IFRS® Accounting

Staff paper

Agenda reference: 30B

IASB® meeting

Date	**July 2024**
Project	**Second Comprehensive Review of the *IFRS for SMEs®* Accounting Standard**
Topic	**Impairment of financial assets—Impairment model**
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Purpose of the paper

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

   (a) consider the feedback from the fieldwork to understand the potential effects of its tentative decision on the impairment of financial assets 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); and

   (b) decide whether to make any changes to the requirements for the impairment of financial assets in Section 11.

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

Staff recommendation

3. The staff recommend the IASB retains the incurred loss model for the impairment of SMEs' financial assets.

Structure of this paper

4. This paper is structured as follows:
   - (a) background (paragraphs 5–25);
   - (b) feedback from fieldwork (paragraphs 26–46);
   - (c) staff analysis (paragraphs 47–86); and
   - (d) staff recommendation and question for the IASB (paragraph 87).

Background

5. The background section is structured as follows:
   - (a) requirements for the impairment of financial assets in the Standard (paragraph 6);
   - (b) development of the proposals in the Exposure Draft (paragraphs 7–10);
   - (c) proposals in the Exposure Draft (paragraphs 11–12);
   - (d) feedback on the proposals in the Exposure Draft (paragraphs 13–14);
   - (e) relevance to SMEs (paragraphs 15–22); and
   - (f) the IASB's January 2024 tentative decision (paragraphs 23–25).

Requirements for the impairment of financial assets in the Standard

6. Section 11 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 the IAS 39 *Financial Instruments: Recognition and Measurement* incurred loss model.

Development of the proposals in the Exposure Draft

7. The IASB discussed aligning the requirements for impairment of financial assets in the Standard with IFRS 9 *Financial Instruments* during its development of the [Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*] (Request for Information). During its discussions, the IASB noted that the scope of the Standard excludes entities that holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Consequently, most banks, credit unions, insurance companies, securities brokers, securities dealers, mutual funds and investment banks have public accountability and are outside the scope of the Standard. Consequently, the IASB's initial view was that the general approach to impairment in IFRS 9 would not be relevant to entities applying the Standard.[1]

8. IFRS 9 includes a simplified approach which requires lifetime expected credit losses to be recognised on trade receivables, contract assets and lease receivables. The approach requires the loss allowance to be measured at an amount equal to lifetime expected credit losses. The approach also removes the need to track separately increases in credit risk.

9. In January 2020, the IASB published the Request for Information which asked for views on introducing the simplified approach in IFRS 9 into the Standard to replace the incurred loss model.[2] Feedback on the Request for Information was that the simplified approach in IFRS 9 was too complex for SMEs and further simplification was needed.

10. Feedback from interviews with global preparers was that implementing the simplified approach in IFRS 9 would be complex for SMEs and may 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 a survey and interviews with users of SMEs' financial statements did not show a demand for more

[1] See paragraph B35 of the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*

[2] See paragraph B36–B37 of the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*

sophisticated information that would be provided by applying an expected credit loss model (ECL model) to financial assets held by SMEs.[3]

Proposals in the Exposure Draft

11. Based on the feedback on the Request for Information, outreach meetings and the advice of the SMEIG, the IASB was of the view that:[4]

    (a) 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 would balance the costs to SMEs that hold trade receivables, which are normally short-term, non-interest-bearing assets.

12. 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 in the Exposure Draft [5]

13. Most respondents to the Exposure Draft disagreed with the proposal to introduce an ECL model for some financial assets for cost-benefit reasons and suggested the incurred loss model is retained for all financial assets measured at amortised cost.

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[3] See paragraphs BC74–BC75 of the Basis of Conclusions on the Exposure Draft

[4] See paragraph BC77 of the Basis of Conclusions on the Exposure Draft

[5] A more detailed summary is presented in paragraphs 6–16 of Agenda Paper 30F *Impairment of financial assets* of the September 2023 IASB meeting.

14. Respondents that disagreed with the proposed ECL model provided the following reasons for their view:

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

    (b) the types of financial assets measured at amortised cost that are held by SMEs are generally straightforward (other than short-term and non-interest-bearing financial instruments such as trade receivables, SMEs might have intragroup and employee receivables) and the benefits of applying the ECL model may not outweigh the costs and practical difficulties for those financial assets.

    (c) many SMEs do not have resources 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.

Relevance to SMEs

15. The alignment approach treats alignment with full IFRS Accounting Standards as the starting point for developing the 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 alignment should take place.

16. The IASB determines relevance to SMEs by assessing whether the problem addressed by a new requirement in full IFRS Accounting Standards would make a difference in the decisions of users of financial statements prepared applying the Standard.[6]

17. At the September 2023 IASB meeting, the staff asked the IASB to discuss whether the ECL model satisfies the 'relevance to SMEs' principle of alignment. The IASB had

[6] Paragraph BC30 of the Basis for Conclusions on the Exposure Draft.

mixed views on whether the principle is met. However, most IASB members were of the view that:

(a) the population of SMEs that has significant exposure to credit risk is small, and for the vast majority of SMEs the problem addressed by the ECL model in IFRS 9 would be unlikely to make a significant difference in the decisions of users of their financial statements (that is it did not meet the relevance principle); and

(b) a small population of SMEs, such as non-bank lenders, might have significant exposure to credit risk.

18. At its September 2023 meeting, the IASB asked the staff to research alternative approaches that would recognise expected credit losses for the small population of SMEs that might have significant exposure to credit risk.

Survey to national standard-setters

19. In November 2023, the staff sent a survey to national standard-setters with the aim of determining the extent of entities applying the Standard that could have significant exposure to credit risk.

20. The staff received responses from national standard-setters in 15 jurisdictions. Some respondents said that there are SMEs that have significant exposure to credit risk in their jurisdiction. However, the respondents generally found it difficult to estimate how many SMEs are the types of entities that could have significant exposure to credit risk. Most of these respondents said there is limited information or insufficient evidence to support making an estimation.

Feedback from the SME Implementation Group (SMEIG)

21. At its December 2023 meeting, SMEIG members were asked their views on estimating how many SMEs are the types of entities that could have significant exposure to credit risk.

22. Some SMEIG members said it was difficult to obtain data to estimate how many SMEs are the types of entities that could have significant exposure to credit risk in their jurisdiction. Some SMEIG members said:

    (a) entities that have significant exposure to credit risk such as non-bank lenders generally apply full IFRS Accounting Standards; and

    (b) there are SMEs that might have significant exposure to credit risk such as micro lenders or those involved in leasing that apply the Standard or local GAAP.

The IASB's January 2024 tentative decision

23. At its January 2024 meeting, the IASB considered the feedback from national standard-setters and the SMEIG and tentatively decided to change the proposals in the Exposure Draft[7]:

    (a) to require SMEs that do not provide financing to customers as one of their primary businesses to continue to use the incurred loss model to measure the impairment of financial assets; and

    (b) to require SMEs that provide financing to customers as one of their primary businesses to apply an ECL model, aligned with the simplified approach in IFRS 9, to measure the impairment of financial assets.

24. At that meeting, the IASB decided to field test its tentative decision to change the proposals in the Exposure Draft with users of SMEs' financial statements, preparers of SMEs' financial statements and accounting practitioners involved in the preparation or assurance of SMEs' financial statements.

25. This paper sets out the summary of the feedback from the fieldwork. The methodology used for the fieldwork is described in Agenda Paper 30A *Impairment of financial assets—Fieldwork methodology* of this meeting.

[7] See Agenda Paper 30C *Impairment of financial assets* of the January 2024 IASB meeting and January IASB update.

Feedback from fieldwork

26. The feedback from fieldwork is structured as follows:

    (a) terminology used (paragraphs 27–30);

    (b) feedback from users (paragraphs 31–37); and

    (c) feedback from preparers and accounting practitioners (paragraphs 38–46).

Terminology used

27. In the feedback summary in this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs* Accounting Standard or local accounting requirements based on the *IFRS for SMEs* Accounting Standard.

28. This paper uses the following terms to give a broad indication of participants' views:

Term	Extent of response among participants
Almost all	all except a very small minority
Most	a large majority, with more than a few exceptions
Many	a small majority or large minority
Some	a small minority, but more than a few
A few	a very small minority

29. All feedback from participants about the ECL model relates to the simplified approach in IFRS 9.

30. The feedback from the fieldwork is discussed for two subgroups of participants:

    (a) users of SMEs' financial statements (users); and

    (b) preparers of SMEs' financial statements—accounting practitioners and SME preparers (preparers).

    See Appendix A of Agenda Paper 30A of this meeting for an overview of the fieldwork participants.

Feedback from users

31. Six users of SMEs' financial statements completed the questionnaire. Follow-up discussions were held with five of these users.

User information needs

32. The users of SMEs' financial statements identified information about cashflows, revenue, profitability, SMEs' growth over the years, future cash flows, sustainability of the business model and working capital as important when making their lending or investing decision to SMEs. A few users indicated that they request additional information from SMEs, such as an analysis of receivables to understand the concentration and collectability of receivables.

Effects of an ECL model

33. User feedback was mixed on the usefulness of information provided by the ECL model for SMEs that provide financing to customers as one of their primary businesses and the effect of the IASB's January 2024 tentative decision on comparability.

34. Half of the users said that the information provided by the ECL model would be useful for this group of SMEs because, in their view, the information would help them forecast cash flows and enhance credit risk monitoring. The other users said the ECL model would not provide useful information for this group of SMEs, or were unsure

whether it would do so, because of the challenges that SMEs will face in applying an ECL model and that the incurred loss model is more appropriate for SMEs due to the short-term nature of SMEs' loans.

35. Users were asked how comparability between the financial statements of SMEs they work with will be affected by the IASB's January 2024 tentative decision (as some SMEs will apply an incurred loss model of impairment, whereas some will apply an ECL model). Some users said the IASB's January 2024 tentative decision would not affect comparability for their purposes because they compare SMEs with similar business models. Some users noted that comparability will be affected when comparing a portfolio of SMEs across different business models and adjustments will be made to their analysis methods.

36. Over half of users said that introduction of the ECL model would result in a significant change in the amounts reported by some SMEs that provide financing to customers as one of their primary businesses. These users said this is due to the timing of the recognition of impairment losses differing between the incurred loss model and ECL model.

Proposed disclosures

37. Half of users said that the proposed disclosures would be sufficient. Other users suggested additional information that would be helpful to understand the SMEs' application of the ECL model, for example to help them assess credit risk management.

Feedback from preparers and accounting practitioners

38. A total of 17 accounting practitioners and six preparers completed the questionnaire. Follow-up discussions were held with 10 accounting practitioners and five preparers.

Determining whether a SME provides financing to customers as one of its primary businesses

39. Most accounting practitioners and almost all preparers said that they could determine whether the SME (or SMEs they work with) provide financing to customers as one of its primary businesses. The accounting practitioners and preparers who were unable to make the determination said that additional guidance would be needed to determine whether an SME provides financing to customers as one of its primary businesses. These accounting practitioners and preparers requested clearer requirements and guidance (including examples) on what constitutes ‘providing financing to customers as one of its primary businesses’, including clarity for SMEs that provide inter-company loans and SMEs that provide goods and/or services with extended payment terms.

40. Many accounting practitioners and most preparers said that there would be costs to determine whether an SME provides financing to customers as one of its primary businesses. The costs included practitioners’ fees and internal training costs.

41. Of the accounting practitioners that responded, half said they have SME clients that provide financing to customers as one of their primary businesses. Most preparers said they determined that their organisation provides financing to customers as one of its primary businesses. The accounting practitioners and preparers determined that the SMEs provide financing as one of their primary businesses because they undertake one of the following (each mentioned by one or a few):

   (a) provide micro-loans and financing to individuals and small businesses and their main revenue is interest income on the loans.

   (b) are engaged in short-term or long-term lending.

   (c) sell on instalment terms and charge interest.

   (d) are investment holding companies that generate income through dividends and extend loans to subsidiaries.

   (e) are lessors.

(f) allow extended payment terms.

42. A few accounting practitioners estimated that their clients that provide financing to customers as one of their primary businesses represent 5% or less of their total clients.

43. Accounting practitioners and preparers identified challenges and costs of applying an ECL model which can be summarised in the following categories: resource constraints, data availability and quality, system/process change and stakeholder communication.

44. Half of the preparers and a few accounting practitioners said SMEs that provide financing to customers have credit risk management systems in place, and as a result have historical data. However, they acknowledged that these SMEs would incur costs to make the data usable for applying the ECL model.

Proposed disclosures

45. Many of the accounting practitioners said, in their view, SMEs will not be able to provide the proposed disclosures because of SMEs' lack of technical expertise and resources.

Potential benefits of applying an ECL model

46. Feedback on the benefits of applying an ECL model by SMEs who provide financing to customers as one of their primary businesses was mixed. A few accounting practitioners and most preparers said that SMEs will benefit from applying an ECL model, by improving their risk management and ability to project future cash flows. However, a few accounting practitioners said SMEs who provide financing to customers as one of their primary businesses will not gain significant benefits from applying an ECL model when the SME's finance is provided by the owner manager.

Staff analysis

47. The staff analysis is set out as follows:

    (a) findings from fieldwork (paragraphs 48–67);

    (b) possible ways forward (paragraphs 68–85); and

    (c) reassessing the impairment of financial assets in a future review (paragraph 86)

Findings from fieldwork

48. The staff analysis of the findings from fieldwork is structured as follows:

    (a) fieldwork participants (paragraphs 49–50);

    (b) feedback from users (paragraphs 51–55);

    (c) feedback from preparers and accounting practitioners (paragraphs 56–66); and

    (d) staff conclusion on fieldwork findings (paragraph 67).

Fieldwork participants

49. As discussed in Agenda Paper 30A of this meeting, the sample of fieldwork participants is not a representative sample because participants choose whether to participate. That is, participants may have chosen to participate because their SME (or their clients) would be affected by introducing an ECL model. For example, all the preparers and accounting practitioners have IFRS 9 experience, however, it is unlikely that preparers applying the Standard have IFRS 9 experience.

50. In addition, the staff acknowledge few users of SMEs' financial statements participated in the fieldwork. Users of SMEs' financial statements are generally limited and a single user may use the financial statements of many SMEs, that is the ratio of a user to SMEs is usually one user for multiple SMEs. The staff think the insights provided by the users who participated in the fieldwork are valuable for the IASB to gain a better understanding of the potential effects of its tentative decision.

The staff note that user information needs are not jurisdiction-specific and in previous outreach with users, we did not limit our engagement to users from jurisdictions that require or permit the Standard.

Feedback from users

51. As discussed in Agenda Paper 30A of this meeting, the objective of the fieldwork conducted with users of SMEs' financial statements was to assess the potential effects of the IASB's January 2024 tentative decision. The staff think that this assessment will provide the IASB with a better understanding of the potential benefits that users of SMEs' financial statements will derive from the introduction of an ECL model for SMEs that provide financing to customers as one of their primary businesses and will inform the IASB's cost-benefit considerations.

52. The IASB's main objective in developing the impairment model in IFRS 9 was to provide users of financial statements with more useful information about an entity's expected credit losses on its financial assets and its commitments to extend credit to facilitate their assessment of the amount, timing and uncertainty of future cash flows.[8]

53. Overall, user feedback was mixed on the usefulness of the information provided by an ECL model when applied to SMEs. As discussed in paragraph 34 of this paper, half of the users said an ECL model would provide more useful information. Users that said the information from an ECL model would not be more useful cited challenges SMEs would have in applying the ECL model; and consequently, the quality of the information from an ECL model.

54. As discussed in paragraph 35 of this paper, user feedback was mixed on the effect of the IASB's January 2024 tentative decision on comparability. The staff think some users will have to make adjustments when comparing SMEs that apply different impairment models. The staff however think that the benefit of requiring SMEs that

[8] Paragraph BCE.96 of the Basis of Conclusions to IFRS 9 *Financial Instruments*

provide financing to customers as one of their primary businesses to apply an ECL model would outweigh the costs to users of making the adjustments.

55. Requiring SMEs that provide financing to customers as one of their primary businesses to apply an ECL model will improve information to users of their financial statements. Based on the users' information needs, as discussed in paragraph 32 of this paper an ECL model will assist users to assess future/expected cashflows, SMEs' growth, and the sustainability of the business model. However, the quality of the information provided will vary depending on the resources available to SMEs to apply the model well (given that some of the users said SMEs will experience difficulties in applying an ECL model).

Feedback from preparers and accounting practitioners

56. As discussed in Agenda Paper 30A of this meeting, the objective of the fieldwork conducted with preparers of SMEs' financial statements, was to identify:

(a) whether SMEs would be able to determine if they provide financing to customers as one of their primary businesses and the costs involved to make this determination.

(b) what would be the costs and benefits of applying an ECL model (aligned with the simplified approach in IFRS 9) for SMEs that provide financing to customers as one of their primary businesses.

Population of SMEs who provide financing to customers as one of their primary businesses

57. At its January 2024 meeting, the IASB discussed that the population of SMEs that has significant exposure to credit risk is likely to be small. As discussed in paragraph 42 of this paper, a few accounting practitioners indicated SMEs with significant exposure to credit risk represented 5% or less of their total clients. This feedback provides evidence that this population of SMEs is likely to be small.

Determining whether an SME provides financing to customers as one of its primary businesses

58. The IASB's January 2024 tentative decision aims to limit the application of an ECL model to a small population of SMEs—those that provide financing to customers as one of their primary businesses. However, all SMEs will be required to decide whether they provide financing to customers as one of their primary businesses so they can determine whether they are required to apply an ECL model or incurred loss model of impairment.

59. The description 'one of its primary businesses' is used in paragraph 1.3 of the Standard, whereas 'provide financing to customers' is not used in the Standard. The questionnaire included paragraphs 1.3–1.4 of the Standard and examples from the Standard's educational modules.

60. Although most accounting practitioners and preparers said they were able to decide if the SME provided finance to customers as one of their primary businesses the feedback also indicated the determination was not straightforward and some participants appeared to reach the incorrect conclusion.

61. The approach to making the assessment appeared to differ. Most accounting practitioners and preparers based the determination on either the SMEs' revenue streams, business activities and/or payment terms.

62. The staff also noted that SMEs are likely to rely on practitioners to make the determination, consequently, there will be a cost to all SMEs in making the determination whether they provide financing to customers as one of their primary businesses. This cost is likely to be a one-off cost unless the SME changes its activities.

63. The staff think that clear requirements, guidance and educational material would be needed for consistent application of the description and to reduce costs for SMEs.

Challenges and costs of applying an ECL model and potential benefits

64. The staff notes that the cost-benefit assessment differs for SMEs that provide financing to customers as one of their primary businesses and those that do not. Applying the January 2024 tentative decision SMEs that do not provide financing to customers as one of their primary businesses will retain the incurred loss model and therefore the costs will relate to making the determination on whether they provide financing to customers as one of their primary businesses.

65. Those SMEs that provide financing to customers as one of their primary businesses will incur costs in making the determination and then transitioning to the ECL model. The staff think that similar to entities applying IFRS 9, these SMEs will incur costs on initial application, however ongoing costs are unlikely to be significant. These costs will be lower than the transition costs that arose on applying IFRS 9 because:

    (a) the ECL model would be aligned with the simplified approach in IFRS 9, so the costs would be lower than applying the general approach in IFRS 9.

    (b) feedback indicates that SMEs that have significant exposure to credit risk have credit risk management systems in place and historical data.

66. The staff, however, think SMEs will need guidance (including examples) on applying the simplified approach.

Staff conclusion on fieldwork findings

67. The feedback from the fieldwork suggests that:

    (a) determining whether an SME provides financing to customers as one of its primary businesses will require judgement and guidance will be needed to ensure consistency in application and to reduce costs for SMEs.

    (b) SMEs that provide financing to customers as one of its primary businesses will be able to apply an ECL model.

Possible ways forward

68. Based on the feedback throughout this comprehensive review, the staff think the IASB should consider the following options:

(a) Option 1—introduce an ECL model for SMEs that provide financing to customers as one of their primary businesses by affirming its January 2024 tentative decision (paragraphs 69–76); or

(b) Option 2—retain an incurred loss model (paragraphs 77–83).

Option 1—Introduce an ECL model for SMEs that provide financing to customers as one of their primary businesses by affirming the January 2024 tentative decision

Reasons in support

69. The IASB developed the ECL model in IFRS 9 to respond to concerns identified during the financial crisis about delayed recognition of credit losses on loan receivables. Requiring SMEs that provide financing to customers as one of their primary businesses to apply an ECL model responds to this concern.

70. The ECL model would be applied by a small population of SMEs, those that have significant exposure to credit risk, and for these SMEs an ECL model would provide better information for users of financial statements. Other SMEs will continue to apply an incurred loss model, which keeps the Standard simple for most SMEs.

71. The tentative decision to introduce an ECL model aligned with the simplified approach in IFRS 9 is a simplification for SMEs because the simplified approach does not require SMEs to track significant increases in credit risk and SMEs can make use of a provision matrix, limiting complexity for these SMEs.

72. The ECL model will provide benefits to users of SMEs' financial statements as discussed in paragraph 55 of this paper.

Possible modifications to an ECL model for SMEs that provide financing to customers as one of their primary businesses by affirming its January 2024 tentative decision

73. As discussed in paragraph 60 of this paper, feedback from the fieldwork suggests that making the determination whether an SME provides financing to customers as one of its primary businesses could add complexity for all SMEs applying the Standard (because all SMEs have to decide if they provide financing to customers as one of their primary businesses). The staff think that this complexity can be reduced with clear requirements and guidance to assist SMEs in making this determination.

74. The staff think the IASB could consider adding a definition or criteria of the description of an SME that provides financing to customers as one of its primary businesses. The definition or criteria should help to clarify which SMEs fall within the scope to apply an ECL model, that is whether the scope includes SMEs that:

(a) engage in lending activities (such as non-deposit taking microlenders); and/or

(b) hold long-term financial assets (for example those that hold long-term trade receivables or loan receivables).

75. The staff note that adding a definition or criteria to support the description 'primary businesses' might affect the current practice of Section 1 *Small and Medium-sized Entities* of the Standard, which sets out the scope of the Standard.[9] To address this, the definition or criteria in paragraph 74 of this paper could be restricted to 'provides financing to customers' otherwise, we should be careful not to go beyond the guidance on 'primary business' in paragraph 1.4 of the Standard. Paragraph 1.4 provides guidance when entities hold assets in a fiduciary capacity for reasons incidental to a primary business.

76. The staff have identified two ways to narrow the scope of SMEs applying an ECL model:

[9] Paragraph 1.3(b) of the *IFRS for SMEs* Accounting Standard states that an entity has public accountability if it hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

(a) Restricting the scope to SMEs that engage in lending activities. Setting the scope based on paragraph 74(a) of this paper would be narrower than that in paragraph 74(b) of this paper. The staff think that SMEs engaged in lending activities are likely to have significant exposure to credit risk. In addition, if the scope is based on paragraph 74(a) of this paper, the complexity of making the determination if SMEs provide financing to customers as one of their primary businesses will be reduced. In other words, the determination will be relatively less complex for SMEs because SMEs will make this assessment based on their business activities.

(b) Restricting the scope to lending outside the group. Preparers and accounting practitioners highlighted challenges in determining whether an SME that holds intercompany loans is providing financing to customers as one of its primary businesses. The staff think the IASB could simplify the proposals by excluding intragroup loans in the determination of whether the SME provides financing to customers as one of their primary businesses. This is because intragroup loans are common among SMEs and excluding these balances will result in the ECL model applying to financial assets where credit exposure is to parties outside the group.

Option 2—Retain an incurred loss model

Reasons in support

77. The Request for Information asked about introducing the simplified ECL model in IFRS 9 into the Standard. Feedback was 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. Feedback was that many SMEs do not have the resources or the ability to apply an ECL model properly, which would reduce the usefulness of the information. Overall, feedback received during this

comprehensive review supports retaining the current requirements in the Standard for impairment of financial assets.

78. Retaining an incurred loss model maintains the simplicity of the Standard by:

(a) avoiding the complexity associated with determining whether an SME provides financing to customers as one of its primary businesses.

(b) responding to concerns that;

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

(ii) two impairment models would add complexity to the Standard.

79. As most SMEs do not have significant exposure to credit risk, an incurred loss model results in faithful representation for most SMEs.

80. Users of SMEs' financial statements are able to make their lending/investing decisions currently using the information produced by the incurred loss model, albeit some users request additional information from the SMEs.

81. The staff note that there are jurisdictions that do not permit entities that have significant exposure to credit risk, such as non-deposit taking microfinance institutions eligible to apply the Standard and require these entities to apply full IFRS Accounting Standards.

Possible modifications to retaining an incurred loss model

82. The staff think a possible modification to retaining the incurred loss model would be to add disclosure requirement for an analysis of financial assets by due date (ageing analysis) to the Standard.

83. Agenda Paper 30C *Impairment of financial assets—Disclosures and Transition* of this meeting addresses the disclosure requirements for SMEs applying the incurred loss model.

Staff conclusion

84. The ECL models in IFRS 9 were introduced to address the delayed recognition of impairment losses by entities with public accountability. SMEs are different as they usually do not have short reporting deadlines and usually report some months after their year-end. In addition, SMEs are financed by lenders and/or venture capitalists. Feedback from users of SME financial statements is that they request additional information from SMEs, such an analysis of receivables. The staff think that retaining an incurred loss model and adding disclosure of an ageing analysis, balances the needs of users of SMEs' financial statements with maintaining the simplicity of the Standard without complex requirements.

85. On balance, considering the reasons in support for Option 2 (as discussed in paragraph 77-81 of this paper), the staff recommend the IASB retains the incurred loss model for the impairment of SMEs' financial assets.

Reassessing the impairment of financial assets at a future review

86. The staff think that the IASB should not defer its decision or reassess its decision on the impairment of financial assets at a future comprehensive review of the Standard. This is because the staff think that IASB has obtained sufficient evidence during this comprehensive review to make a decision. The staff do not think there would be any new evidence at a future review that would result in a different outcome.

Staff recommendation and question for the IASB

87. The staff recommend the IASB retains the incurred loss model for the impairment of SMEs' financial assets.

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 87 of this paper?