requires an entity to track changes in credit risk to determine whether there has been a significant increase in credit risk.

Feedback on the 2020 Request for Information

6. In January 2020, the IASB published Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* as a first step in its second comprehensive review. When developing the Request for Information, the IASB considered aligning the requirements for the impairment of financial assets in Section 11 with IFRS 9. The IASB noted that the scope of the Standard excludes any entity that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Banks, credit unions, insurance companies, securities brokers, securities dealers, mutual funds and investment banks often meet this criterion. Therefore, the general approach to impairment in IFRS 9 would not be relevant to many entities applying the Standard. This means, for SMEs, the simplified approach would be expected to achieve a similar outcome as IFRS 9's general approach. The IASB observed that the ECL model is widely regarded as an improvement on the approach in IAS 39 and so the IASB included a question in the Request for Information about introducing the simplified approach in IFRS 9 into the Standard.

7. Feedback on the Request for Information was mixed. Many respondents agreed with alignment with the simplified approach in IFRS 9, but many of these respondents also said that the simplified approach in IFRS 9 was too complex for SMEs and should be further simplified. Some respondents and some SMEIG members 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. Some respondents disagreed with alignment and expressed concerns that an ECL model would impose undue cost or effort on SMEs.

8. Feedback from interviews with preparers indicated that implementing the simplified approach in IFRS 9 would be complex for SMEs and would not result in significant changes in the amount of impairment for the types of financial assets held by typical

SMEs, namely short-term trade receivables. Feedback from the user survey and user interviews did not show a demand for the more sophisticated information that would be provided by applying an ECL model to financial assets held by SMEs.

Proposals in the Exposure Draft

9. Some IASB members expressed concern about modifying the simplified approach in IFRS 9 for SMEs, for example, by introducing a best–estimate approach. Their concern was that such an approach may imply an outcome aligned with the ECL model in IFRS 9, which may not necessarily be true. The IASB observed that the ECL model in IFRS 9 contains several expedients and was designed to be proportionate for different types of entities, because 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 decided that if a forward-looking impairment model is proposed, the Standard should be aligned with the simplified approach in IFRS 9, with further simplifications for SMEs if necessary, rather than introducing modifications to that model for SMEs. The IASB's reasoning is further explained in paragraph BC76 of the Basis for Conclusions on the Exposure Draft (see Appendix B).

10. The IASB concluded that the feedback on the Request for Information, supplemented by interviews with preparers, provided evidence that:

    (a) moving to an ECL model would provide better information for users of financial statements when SMEs hold longer-term financial assets; but

    (b) retaining an incurred loss model for impairment would be the approach best supported by cost–benefit considerations for SMEs that hold trade receivables, which are normally short-term, non-interest-bearing assets.

11. Therefore, in the Exposure Draft, the IASB proposed to:

    (a) retain the incurred loss model for trade receivables and contract assets in the scope of the proposed revised Section 23 *Revenue from Contracts with Customers*;

(b) require an ECL model for all other financial assets measured at amortised cost, aligned with the simplified approach in IFRS 9; and

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

Feedback on the proposals (Question 4 of the Exposure Draft)

Question 4—Proposed amendments to impairment of financial assets in Section 11	
4(i)	Do you agree with the proposal to introduce an ECL model for only some financial assets? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.
4(ii)	Do you agree that the proposal strikes the right balance in deciding which financial assets should be in the scope of the ECL model, considering the costs for SMEs and benefits for users of SMEs' financial statements?

Overall feedback on Question 4

12. Most respondents disagreed with the proposal to introduce an ECL model for some financial assets. Most of these respondents said that the incurred loss model should be retained for all financial assets measured at cost or amortised cost. Further detail on the feedback received is set out in paragraphs 13–16.

Impairment model

13. Some respondents agreed with the proposal to introduce an ECL model for only some financial assets. Some of these respondents noted that the proposal would increase complexity for SMEs that have financial assets other than trade receivables and contract assets, but strikes the right balance considering the costs for SMEs and benefits for users of their financial statements. However, in determining which financial assets should be in the scope of the ECL model:

(a) a few respondents said the IASB should consider whether the financial assets have a financing component and their exposure to credit risk, for example period to maturity, rather than type of financial asset; and

(b) some respondents said the incurred loss model should also be retained for intragroup or related party balances because applying an ECL model to such receivables, which are often one-off in nature, involves a high level of estimation and complexity, with limited information benefits.

14. Most respondents disagreed with the proposal to introduce an ECL model for some financial assets. Most of these respondents said that the incurred loss model should be retained for all financial assets measured at cost or amortised cost (see paragraph 15). Other respondents were generally divided between:

(a) giving SMEs an accounting policy choice between the simplified ECL model in the Exposure Draft and the incurred loss model, and apply this to all financial assets measured at cost or amortised cost. These respondents said this would strike a better balance considering the costs for SMEs and benefits for users of their financial statements.

(b) requiring the ECL model in the Exposure Draft to be applied to all financial assets measured at cost or amortised cost because it provides better information to users of SMEs’ financial statements.

Reasons for retaining the incurred loss model

15. Approximately half of the respondents that commented on Question 4 supported retaining the incurred loss model for all financial assets measured at cost or amortised cost. Many of these respondents noted that the benefits of introducing an ECL model, even with the simplifications proposed in the Exposure Draft, are unlikely to outweigh the costs of applying the proposed model. Those that held this view said:

(a) the existence of two impairment models for financial assets would lead to complexity and confusion for SMEs and users of their financial statements, and does not meet the IASB’s simplicity principle.

(b) generally, entities with complex financial instruments would be outside the scope of the Standard, such as, financial institutions. The types of financial assets measured at amortised cost that are held by SMEs are generally straightforward (short-term and non-interest-bearing financial instruments such as trade receivables, and intragroup and employee loan receivables) and the benefits of applying the ECL model may not outweigh the costs and practical difficulties for these financial assets.

(c) many SMEs do not have the resources or the ability to apply an ECL model properly, which would reduce the usefulness of the information.

(d) the incurred loss model is sufficient to meet the needs of the users of SMEs' financial statements.

(e) the IASB should wait until after the post-implementation review of the impairment requirements in IFRS 9 before considering an ECL model for SMEs because the IASB would then be in a better position to understand the practical issues with the ECL model.

(f) the incurred loss model could be enhanced by incorporating additional indicators of objective evidence of impairment within that model to reflect earlier a credit deterioration that could lead to a default.

Suggestions to improve/simplify the ECL model

16. Some respondents had suggestions on how to improve or simplify the ECL model in the Exposure Draft if this model is included in the final updated Standard. Suggestions for improvements—each made by a few respondents—included:

(a) allowing SMEs to measure expected credit losses using a single loss scenario (or best estimate) rather than a fully probability weighted method;

(b) providing guidance on the practical expedients that SMEs can apply in measuring expected credit losses (paragraph 11.26E of the Exposure Draft);

(c) clarifying the considerations of SMEs in assessing 'undue cost or effort' in obtaining reasonable and supportable information for measuring expected credit losses (paragraph 11.26B(c) of the Exposure Draft);

(d) providing illustrative examples to help SMEs apply the ECL model; and

(e) introducing the rebuttable presumptions from IFRS 9 that:

    (i) the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due; and

    (ii) a default does not occur later than when a financial asset is 90 days past due.

Feedback from the SME Implementation Group (SMEIG)

17. The SMEIG met on 13 July 2023 to discuss the feedback on the Exposure Draft. At that meeting the SMEIG was asked to provide advice on how the IASB should address the feedback on the IASB's proposal to introduce an ECL model for only some financial assets.

18. Some SMEIG members suggested retaining the incurred loss model for all financial assets for cost–benefit reasons. Other SMEIG members suggested widening the scope of the incurred loss model proposed in the Exposure Draft to include intercompany financial assets. However, these SMEIG members said SMEs with more complex lending arrangements should apply an ECL model.

19. SMEIG members made the following suggestions for how the IASB could respond to the feedback:

    (a) requiring an SME to apply an ECL model if it provides financing as a primary or major business activity;

    (b) permitting an accounting policy option to apply the ECL model or the incurred loss model;

(c) requiring an SME to apply an ECL model unless doing so causes undue cost or effort; and

(d) supplementing the incurred loss model with disclosures, for example for an SME that provides financing as a primary or major business activity.

20. SMEIG members were also asked if an ECL model is not introduced for any financial assets during this comprehensive review, what alternative approaches the IASB should consider for accounting for issued financial guarantee contracts. Two SMEIG members suggested that SMEs account for issued intercompany financial guarantee contracts applying Section 21 *Provisions and Contingencies*, with appropriate disclosures.

Staff analysis

21. The staff analysis is set out as follows:

(a) application of the alignment approach to impairment of financial assets (see paragraph 22);

(b) assessment of relevance to SMEs (see paragraphs 23–28);

(c) possible simplifications to the proposals and assessment of cost-benefits (see paragraph 29–32);

(d) four alternative approaches to consider (see paragraph 33–53); and

(e) other considerations (see paragraph 54–55).

Application of the alignment approach

22. The IASB proposed to introduce the ECL model for some financial assets based on applying its alignment approach. The alignment approach treats alignment with full IFRS Accounting Standards as the starting point for developing the *IFRS for SMEs* Accounting Standard, and applies the principles of relevance to SMEs, simplicity and faithful representation, including the assessment of costs and benefits, in determining

whether and how that alignment should take place. Agenda Paper 30A describes the IASB's alignment approach. Most respondents disagreed with the proposals for impairment of financial assets in the Exposure Draft. Consequently, the staff think the IASB should reconsider how the alignment approach was applied to the impairment of financial assets. Paragraphs 23–32 provide the staff analysis of the alignment principles.

Assessment of relevance to SMEs

23. During development of the proposals for impairment of financial assets, the IASB concluded that the relevance principle is met because introducing an ECL model into the Standard would affect SMEs and affect the decisions of some users of financial statements prepared applying the Standard. However, the staff observe that this is slightly different to the way the relevance principle was first described in the Request for Information and then confirmed in the Basis for Conclusions on the Exposure Draft. The description in the Exposure Draft is 'The IASB determines relevance to SMEs by assessing whether *the problem* addressed by a new requirement in full IFRS Accounting Standards (in the scope of the review) would make a difference in the decisions of users of financial statements prepared applying the *IFRS for SMEs* Accounting Standard' (see paragraph BC30 of the Basis for Conclusions on the Exposure Draft and paragraph 6 of Agenda Paper 30A *Project Plan*).

What is the problem addressed by the ECL model in IFRS 9?

24. The IASB developed the ECL model in IFRS 9 predominately to respond to concerns identified during the financial crisis about delayed recognition of credit losses on loan receivables. The IASB also had the aim of applying a single impairment method to all financial assets not measured at fair value, replacing the different impairment methods associated with the numerous classification categories in IAS 39.

Does the same problem exist for SMEs?

25. The scope of the Standard excludes any entity that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Banks, credit unions, insurance companies, securities brokers, securities dealers, mutual funds and investment banks often meet this criterion. SMEs do not typically have significant long-term loan receivables or investments in bonds. Furthermore, Section 11 does not have different impairment models and classification categories as IAS 39 did.

26. The types of financial assets held by SMEs typically consist of short-term financial assets (such as trade receivables), and intercompany loan receivables, such as loans to group entities and directors, which are often one-off in nature. Applying the requirements in Section 11, these are all measured at amortised cost and subject to an incurred loss impairment model.

27. The staff think the IASB should consider whether the problem it sought to resolve when introducing the ECL model in IFRS 9 is prevalent for SMEs, including whether moving to an ECL model would make a significant difference to users of SME financial statements, and hence whether it is satisfied that the relevance principle is met. Some respondents to the Exposure Draft noted that users do not require the more sophisticated information provided under an ECL model. Furthermore, our outreach with lenders to SMEs confirmed the principles in paragraph BC157 of the Basis for Conclusions on the Standard that describe their information needs, particularly that they require information to help them determine the future cash flows. The staff think user needs may be better satisfied by simple disclosures, such as an aging analysis of financial assets and/or greater disaggregation of financial assets in paragraph 11.41 of the Standard, rather than the more judgemental and sophisticated information provided under an ECL model that some SMEs may not have the resources to apply well.

28. If the IASB is not satisfied that the relevance principle is met, we think the incurred loss model for all financial assets measured at cost or amortised cost should be retained, possibly with additional disclosures (see Alternative 4 below).

Assessment of simplicity and cost-benefits

29. Applying the principle of simplicity involves looking at requirements in the IFRS Accounting Standards that have satisfied the relevance principle and then assessing what simplifications are appropriate. If the IASB affirms that the relevance condition is met, the staff think the IASB should then consider whether the proposals in the Exposure Draft can be simplified.

30. Feedback on the Request for Information indicated that the simplified approach in IFRS 9 is too complex for SMEs. Therefore, during development of the Exposure Draft, the IASB discussed ways to further simplify the simplified approach in IFRS 9. However, as noted in paragraph 9, some IASB members expressed concern about modifying the simplified approach in IFRS 9. Therefore, the IASB decided that if a forward-looking impairment model is proposed, the Standard should be aligned with the simplified approach in IFRS 9, with further simplifications for SMEs if necessary (provided they do not modify that model).

31. The Exposure Draft did not introduce modifications to the simplified ECL model in IFRS 9, apart from simplified drafting. But as a simplification it proposed to apply the simplified ECL model to a different scope of financial assets than IFRS 9 requires (see paragraphs 5 and 11).

32. Feedback on the Exposure Draft did not identify any new suggestions for how to modify the simplified approach in IFRS 9. However, some respondents and SMEIG members suggested alternative approaches to determining which financial assets should be in the scope of the ECL model, considering the costs for SMEs and benefits for users of SMEs' financial statements. These suggestions are considered below (see Alternatives 1–3 below).

Alternatives to consider

33. If the IASB affirms that the relevance condition is met, the staff seek the IASB's view on whether to explore further any of the following three alternatives for incorporating a simplified ECL model into the Standard:

    (a) Alternative 1—retaining or refining the proposals in the Exposure Draft (see paragraphs 36–37);

    (b) Alternative 2—providing an accounting policy option to use either the simplified ECL model or the incurred loss model (paragraphs 38–40); and

    (c) Alternative 3—only requiring application of the simplified ECL model if an SME provides financing to customers as a main business activity (paragraphs 41–44).

34. The feedback on the Exposure Draft supports the IASB retaining the incurred loss model for all financial assets measured at cost or amortised cost. Furthermore, the staff are questioning if the problem addressed by the ECL model in IFRS 9 is prevalent for SMEs. Consequently, the staff think irrespective of IASB members' views on Alternatives 1–3, the IASB should consider whether to retain the current requirements in the Standard for impairment of financial assets and explore requiring additional disclosures (Alternative 4—see paragraph 45–53).

35. We do not recommend the IASB considers the following suggestions made by respondents and SMEIG members for the reasons stated:

    (a) *measuring expected credit losses using a single loss scenario (or best estimate)*—as explained in paragraph 9, the IASB discussed but rejected a best–estimate approach when developing the Exposure Draft.

    (b) *requiring an SME to apply an ECL model unless it results in undue cost or effort*—the measurement of expected credit losses is based on reasonable and supportable information that is available without undue cost or effort (see paragraph 11.26B of the Exposure Draft). Consequently, an SME is only required to source information that does not require undue cost or effort. The

staff think it would be confusing to introduce a further undue cost or effort exemption from application of the ECL model.

Alternative 1—retaining or refining the proposals in the Exposure Draft

36. In the Exposure Draft the IASB proposed to:

    (a) retain the incurred loss model for trade receivables and contract assets in the scope of the revised Section 23 *Revenue from Contracts with Customers*;

    (b) require an ECL model for all other financial assets measured at amortised cost, aligned with the simplified approach in IFRS 9; and

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

37. Some respondents agreed that the proposal in the Exposure Draft strikes the right balance considering the costs for SMEs and benefits for users of their financial statements. However, other respondents suggested modifications in determining which financial assets should be in the scope of the ECL model:

    (a) *Consider the term and exposure of financial assets*—a few respondents suggested the IASB consider whether the financial assets have a financing component and their exposure to credit risk, rather than type of financial asset. Some outreach participants noted that some companies have a longer working capital cycle, for example in the agricultural sector, and so trade receivables may be longer-term. The staff observe that requiring the ECL model to be applied to long-term trade receivables would be consistent with the IASB's view when developing the proposals that an ECL model would provide better information when SMEs hold longer-term financial assets.

    (b) *Relief for intragroup or related party balances*—some respondents suggested the incurred loss model should be retained for all intragroup or related party receivables. They noted such receivables are often one-off in nature and applying the ECL model to such receivables would involve a high level of estimation and complexity, and would provide limited information benefits.

The staff think, if the IASB considers this suggestion, the IASB should also reconsider the measurement requirements for intragroup or related party issued financial guarantee contracts, because expected credit losses determine their subsequent measurement (see paragraph 11.14(d) of the Exposure Draft).

Alternative 2—giving SMEs an accounting policy choice

38. Some respondents said SMEs should be given an accounting policy option between the simplified ECL model in the Exposure Draft and the incurred loss model, to be applied to all financial assets. These respondents said this would strike a better balance considering the costs for SMEs and benefits for users of their financial statements.

39. The IASB aims to restrict accounting policy options in the Standard because including more complex options generally increases complexity and options also reduce comparability. Paragraphs BC208–BC209 of the Basis for Conclusions on the Standard explain the IASB’s reasons for restricting accounting policy options.

40. Nevertheless, in limited cases, the IASB includes accounting policy options in the Standard applying the simplification principle. For example, the cost model, the equity method or the fair value model is permitted for accounting for investments in associates. The IASB could consider giving SMEs an option to apply an incurred loss model, instead of the simplified ECL model, if it considers this to be an appropriate application of the simplification and faithful representation principles. Nevertheless, the staff note that under this alternative, an entity could choose to apply an incurred loss model to all its financial assets, even if it has financial assets other than trade receivables and contract assets.

Alternative 3—Simplified ECL model if SME provides financing to customers as a main business activity

41. Some SMEIG members suggested requiring an SME to apply the ECL model if it provides financing as a primary or major business activity, otherwise the SME would apply the incurred loss model. Under this alternative, the simplified ECL model might

be applied to all of the SME's financial assets measured at cost or amortised cost, or only those related to the activity of providing financing to customers.

42. The IASB developed the ECL model in IFRS 9 predominately to respond to concerns identified during the financial crisis about delayed recognition of credit losses on loan receivables. Alternative 3 would respond directly to this concern.

43. SMEs do not typically have significant long-term loan receivables or investments in bonds. Therefore, SMEs are unlikely to provide financing to customers as a main business activity. However, the staff is aware that some non-bank lenders such as non-deposit-taking microfinance institutions could be eligible to apply the Standard.

44. Following our discussion of relevance to SMEs (see paragraphs 23–28), if the IASB decides to explore Alternative 3, we think that the IASB should consider whether an ECL model should be added to the Standard to cater for relatively few SMEs. An alternative might be to retain an incurred loss model for all SMEs, with additional credit risk disclosures for the small subset of SMEs that provide financing to customers as main business activity (see Alternative 4 below).

Alternative 4—Incurred loss model with disclosures

45. The Request for Information asked about introducing the simplified ECL model in IFRS 9 into the Standard. Feedback indicated that the simplified approach in IFRS 9 was too complex for SMEs and should be further simplified. After considering this feedback, in the Exposure Draft the IASB proposed to introduce a simplified ECL model for only some financial assets. However, most respondents to the Exposure Draft disagreed with the proposal for cost-benefit reasons and suggested the incurred loss model is retained for all financial assets. Overall, feedback received during this comprehensive review most strongly supports retaining the current requirements in the Standard for impairment of financial assets. Therefore, even if the IASB affirms the relevance principle, the staff think the IASB should consider retaining an incurred loss model for all financial assets measured at cost or amortised cost, with additional disclosures if necessary.

Are additional disclosures needed?

46. The staff think the disclosure requirements in the Standard are sufficient to support the incurred loss model for most SMEs. In particular, paragraph 11.42 requires:

> 11.42 An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance. For example, for long-term debt such information would normally include the terms and conditions of the debt instrument (such as interest rate, maturity, repayment schedule, and restrictions that the debt instrument imposes on the entity).

47. Nevertheless, some IASB members and some stakeholders may have concerns about the loss of credit risk information for users of SME financial statements if the IASB decides to retain the incurred loss model. Therefore, the staff suggest the IASB explores whether it can mitigate these concerns through additional disclosure requirements.

Who would additional disclosures apply to?

48. When the IASB developed the proposals in the Exposure Draft, it concluded that:

    (a) moving to an ECL model would provide better information for users of financial statements when SMEs hold longer-term financial assets; but

    (b) retaining an incurred loss model for impairment would be the approach best supported by cost–benefit considerations for SMEs that hold trade receivables, which are normally short-term, non-interest-bearing assets.

49. Therefore, the IASB could consider requiring additional disclosures to support the incurred loss model when SMEs have significant long-term financial assets, for example, SMEs that provide financing to customers as a main business activity. This would avoid adding excessive disclosures for all SMEs. Alternatively, the IASB could introduce some disclosures for all SMEs, such as an aging analysis of financial assets and/or greater disaggregation of financial assets, and then consider whether to require additional credit risk disclosures for SMEs that provide financing to customers as a main business activity. Such an approach would be consistent with decisions taken by the IASB in April and May 2023 for the IFRS 7 credit risk disclosure requirements in

its Subsidiaries without Public Accountability project. The IASB decided that in the forthcoming IFRS Accounting Standard *Subsidiaries without Public Accountability* (Subsidiaries Standard) the disclosure requirements proposed in paragraph 62, 66 and 67 of the Exposure Draft ED/2021/7 *Subsidiaries without Public Accountability: Disclosures* (which relate to credit risk management practices, changes in the loss allowance and credit risk exposure) would only be applicable to subsidiaries that provide financing to customers as a main business activity. IASB members observed that for many subsidiaries without public accountability, these disclosure requirements could be excessive—but for subsidiaries such as non-bank lenders, they included critical information.

How could additional credit risk disclosures be developed?

50. When the IASB proposes amendments to the recognition and measurement requirements in the *IFRS for SMEs* Accounting Standard to align them with full IFRS Accounting Standards, the disclosures in the forthcoming Subsidiaries Standard are an appropriate starting point for amending disclosures in the *IFRS for SMEs* Accounting Standard because these are reduced from full IFRS Accounting Standards. However, unless the IASB decides to align the *IFRS for SMEs* Accounting Standard with an ECL model, the credit risk disclosure requirements in the Subsidiaries Standard (which are reduced from IFRS 7) would not be a good starting point because they depend on ECL information. Furthermore, as part of the Post-implementation Review of IFRS 9 Impairment project, the IASB is seeking feedback on concerns raised by stakeholders that there is lack of consistency in the type and granularity of information disclosed by different entities for credit risk.

51. The staff think it is important for SMEs and users of SME financial statements to have straight forward, objective disclosure requirements that enable them to assess an SME’s future cash flows. As noted in paragraph 27, the staff think user needs may be better satisfied by simple disclosures such as an aging analysis of financial assets and greater disaggregation of financial assets in paragraph 11.41 of the Standard, rather than the more judgemental and sophisticated ECL information.

52. One SMEIG member noted that FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of* Ireland, which is based on the *IFRS for SMEs* Accounting Standard, extends paragraph 11.42 by adding:

> 11.42 …. When the risks arising from financial instruments are particularly significant to the business (for example because they are principal risks for the entity), additional disclosure may be required. Paragraphs 34.19 to 34.30, which set out disclosure requirements for financial institutions, include examples of disclosure requirements for risks arising from financial instruments that may be relevant in such cases.

FRS 102 was based on the *IFRS for SMEs* Accounting Standard and applies an incurred loss model to financial assets. However, it is applied to a wider scope of entities that the *IFRS for SMEs* Accounting Standard, including some financial institutions (for example, non-listed banks, credit unions and building societies).

53. The staff think the IASB could consider the following disclosures in paragraphs 34.19 to 34.30 of FRS 102 when developing additional disclosures to support the incurred loss model as these were based on the credit risk disclosure requirements in IFRS 7 before it was updated for the introduction of the ECL model in IFRS 9 (see FRS 102 for the full disclosure requirements):

(a) paragraphs 34.23 and 34.24 of FRS 102 require a financial institution to disclose information that enables users of its financial statements to evaluate the nature and extent of credit risk, liquidity risk and market risk arising from financial instruments to which the financial institution is exposed at the end of the reporting period, including disclosing for each type of risk:

(i) the exposures to risk and how they arise;

(ii) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and

(iii) any changes in (a) or (b) from the previous period.

(b) paragraphs 34.25 and 34.26 include credit risk disclosure requirements, for example, a financial institution is required to disclose the following by class of financial instrument:

(i) the amount that best represents its maximum exposure to credit risk at the end of the reporting period. This disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

(ii) information about the credit quality of financial assets that are neither past due nor impaired.

(iii) an analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired.

(iv) an analysis of the financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the financial institution considered in determining that they are impaired.

Other considerations—financial guarantee contracts

54. Issued financial guarantee contracts are measured at fair value with changes in fair value recognised in profit or loss applying Section 12 *Other Financial Instrument Issues* of the Standard. The IASB has received feedback that the requirements for issued financial guarantee contracts in the Standard are more complex than the requirements in IFRS 9. The Exposure Draft proposed to align the requirements for issued financial guarantee contracts in the Standard with IFRS 9, with simplifications (see paragraph 11.14(d) of the Exposure Draft). If an ECL model is not introduced for all SMEs that issue financial guarantee contracts (for example, under Alternatives 2–4), then the IASB would need to reconsider its proposals for issued financial guarantee contracts.

55. Under an incurred loss model, the staff have identified the following alternatives that could be considered for issued financial guarantee contracts:

(a) retain the existing requirements in the Standard—issued financial guarantee contracts would continue to be measured at fair value with changes in fair value recognised in profit or loss.

(b) require SMEs to account for issued financial guarantee contracts applying Section 21 *Provisions and Contingencies*, with appropriate disclosures.

(c) consider the accounting requirements for issued financial guarantee contracts under full IFRS Accounting Standards prior to introduction of an ECL model (in IAS 39), with appropriate simplifications.[1]

The staff will bring a paper to a future IASB meeting with our recommendations for accounting for issued financial guarantee contracts.

Questions for the IASB

56. The staff seek the IASB's views on whether the ECL model meets the relevance principle for SMEs and also a decision on which of the four alternatives the staff should develop further for discussion at a future IASB meeting.

Questions for the IASB
1) Does the IASB think that the ECL model meets the relevance principle for SMEs? 2) If the IASB is not satisfied that the ECL model meets the relevance principle, does the IASB agree to retain an incurred loss model for financial assets measured at cost or amortised cost and consider whether to introduce additional disclosure requirements (Alternative 4)? 3) If the IASB is satisfied that the ECL model meets the relevance principle, which of the Alternatives 1–4 would the IASB like the staff to develop further?

Next steps

57. The staff will bring a paper to a future IASB meeting on the alternative or alternatives that the IASB has chosen for further consideration. The paper will also provide recommendations for accounting for issued financial guarantee contracts.

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[1] Under IAS 39 *Financial Instruments: Recognition and Measurement*, an issued financial guarantee contract was initially recognised at fair value and then subsequently measured at the higher of (a) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

Appendix—extract from the Basis for Conclusions on the Exposure Draft

A1. The following extract summarises the considerations of the IASB when developing the proposals for the impairment of financial assets.

BC76 Some IASB members expressed concern about modifying the simplified approach in IFRS 9 for SMEs, for example, by introducing a best–estimate approach. Their concern was that such an approach may imply an outcome aligned with the expected credit loss model in IFRS 9, which may not necessarily be true. For example, some members raised concerns that an SME's best estimate might be interpreted as the most likely repayment outcome, meaning an SME could conclude that its best estimate of credit losses is nil. Such an interpretation would be inconsistent with the IFRS 9 expected credit loss model, which requires an entity to consider the possibility that a credit loss will occur even if the possibility is low. The IASB observed that the expected credit loss model in IFRS 9 contains several expedients and was designed to be proportionate for different types of entities, because 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 decided that if a forward-looking impairment model is proposed the Standard should be aligned with the simplified approach in IFRS 9, with further simplifications for SMEs if necessary, rather than introducing modifications to that model for SMEs. In considering whether to include an expected credit loss model into the Standard, the IASB observed that:

(a) the expected credit loss model in IFRS 9 was developed predominantly to respond to concerns, which were highlighted during the 2008 financial crisis, about delayed recognition of credit losses on loans. Financial institutions are generally outside the scope of the Standard. SMEs typically have no significant long-term loan receivables or investments in bonds. Many SMEs only hold short-term, non-interest-bearing financial assets, specifically trade

receivables.

(b) feedback on the Request for Information and from interviews with preparers identified that SMEs already consider forward-looking information when assessing the impairment of trade receivables. Such information is considered because SMEs usually prepare less timely financial statements, meaning SMEs 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.

(c) feedback also identified that many SMEs already apply a collective impairment approach using a provision matrix. This feedback highlighted that, for SMEs holding only trade receivables, moving to an expected credit loss model is likely to involve substantial implementation costs without a substantial change in impairment information or benefits for users of their financial statements.