**Staff paper**

Agenda reference: 30C

**IASB® meeting**

| | |
|---|---|
| Date | **July 2024** |
| Project | **Second Comprehensive Review of the *IFRS for SMEs*® Accounting Standard** |
| Topic | **Impairment of financial assets—disclosures and transition** |
| Contact | Tinyiko Denhere (tinyiko.denhere@ifrs.org) |



## Introduction

1. Agenda Paper 30B *Impairment of financial assets—Impairment model* of this meeting discusses the recognition and measurement requirements for impairment of financial assets.

2. This paper discusses the disclosure and transition requirements for impairment of financial assets.

3. If the IASB agrees with the staff recommendation in Agenda Paper 30B of this meeting, then Part 2 (paragraphs 19–50) of this paper will not be discussed.

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

## Purpose of the paper

5. The purpose of this paper is for the International Accounting Standards Board (IASB):

   (a) to consider feedback on the disclosure requirements for impairment of financial assets proposed in Section 11 *Basic Financial Instruments* (proposed to be renamed *Financial Instruments*) of the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft);

(b) to consider differences between the proposed disclosure requirements and the disclosure requirements for impairment of financial assets in IFRS 19 *Subsidiaries without Public Accountability: Disclosures*;

(c) to consider feedback on the proposed transition requirements for initial application of the amended requirements for impairment of financial assets in Section 11; and

(d) to decide whether to change the proposed disclosure and transition requirements.

## Staff recommendation

6. If the IASB agrees with the staff recommendation in Agenda Paper 30B (retain the incurred loss model for all SMEs), the staff recommend the IASB add a requirement for SMEs to disclose an analysis of financial assets by due date (ageing analysis).

7. If the IASB does not agree with the staff recommendation in Agenda Paper 30B (introduce an expected credit loss model (ECL model) for SMEs that provide financing to customers as one of their primary businesses and retain the incurred loss model for other SMEs), the staff recommend the IASB:

   (a) add a requirement for SMEs to disclose a provision matrix when applying the ECL model;

   (b) confirm the proposed disclosure requirements in paragraph 11.49–11.50 of the Exposure Draft which require an SME applying an ECL model:

      (i) to explain the basis of inputs and assumptions and the estimation techniques used when measuring expected credit losses; and

      (ii) to explain the changes in the allowance for expected credit losses and the reasons for those changes;

(c) add a requirement for SMEs to disclose an ageing analysis when applying the incurred loss model; and

(d) finalise its proposals for initial application of the amended requirements in Section 11 for applying the ECL model retrospectively unless impracticable.

## Structure of this paper

8. This paper is structured as follows:

(a) Part 1—disclosure and transition requirements for impairment of financial assets if the IASB agrees with the staff recommendation in Agenda Paper 30B (Option 2 in that paper—retain an incurred loss model) (paragraphs 9–18);

(b) Part 2—disclosure and transition requirements for impairment of financial assets if the IASB does not agree with the staff recommendation in Agenda Paper 30B (Option 1 in that paper—introduce an ECL model) (paragraphs 19–50); and

(c) Appendix A—illustrative example of a provision matrix.

## Part 1—Disclosure and transition requirements for impairment of financial assets if the IASB agrees with the staff recommendation in Agenda Paper 30B

9. Part 1 of this Agenda Paper is structured as follows:

(a) disclosure requirements when applying the incurred loss model (paragraphs 10–16);

(b) transition requirements when applying the incurred loss model (paragraph 17); and

(c) staff recommendation and question for the IASB (paragraph 18).

### ***Disclosure requirements when applying the incurred loss model***

*Background*

10. The impairment model in the second edition of the Standard is an incurred loss model. The disclosure requirements are set out in paragraph 11.39–11.48 of the Standard. In particular, paragraph 11.42 of the Standard states that:

> 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).

*Staff Analysis*

11. At its September 2023 meeting, the IASB considered four alternative approaches to address the feedback on the proposals for impairment of financial assets in the Exposure Draft.[1]

12. Alternative 4 considered whether to retain the incurred loss model in the Standard for impairment of financial assets and explore requiring additional disclosures. The additional disclosures that the IASB discussed included an ageing analysis (based on the disclosures in IFRS 7 *Financial Instruments: Disclosures* before it was updated for the introduction of the ECL model) and/greater disaggregation of financial assets for all SMEs.

13. As discussed in paragraph 32 of Agenda Paper 30B, a few users of SMEs' financial statements said they request additional information from SMEs such as an analysis of receivables to understand the concentration and collectability of receivables. In

[1] See Agenda Paper 30F *Impairment of financial assets* of the September 2023 IASB meeting.

addition, during the comment period on the [Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*], the staff conducted user outreach and users agreed that the principles in paragraph BC157 of the Basis for Conclusions on the second edition of the Standard continue to be appropriate for setting disclosure requirements in the Standard. Furthermore, some users said that cash flow information is important in understanding an SMEs' financial health and that further disaggregation of other payables and other receivables would be useful.

14. In addressing the user feedback on the disaggregation of other payables and other receivables the IASB proposed in paragraph 4.3 of the Exposure Draft, the disaggregation of line items in the statement of financial position when such presentation helps users understand the SME's financial position. In addition, in May 2024, the IASB tentatively decided to add a requirement to Section 11 for an SME to disclose a maturity analysis for financial liabilities (based on paragraph 39 of IFRS 7).

15. The staff think that an ageing analysis will provide users of SMEs' financial statements with information about the SME's expected cash flows. As most IT systems include the functionality to produce an aged receivables list, the cost to SMEs of obtaining the information to provide an ageing analysis will not be significant. Therefore, the staff think that the benefit to users would outweigh the costs to SMEs.

*Staff recommendation*

16. The staff recommend the IASB add a requirement for SMEs to disclose an ageing analysis.

### *Transition requirements when applying the incurred loss model*

17. If the incurred loss model for the impairment of financial assets is retained for all SMEs, the staff note that there will be no change in accounting policy for SMEs and thus there is no need for transition requirements.

## Staff recommendation and question for the IASB

18. The staff recommend the IASB add a requirement for SMEs to disclose an ageing analysis.

| Question for the IASB |
| --- |
| 1. Does the IASB agree with the staff recommendation in paragraph 18 of this paper? |

## Part 2—Disclosure and transition requirements for impairment of financial assets if the IASB does not agree with the staff recommendation in Agenda Paper 30B

19. Part 2 of this Agenda Paper is structured as follows:

(a) disclosure requirements when applying the ECL model (paragraphs 20–37);

(b) disclosure requirements when applying the incurred loss model (paragraphs 38–39);

(c) transition requirements when applying the ECL model (paragraphs 40–48);

(d) transition requirements when applying the incurred loss model (paragraph 49); and

(e) staff recommendation and question for the IASB (paragraph 50).

### *Disclosure requirements when applying the ECL model*

*Background*

20. In setting disclosure requirements to include in the Standard, where recognition and measurement requirements are aligned with full IFRS Accounting Standards, the IASB uses the disclosure requirements in full IFRS Accounting Standards and reduces those disclosure requirements for SMEs using the principles in paragraph BC157 of the Basis for Conclusions on the Standard.

21. In the Exposure Draft, the IASB proposed an SME apply an ECL model for some financial assets and disclose:

    (a) the basis of the inputs, assumptions and estimation techniques used to apply the ECL model, including how forward-looking information has been incorporated into the determination of expected credit losses; and

    (b) a reconciliation of the opening balance to the closing balance of the allowance for expected credit losses by class of financial instrument.[2]

22. The staff analysis in this paper does not reconsider how the proposed disclosure requirements in the Exposure Draft were reduced from full IFRS Accounting Standards but analyses the feedback on the proposed disclosure requirements.

### *Feedback from fieldwork participants on the proposed disclosure requirements*

23. During the fieldwork (see Agenda Paper 30B of this meeting), users of SMEs' financial statements were asked their views on the proposed disclosure requirements in the Exposure Draft and if there is any additional information that would be helpful to understand the effects of SMEs' application of the ECL model.

24. Half of users said that the proposed disclosure requirements would be sufficient. Other users suggested additional information that would be helpful to understand the SMEs' application of the ECL model. Suggestions included:

    (a) a detailed breakdown of financial instruments by type and risk characteristics.

    (b) a description of risk management practices, including how SMEs identify, measure, and monitor credit risk, as well as the strategies they employ to mitigate such risks. Understanding an entity's approach to risk management can provide confidence in the robustness of the ECL calculations.

[2] This paragraph summarises the proposed disclosure requirements. See paragraphs 11.49-11.50 of the Exposure Draft for the disclosure requirements.

(c) more granular disclosure on the forward-looking information, including economic and credit condition forecasts that influence the ECL estimates. This could involve disclosing the scenarios considered and their respective impacts on expected credit losses.

(d) a comparison of loss allowances under the incurred loss model and the ECL model for a transitional period, to help stakeholders gauge the impact of the change in methodology on the allowance for credit losses.

25. Simultaneously, preparers of SMEs' financial statements and accounting practitioners who took part in the fieldwork were asked if SMEs will be able to provide the proposed disclosure requirements. Many of the accounting practitioners said, in their view, SMEs would not be able to provide the proposed disclosure requirements because of SMEs' lack of technical expertise and resources.

### *Feedback from Exposure Draft Subsidiaries without Public Accountability: Disclosures*

26. At the May 2024 IASB meeting, the IASB considered the differences between the disclosure requirements in the Standard and those in IFRS 19 *Subsidiaries without Public Accountability Disclosures* and tentatively decided whether to make changes to the disclosure requirements in the Standard.[3]

27. At that meeting the IASB did not consider the disclosure requirements relating to impairment of financial assets. Therefore, this section discusses whether changes made to the proposed disclosure requirements for impairment of financial assets in finalising IFRS 19 should be reflected in the third edition of the Standard, if an ECL model is required.

28. Paragraph 54(c) of the Exposure Draft *Subsidiaries without Public Accountability: Disclosures* (Subsidiaries Exposure Draft) was based on paragraph 11.48(c) of the

[3] See Agenda Paper 30D *Disclosure requirements: IFRS for SMEs Accounting Standard and IFRS 19 Subsidiaries without Public Accountability: Disclosures* of the May 2024 IASB meeting.

Standard and requires disclosure of the amount of any impairment loss for each class of financial asset. In finalising IFRS 19, the IASB withdrew this proposed disclosure requirement as it is not required by IFRS 7. The IASB aligned IFRS 19 with IFRS 7 which requires information about changes in the loss allowance.

29. In finalising IFRS 19, the IASB restricted the application of the following disclosure requirements to an entity that provides financing to customers as a main business activity as described in IFRS 18 *Presentation and Disclosure in Financial Statements*:

    (a) paragraph 35F(a) of IFRS 7 which requires disclosure of how an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including how financial instruments are considered to have low credit risk;

    (b) paragraph 35F(b) of IFRS 7 which requires disclosure of an entity's definitions of default, including the reasons for selecting those definitions;

    (c) paragraph 35I of IFRS 7 which requires disclosure of an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance; and

    (d) paragraph 35M of IFRS 7 which requires disclosure by credit risk rating grades, of the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts.

30. The disclosure requirements in paragraph 29 of this paper were not proposed in the Exposure Draft.

*Staff Analysis*

31. The requirements in paragraph 29(a)–(b) of this paper (paragraph 35F(a)–(b) of IFRS 7) relate to the general approach applying IFRS 9 *Financial Instruments*. Should the IASB introduce an ECL model into the Standard it would be aligned with the simplified approach in IFRS 9 (as proposed in the Exposure Draft). Therefore, paragraph 35F(a) and 35F(b) of IFRS 7 would not be applicable.

32. The disclosure requirements in paragraph 29(c)–(d) of this paper (paragraphs 35I and 35M of IFRS 7) are partially applicable to the simplified approach and were included in IFRS 19 as they provide users of financial statements with disaggregation and information on measurement uncertainty (see paragraph BC157 of the Basis for Conclusions on the Standard).

33. Paragraph 35I of IFRS 7 provides information to help users of financial statements understand the changes in the loss allowance by explaining the relationship between the gross carrying amount of financial instruments and its loss allowance. Paragraph 11.50 of the Exposure Draft proposed to require an SME to provide a reconciliation from the opening balance to the closing balance of the allowance to explain the changes in the allowance for expected credit losses and the reasons for those changes. The staff think that the proposed disclosure in paragraph 11.50 of the Exposure Draft will provides users of SMEs' financial statements with information about the changes in the loss allowance.

34. Paragraph 35M of IFRS 7 requires the disclosure, by credit risk rating grades, of the gross carrying amount of financial assets and the exposure to credit risk on loan commitment and financial guarantee contracts. Paragraphs 35M(b)(iii) and 35M(c) apply to financial assets to which the simplified approach is applied. As explained if the IASB introduce an ECL model it will be the simplified approach therefore these paragraphs could be applicable to SMEs.

35. Paragraph 35N of IFRS 7 permits the information provided in accordance with paragraph 35M to be based on a provision matrix. The staff think, requiring SMEs to disclose a provision matrix will provide users of SMEs' financial statements with information on measurement uncertainty but will avoid the cost of providing the information required by paragraph 35M of IFRS 7. The staff think that SMEs that provide financing to customers as one of their primary businesses will have the information to disclose a provision matrix as they have credit risk management processes, and so the costs of providing this disclosure are not expected to be

significant. See Appendix A to this paper for an illustrative example of a provision matrix.

36. Feedback from fieldwork, one the one hand, indicated that users would like additional disclosures when SMEs apply an ECL model (see paragraph 24 of this paper). On the other hand, feedback from accounting practitioners indicated that SMEs will not be able to provide the proposed disclosures due to limited resources (see paragraphs 25 of this paper). The staff think requiring SMEs to disclose a provision matrix strikes the right balance of costs to SMEs and benefits to users of SMEs' financial statements. This is because the costs to SMEs are not expected to be significant (as discussed in paragraph 35 of this paper) and the provision matrix will provide users of SMEs' financial statements with an analysis of the financial assets, which will provide information on measurement uncertainty.

### *Staff recommendation*

37. The staff recommend the IASB:

(a) add a requirement for SMEs to disclose a provision matrix when applying the ECL model; and

(b) confirm the proposed disclosure requirements in paragraph 11.49–11.50 of the Exposure Draft which require an SME applying an ECL model:

(i) to explain the basis of inputs and assumptions and the estimation techniques used when measuring expected credit losses; and

(ii) to explain the changes in the allowance for expected credit losses and the reasons for those changes.

### ***Disclosure requirements when applying the incurred loss model***

*Staff Analysis*

38. The staff notes that if the IASB introduce an ECL model for SMEs that provide financing to customers as one of their primary businesses, other SMEs will apply an incurred loss model. The staff think the disclosure requirements discussed in Part 1 of this paper (see paragraphs 10–15 of this paper) will apply to these other SMEs.

*Staff recommendation*

39. The staff recommend the IASB add a requirement for SMEs to disclose an ageing analysis when applying the incurred loss model.

### ***Transition requirements when applying the ECL model***

*Proposals in the Exposure Draft*

40. In the Exposure Draft, the IASB proposed to require SMEs to apply an ECL model for financial assets measured at amortised cost except for trade receivables and contract assets within the scope of revised Section 23 *Revenue from Contracts with Customers*.

41. The IASB also proposed that an SME apply the amended impairment requirements in Section 11 retrospectively, subject to the impracticability exemption for SMEs (applying paragraph 10.12 of the Standard).

42. The impracticability exemption in paragraph 10.12 of the Standard states that, when it is impracticable to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, an SME is required to apply the new accounting policy to the carrying amounts of assets and liabilities at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding

adjustment to the opening balance of each affected component of equity for that period.

*Feedback on proposed Section 11 transition requirements*

43. Most respondents agreed with the proposed Section 11 transition requirements. However, a few respondents disagreed with the proposed Section 11 transition requirements for impairment of financial assets. Each of the following comments were made by a few respondents:

(a) the IASB should provide relief from retrospective application similar to that given to preparers transitioning to IFRS 9; and

(b) the IASB should provide an undue cost or effort exemption from retrospective application of the proposed requirements for impairment of financial assets. The respondents noted that retrospective application is costly and might potentially compromise the reliability of the information given the resource constraints of SMEs.

*Staff analysis*

44. Introducing an ECL model for SMEs that provide financing to customers as one of their primary businesses is different to the proposals in the Exposure Draft (see paragraph 40 of this paper). However, the staff think that the proposed transition requirements remain appropriate because the same ECL model would be introduced in the third edition of the Standard, albeit that it would be applied based on the entity's activities rather than type of financial assets.

45. When the IASB proposed the transition requirement in the Exposure Draft, it proposed some relief to retrospective application. The reliefs were generally to reflect the comparable transition reliefs in full IFRS Accounting Standards, with simplifications when they were considered appropriate for SMEs. Therefore, in

proposing the transition requirements in paragraph 41 of this paper, the IASB considered the transition reliefs available in IFRS 9.[4]

46. The transition relief in IFRS 9 related to the concept of significant increase in credit risk (see paragraphs 7.2.17–7.2.20 of IFRS 9). This relief is not applicable because should the IASB proceed with an ECL model in the Standard it will be aligned with the simplified approach in IFRS 9 (as proposed in the Exposure Draft), and does not require the tracking of significant increases in credit risk.

47. The Glossary to the Standard defines impracticable as 'applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so'. The staff acknowledges that impracticability is a higher hurdle than undue cost or effort, because unlike the undue cost or effort exemption, it does not allow for an entity to assess whether the benefits of making a change justify the costs. However, the staff think the impracticability exemption would result in more comparable financial statements and therefore result in the most useful information for users of SMEs' financial statements.

*Staff recommendation*

48. The staff recommend the IASB finalise its proposals for initial application of the amended requirements in Section 11 for applying the ECL model retrospectively unless impracticable.

### *Transition requirements when applying the incurred loss model*

49. If the IASB introduces an ECL model for SMEs that provide financing to customers as one of their primary businesses, other SMEs will continue to apply an incurred loss model. The staff notes that there will be no changes to the accounting policy for these SMEs and thus there is no need for transition requirements.

[4] See Agenda Paper 30E *Towards an exposure draft–IFRS for SMEs Accounting Standard transition requirements for alignment with new IFRS Accounting Standards* of the May 2022 IASB meeting.

## Staff recommendation and question for the IASB

50. The staff recommend the IASB:

(a) add a requirement for SMEs to disclose a provision matrix when applying the ECL model;

(b) confirm the proposed disclosure requirements in paragraph 11.49–11.50 of the Exposure Draft which require an SME applying an ECL model:

(i) to explain the basis of inputs and assumptions and the estimation techniques used when measuring expected credit losses; and

(ii) to explain the changes in the allowance for expected credit losses and the reasons for those changes;

(c) add a requirement for SMEs to disclose an ageing analysis when applying the incurred loss model; and

(d) finalise its proposals for initial application of the amended requirements in Section 11 for applying the ECL model retrospectively unless impracticable.

| Question for the IASB |
|---|
| 2. Does the IASB agree with the staff recommendation in paragraph 50 of this paper? |

## Appendix A— illustrative example of a provision matrix

A1. The following example from paragraph IG20D of the Implementation Guidance on IFRS 7 illustrates the use of a provision matrix as a risk profile disclosure under the simplified approach.

A2. Entity A manufactures cars and provides financing to both dealers and end customers. Entity A discloses its dealer financing and customer financing as separate classes of financial instruments and applies the simplified approach to its trade receivables so that the loss allowance is always measured at an amount equal to lifetime expected credit losses.

| **20XX**<br>CU'000 | **Trade receivables days past due** | | | | |
|---|---|---|---|---|---|
| **Dealer financing** | **Current** | **More than 30 days** | **More than 60 days** | **More than 90 days** | **Total** |
| Expected credit loss rate | 0.10% | 2% | 5% | 13% | |
| Estimated total gross carrying amount at default | CU20,777 | CU1,416 | CU673 | CU235 | CU23,101 |
| Lifetime expected credit losses—dealer financing | CU21 | CU28 | CU34 | CU31 | CU114 |
| **Customer financing** | | | | | |
| Expected credit loss rate | 0.20% | 3% | 8% | 15% | |
| Estimated total gross carrying amount at default | CU19,222 | CU2,010 | CU301 | CU154 | CU21,687 |
| Lifetime expected credit losses— customer financing | CU38 | CU60 | CU24 | CU23 | CU145 |