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PIR IFRS 9 Impairment

Other matters

Objective

- 1 The objective of this session is to seek EFRAG FR TEG views on the IASB staff feedback analysis and recommendations and the IASB tentative decisions on other matters related to PIR IFRS 9 Impairment, namely the simplified approach and update on intragroup financial instruments.

Summary of the feedback received

Simplified approach

- 2 On the simplified approach the IASB received little feedback though comment letters. Most of the respondents who commented on the issue noted that the approach works well and that there are **no fatal flaws**. Stakeholders noted that the simplified approach is widely applied by non-financial entities (including the use of a provision matrix as a practical expedient) and is generally appropriate for companies without sophisticated credit risk management systems.
- 3 The following challenges were identified by the respondents:
 - (a) **Difficulties in sourcing and using forward-looking information to measure ECL.** Some entities estimate ECL solely on the basis of historical loss rates without considering forward-looking information. A securities regulator said that they observe diversity in practice with regards to how entities incorporate forward-looking information but did not elaborate further on the root cause or whether consequences are substantial.
 - (b) **Applying the simplified approach to financial instruments for which there is a lack of historical loss data** (e.g. trade receivables arising in new markets or from new products/customers or trade receivables from related parties).
- 4 These respondents suggested that the IASB supports preparers by providing application guidance or examples illustrating:
 - (a) How to adjust historical data to reflect the effects of forecasts of future economic conditions and when historical data can be used without adjustments (e.g., by expanding Example 12 of the Illustrative Examples accompanying IFRS 9);

- (b) How to estimate ECL when there is little or no historical information available – e.g., by issuing specific guidance or by moving the existing guidance from paragraph BCE.164 of the Basis for Conclusions on IFRS 9 into the application guidance of IFRS 9 (i.e., that entities with little historical information would, for example, draw their estimates from internal reports or statistics instead of extensive search for information in evaluating significant increases in credit risk (SICR))

Intragroup financial instruments

- 5 The IASB staff referred to the discussions at the February 2024 meeting concerning application of the general approach to particular financial instruments, such as instruments between entities under common control (intragroup financial instruments) and instruments issued on non-commercial terms or for reasons that are not purely commercial (non-commercial financial instruments). The PIR feedback indicated that the costs of applying the general approach to some of those instruments might appear to be excessive in some cases if requirements in IFRS 9 are applied mechanically. In February, the IASB tentatively decided not to take standard-setting action on this matter.
- 6 However, the matter was further discussed with the IFRS Interpretations Committee (IFRS IC) and the Accounting Standards Advisory Forum (ASAF) in March 2024 to see what the root cause of excessive costs is and whether the IASB could take any non-standard-setting actions to provide further support for preparers (e.g., through illustrative examples or educational material).
- 7 Most IFRS IC and ASAF members agreed that this matter requires no standard-setting actions. However, they noted that such instruments are different to the ‘typical’ instruments issued to third parties for which IFRS 9 works very well. Accordingly, many IFRS IC members said that the root cause of application costs is not inadequate requirements in IFRS 9, but rather the limited credit risk management information and the subjective features of these instruments.
- 8 **There were mixed views among the IFRS IC and the ASAF members about whether the IASB should take further action on this matter and whether such actions could be useful. Some members suggested that no further action is taken**, because the existing IFRS 9 allows to adjust the entity’s approach based on the features of the instrument and entity’s credit risk management practices. **A few suggested that an educational material might be helpful** to remind entities of the simplifications available in IFRS 9 and that mechanistic approaches are inconsistent with the objective of impairment and noted that some of the messages in the IASB’s educational material published during covid-19 could be useful. In contrast, a few other members said that educational material might not be an effective tool because they are not translated and do not form part of IFRS literature, hence not widely accessible. **Some of these members suggested developing illustrative examples** because examples are translated and more accessible for preparers. However, a few other members cautioned that intragroup instruments are a very broad population, therefore, providing a useful illustrative example can be challenging.

IASB staff analysis

Simplified approach

- 9 **With regards to the issue described in paragraph 3(a) above, the IASB staff referred to the existing guidance in IFRS 9, namely:**

- (a) In describing what constitutes ‘reasonable and supportable information’, paragraph B5.5.49 of IFRS 9 refers to information about past events, current conditions and forecasts of future economic conditions, while paragraph B5.5.51 of IFRS 9 adds an important qualification by stating that an entity should use reasonable and supportable information that is available *without undue cost or effort and that is relevant to the estimate of expected credit losses*. This is further supported by the statement in paragraph BC5.140 of the Basis for Conclusions on IFRS 9 that an entity should consider ‘*the effect of forward-looking information (i.e. changes in macroeconomic indicators) that affect the risk of a default occurring*’. In the view of the IASB staff, this statement, made in the context of determining SICR using a collective assessment, equally applies to the measurement of ECL, regardless of which approach an entity uses.
- (b) Paragraph B5.5.52 of IFRS 9 acknowledges that in some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historic information and when it was calculated compared to the circumstances at the reporting date and the characteristics of the financial assets being considered.
- 10 With regards to the issue described in paragraph 3(b) above, the IASB staff observed that the issue of additional guidance on how to estimate ECL when they have limited information available is common for the general and the simplified approach.
- 11 **The IASB staff noted that IFRS 9 requires that estimating ECL is based on reasonable and supportable information that is available to an entity without undue cost or effort** and more specifically that:
- (a) **An exhaustive search for information is not required.** Paragraph B5.5.51 of IFRS 9 provides application guidance supporting this relief, noting that an entity may use various sources of data that are relevant to the estimate of ECL, which may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings, credit loss experience of other entities and external ratings, reports and statistics. The IASB staff further referred to paragraph BCE.164 of Basis for Conclusions on IFRS 9 which explains that entities with little historical information would draw their estimates from internal reports and statistics (which may, for example, have been generated when deciding whether to launch a new product), information that they have about similar products or from peer group experience for comparable financial instruments.
- (b) Simplifications and practical expedients to estimate ECL are provided, for example, using a provision matrix for trade receivables. The IASB staff referred to paragraph B5.5.35 of IFRS 9 which elaborates use of a provision matrix, as well as to Illustrative Example 12 accompanying IFRS 9 which further illustrates the use of provision matrix to calculate ECL for trade receivables.
- 12 Therefore, **the IASB staff thinks that incremental benefits from additional application guidance would be limited**, because IFRS 9 already has well-described principles and application guidance equally relevant to financial instruments in scope of the simplified approach. At the same time, developing effective examples illustrating how to estimate ECL when there is limited information would require careful consideration. That is because,

among other factors, what represents ‘reasonable and supportable information available without undue cost or effort’ would inevitably vary from entity to entity and instrument to instrument, as well as over time.

Intragroup financial instruments

- 13 The IASB staff noted the input from the IFRS IC and ASAF members is largely consistent with the staff analysis for the IASB February 2024 meeting. In particular, it confirms that
- (a) IFRS 9 provides an adequate basis for entities to estimate ECL for intragroup or similar financial instruments;
 - (b) Intragroup instruments are prevalent and high application and auditing costs could arise in practice. In most cases, the root cause for such costs is a lack of credit risk management information and the high level of management judgement required in estimating ECL because of the characteristics of financial instruments (e.g. subjective terms).
 - (c) There is no consensus on whether the most effective tool would be educational material or illustrative examples.
- 14 The IASB staff noted that there are common features for the instruments for which respondents are asking for guidance, for example, issued at terms that are not on an arms’ length basis / between related parties, and limited credit risk management information available, particularly quantitative information. **Accordingly, the IASB could explore whether it can develop examples that would be useful for instruments with such features, and therefore, respond to the PIR feedback.** However, the IASB staff acknowledges that developing an example for such financial instruments could pose challenges, e.g. a potential illustrative example could risk being too broad or too simplified to be useful; or too narrow or complex because it might attempt to illustrate application of requirements to instruments with very specific characteristics.
- 15 Therefore, **the IASB staff recommended that the IASB classifies the issue as medium priority and adds to its research pipeline the matter relating additional illustrative examples for financial instruments with particular features** (such as between related parties).

EFRAG comment letter

- 16 EFRAG considered that the simplified approach generally achieves the objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables, especially to entities which are not financial institutions and do not have complex credit risk management systems.
- 17 EFRAG also noted that the practical expedient in paragraph B5.5.35 allows entities to use a provision matrix with historical loss rates to calculate ECL on trade receivable balances, which further simplifies the ECL calculation. EFRAG is not aware that the costs of applying the simplified approach are significantly higher and that the benefits are lower than expected.
- 18 EFRAG has identified the issue of intragroup financial instruments as medium priority and suggested the IASB provides simplified rules for accounting for these loans.

IASB discussions and tentative decision

- 19 **The IASB members agreed not to perform any standard-setting on the simplified approach** (all 14 IASB members voted in favour) **and disagreed with the IASB staff recommendation to add an illustrative example of intra-group financial instruments with specific features and classify it as medium priority** (six of 14 IASB members voted in favour).
- 20 **The main reasons for this decision were that the issue was very narrow, and any standard-setting would not be warranted and could be disruptive. Many IASB members disagreed with the medium priority assigned to this issue.**

EFRAG Secretariat analysis

- 21 The EFRAG Secretariat agrees with the IASB tentative decision regarding the simplified approach which is in line with the EFRAG recommendation in its comment letter.
- 22 However, unlike the IASB members, the EFRAG Secretariat considers the issue of intragroup financial instruments as medium priority.

EFRAG FIWG feedback

- 23 EFRAG FIWG discussed this topic at its meeting on 13 June 2024. Several members emphasised that the prevalence and the complexity of the issue of ECL for intragroup financial instruments should not be underestimated. However, in their view, the IASB decision not to undertake standard setting is reasonable in order to avoid disruption of the current practice and because there is no common understanding on how to solve the issue.
- 24 One member noted that providing illustrative examples may result in unintended consequences. E.g., while not necessarily resolving the existing issues, they may be used by analogy to a broader set of financial instruments than intended by the standard-setter.
- 25 One member noted that a possible solution could be providing simplifications to the ECL model for a clearly defined and narrow scope of intercompany financial instruments.
- 26 The IASB representative agreed that the issue is prevalent and explained that the key reason for not undertaking a standard-setting action at this point was a lack of common understanding at the IASB as to which potential standard-setting actions could resolve the issue, not because it is not prevalent.

Questions to EFRAG FR TEG

- 1 Does EFRAG FR TEG agree with the IASB staff analysis and the IASB tentative decision to take no standard-setting action with regards to the simplified approach, not to add an illustrative example of intra-group financial instruments with specific features and not to classify this issue as medium priority?
- 2 Does EFRAG FR TEG have any comments on the EFRAG Secretariat analysis?

Appendix A – IASB staff conclusion (please note the IASB conclusions in paragraph 19-20 above)

Step 1 - Is further action needed?

- 1 The IASB staff assessed the above matters against the PIR framework to determine whether any further action needs to be taken:

PIR evaluation requirement	IASB staff analysis
Simplified approach	
Are there fundamental questions (i.e. ‘fatal flaws’) about the clarity and suitability of the core objectives or principles in the new requirements?	<p>No. PIR feedback and the staff analysis indicates that the requirements on the simplified approach for recognising ECL are working as intended and that there are no fundamental questions about the clarity and suitability of the objectives or principles in IFRS 9.</p> <p>Majority of respondents said that the simplified approach also meets the objective for which it was intended and works well in practice for most financial instruments.</p>
Are the benefits to users of financial statements of the information arising from applying the new requirements significantly lower than expected?	<p>No. PIR feedback did not provide any evidence that the benefits to users of financial statements of information arising from applying the simplified approach requirements to relevant financial instruments are significantly lower than expected.</p> <p>In fact, as noted in paragraph 9 of this paper, most stakeholders said that the simplified approach achieves the objective of reducing costs for preparers without causing loss of useful information to users of financial statements.</p>
Are the costs of applying the new requirements and auditing and enforcing their application significantly greater than expected?	<p>Yes, to some extent. Feedback indicates that the costs of applying the relevant IFRS 9 requirements to particular financial instruments might be high, and possibly exceed the benefits from the resulting information, if an entity does not make appropriate use of the application guidance, simplifications and practical expedients available in IFRS 9. In other words, the application costs might be higher than expected if the requirements are applied in a way that the IASB did not intend.</p>

PIR evaluation requirement	IASB staff analysis
Simplified approach	
	Guidance, such as illustrative examples, might assist entities to estimate ECL for some instruments more efficiently and avoid situations in which the requirements are applied in a way not intended by the IASB.

Step 2 - Is the finding high, medium or low priority?

- 2 This table sets out each of the factors the IASB considers in assessing the priority for taking an action in response to findings raised in a PIR, and the IASB staff assessment of the priority that should be assigned to possible action in response to findings discussed in this paper.

Does PIR feedback indicate:	IASB staff assessment
Simplified approach	
(a) the matter has substantial consequences?	<p>Yes, to some extent. PIR feedback does not necessarily provide evidence that there are substantial operational or financial reporting consequences. Financial instruments such as intragroup instruments are widespread transactions but generally not the most significant part of entities’ financial assets.</p> <p>However, respondents raise concerns that application costs, in some cases, might exceed the benefits of the resulting information. We also note that if entities apply the IFRS 9 requirements in a way not intended by the IASB, the application costs would be greater than the IASB expected when developing the requirements.</p>
(b) the matter is pervasive?	<p>Yes. As previously noted, the same underlying concern is raised by respondents for different financial instruments. Essentially, respondents are asking the IASB to illustrate how the principles in IFRS 9 would apply to a financial instrument with ‘atypical’ features— such as, issued at terms that are not on an arms’ length basis / between related parties, limited credit risk management information available, particularly, quantitative information.</p>

Does PIR feedback indicate:	IASB staff assessment
Simplified approach	
(c) the finding could be addressed by the IASB or the Committee?	<p>Yes. We think the finding could be addressed by the IASB. We note that, in developing IFRS 9, the IASB designed principle-based requirements, simplifications and practical expedients so that the costs of applying the requirements do not significantly exceed the benefits of the resulting information and so that, useful information is provided to users about the economics of transactions.</p> <p>In the light of PIR feedback, we think that an illustration of such requirements, might reduce application challenges faced in relation to estimating ECL for financial instruments with particular features.</p>
(d) the benefits of any action would be expected to outweigh the costs?	<p>Yes. As previously noted, examples that illustrate how an entity could estimate ECL applying IFRS 9, including the simplifications and practical expedients available, would support entities estimate ECL for particular instruments in a more efficient manner.</p> <p>The staff view is that any potential examples should focus on broader credit risk management characteristics of a financial instrument and that such characteristics should be generally applicable, rather than being limited to a particular type of instruments. The staff think any potential examples are unlikely to disrupt current practice and would not necessitate entities to reassess their ECL approaches. Illustrative examples are not mandatory and do not add or change requirements. Such a potential example would be designed to reduce operational burden for preparers, including non-financial institutions. Nonetheless, any potential project to add illustrative examples to IFRS 9 would require further outreach with stakeholders to minimise the risk of unintended consequences.</p>

IASB staff conclusions

- 3 Based on the assessment set out above, IASB Staff note that most of the prioritisation characteristics are present to some extent and the benefits of any action are expected to exceed the costs.

- 4 Applying the PIR framework, IASB Staff recommend that the IASB classify as medium priority the matter relating additional illustrative examples for financial instruments with particular features (such as between related parties, limited information available).
- 5 According to that framework, medium priority findings would be added to the research pipeline. The IASB will endeavour to make pipeline projects active before the next agenda consultation.
- 6 IASB Staff did not think that considering this matter as part of the next agenda consultation would be beneficial. The matter is specific to the impairment requirements of IFRS 9, and a broader consultation is unlikely to provide new information. The IASB has already gathered sufficient evidence from respondents to the RFI and consultations with ASAF and the Committee.
- 7 The IASB did not agree with the IASB Staff. See paragraph 19 above.