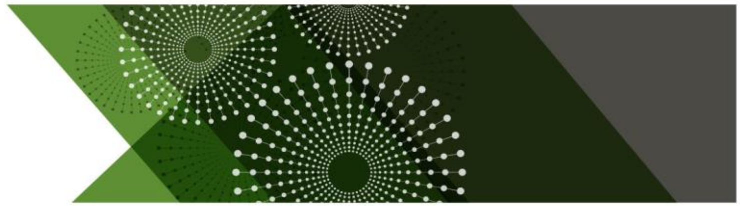

Mr Andreas Barckow
Chair of the International Accounting Standards Board
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25 September 2023

Submitted to: www.ifrs.org

Dear Andreas

IASB Request for Information *Post-Implementation Review of IFRS 9 – Impairment ('the RFI')*

Thank you for the opportunity to comment on the RFI.

In developing our responses to the RFI, we have focused on the application of the 'expected credit loss' (ECL) requirements of IFRS 9 by corporate entities that are *not* banks or financial institutions.

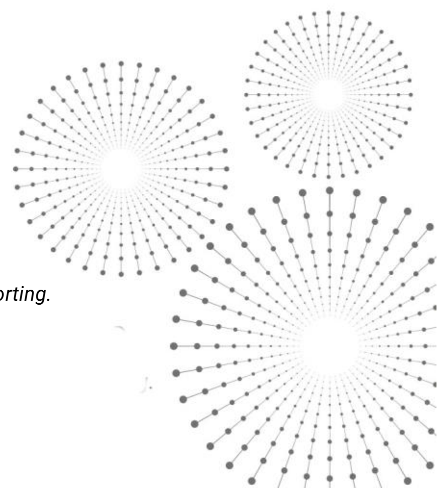
While we have not identified 'fatal flaws' with respect to the ECL requirements in IFRS 9, we are aware of the following application challenges, in the context of the simplified approach – and we recommend addressing these challenges as explained below:

- Some corporate entities are effectively continuing to apply the superseded 'incurred loss' model, and/or are not adjusting historical default rates for current and future expectations. We recommend publishing educational material to remind stakeholders of the difference between the old 'incurred loss' model and the ECL model, and enhancing the existing illustrative example relating to the provision matrix, so that it illustrates adjustments for current conditions and future expectations.
- It can be challenging to determine default rates as part of the ECL calculation when no historical data are available – e.g. when the entity enters into a new market. We recommend adding application guidance and an illustrative example on this matter.

Our recommendations and responses to the specific questions are provided in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Gali Slyuzberg (gali.slyuzberg@xrb.govt.nz) or me.

Yours sincerely

Carolyn Cordery
Chair – New Zealand Accounting Standards Board



Appendix

Questions 1–3: We have not commented on these questions.

We have responded to Questions 4 and 5 together

Question 4 – Measuring expected credit loss
(a) Are there fundamental questions (fatal flaws) about requirements for measuring expected credit losses? If yes, what are those fundamental questions? Please explain whether the requirements for measuring expected credit losses achieve the IASB's objective of providing users of financial statements with useful information about the amount, timing and uncertainty of an entity's future cash flows. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the measurement requirements. **(b) Can the measurement requirements be applied consistently? Why or why not?** Please explain whether the requirements provide an adequate basis for entities to measure expected credit losses consistently for all financial instruments within the scope of impairment requirements in IFRS 9. If diversity in application exists for particular financial instruments or fact patterns, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. If you have identified diversity in application of the requirements, please provide your suggestions for resolving that diversity. In responding to (a) and (b), please include information about forward-looking scenarios (see Spotlight 4.1), post-model adjustments or management overlays (see Spotlight 4.2) and off-balance-sheet exposures (see Spotlight 4.3), as relevant.

Question 5 – Simplified approach for trade receivables, contract assets and lease receivables
(a) Are there fundamental questions (fatal flaws) about the simplified approach? If yes, what are those fundamental questions? Does applying the simplified approach achieve the IASB's objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables? If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the simplified approach. **(b) Are the costs of applying the simplified approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?** If, in your view, the ongoing costs of applying the simplified approach are significantly greater than expected, or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment.

Response to Questions 4 and 5

1. Corporate entities face some application challenges relating to the measurement of ECL. Given that corporate entities mainly use the simplified approach to determining ECL, the application challenges referred to in this letter are in the context of the simplified approach (which is the reason why we respond to Questions 4 and 5 together). Outside of these particular application challenges, the ECL requirements are generally working well, and stakeholder feedback highlighted improved comparability among industry peers in terms of impairment of financial assets, and that the impairment requirements of IFRS 9 were helpful for internal management purposes – they have facilitated better management of debtors.

2. We do *not* consider the application challenges mentioned in this letter to be 'fatal flaws' in IFRS 9. Nevertheless, action is needed to help corporate entities, to better understand and apply consistently the ECL requirements and the simplified approach to ECL.

Application challenges relating to the simplified approach to ECL for corporate entities

3. We have received feedback about the following application challenges relating to corporate entities:

   (a) Some corporate entities effectively continue to use the 'incurred loss' model, and/or consider only historical loss data when determining ECL under the simplified approach, without considering adjustments for current conditions and future expectations;

   (b) It can be challenging to determine ECL when no historical loss data is available – which can happen when an entity enters into a new market, and therefore does not have previous experience with the type of debtors that make up the receivables balance;

   (c) Some corporate entities do not have a good understanding of the ECL requirements under the simplified approach, including the concept of a 'provision matrix'.

4. Our recommendations to address the above matters are explained below.

General recommendation: educational material

5. We recommend publishing educational material aimed at corporate entities (hereafter referred to as 'educational material'), which would include the following:

   (a) A reminder that for trade receivables and contract assets without a significant financing component, ECL is determined using the 'simplified approach' – and how to apply this approach – which would include:

      (i) A general explanation of the key aspects of the ECL approach – including that ECL refers to the difference between the cash flows that the entity is entitled to receive as compared to the cash it expects to receive, and therefore reflects the probability of a 'default' occurring in the future with respect to the receivables, etc. It would be useful to include an explanation of what could constitute 'default' – given that the IASB had previously decided not to define 'default' in IFRS 9.

(ii) An explanation of how the simplified approach applies to receivables and contract assets, using clear language and step-by-step examples – including more detailed guidance on using a 'provision matrix' (in addition to the guidance provided in the Illustrative Examples accompanying IFRS 9), and a reminder about the content of paragraphs B5.5.51 and B5.5.52 of IFRS 9, which provide some guidance on using historical loss rates and adjusting them for current and forecast future conditions when determining ECL – as well as a reminder of the circumstances when unadjusted historical rates from previous years can be used (see below); and

(iii) An explanation of how the simplified approach to ECL is different to the application of the previous 'incurred loss' requirements in IAS 39 – which could be built into the abovementioned explanation of the ECL requirements and application examples.

(b) A brief description of how the 'simplified approach' to ECL is different to the 'general approach', and the types of assets that the general approach would apply to – to help entities understand the difference between the two approaches, but without necessarily going into the details of the general approach.

6. As a useful starting point for developing this educational material, we recommend considering the following guidance document issued by the New Zealand Treasury: *Guidance on Accounting for Financial Instruments Under PBE IFRS 9 for Non-financial Entities*. This guidance was published when the New Zealand Government adopted the IFRS 9-based standard PBE IFRS 9 *Financial Instruments* – which included ECL requirements aligned with IFRS 9. The guidance focuses on the application of PBE IFRS 9 to receivables and term deposits – being simple financial assets that are commonly held by many non-bank entities. The document included guidance on applying the ECL requirements to receivables, using an example with a 'provision matrix' and including an explanation of how the ECL method is different to the previous 'incurred loss' requirements.

Recommended enhancements to the provision matrix example – adjustments to historical loss rates

7. We also recommend enhancing one of the illustrative examples that accompany IFRS 9 – Illustrative Example 12, which relates to the provision matrix – so that it includes more guidance on adjusting historical loss rates for forward-looking estimates.

8. Our recommendations regarding Illustrative Example 12 are explained in more detail below.

(a) Illustrative Example 12 already states the following: "The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. At every reporting date the historical observed default rates are updated and changes in the forward-looking estimates are analysed. In this case it is forecast that economic conditions will deteriorate over the next year".

(b) We recommend enhancing this example by illustrating *how* the historical loss rates were adjusted for forward-looking expectations.

(c) One way to do this could be by showing the prior year actual loss rates with respect to the entity's receivables, explaining what forward-looking information the entity has considered to adjust the historical rates (i.e. which economic indicator or other piece of information was used – and which other indicators could have been used but were not selected in this case), and explaining how this information resulted in the expected default rates that are currently shown in the Illustrative Example. We recommend mentioning that climate-related risks could be one of the factors to consider when determining adjustments to historical loss rates – for example, if the entity has customers in an industry or sector where climate-related risks could affect the customers' ability to pay the entity (e.g. because many entities in the industry/sector are likely to stop operating or suffer significant losses due to climate-related risks).

Recommendations relating to the ability to use unadjusted historical rates in some circumstances

9. Paragraph B5.5.52 explains that when determining ECL, in some cases the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered.

10. Therefore, it could be appropriate for an entity to determine ECL using *unadjusted historical loss data from a previous year* (not necessarily the immediately preceding accounting period) where the *economic conditions and outlook were similar to what they are in the current year*, and the debtors that make up the receivables balance in that year are of a *similar type to the current year debtors* – because in that case, the historical rates would be reflective of conditions similar to the current and future economic conditions as at the current year.

11. Some corporate entities may not be aware of this approach and when it is appropriate to apply. We recommend adding a new Illustrative Example which demonstrates these points, and drawing attention to paragraph B5.5.52 and its implications in the abovementioned educational material.

Recommendations relating to challenges in measuring ECL when historical data is not available

12. The application guidance in Appendix B of IFRS 9 contains some general guidance that could be relevant for considering how to determine ECL when historical loss data is not available. For example, paragraph B5.5.49 refers to using reasonable and supportable information that is available without undue cost or effort, paragraph B5.5.51 says that an entity may use internal and external sources of information, and paragraph B5.5.51 also notes that "entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument".

13. However, the above guidance is quite general, and we consider that additional guidance on lack of historical data is needed to help entities with applying the ECL requirements in such situations.

14. We recommend adding integral application guidance and an illustrative example covering this situation, as explained below.

    (a) We recommend bringing the Basis for Conclusions paragraph BCE 164 into the application guidance in Appendix B of IFRS 9 – given that this Basis for Conclusions paragraph refers more specifically to sources of information that could be used when historical loss data is not available. Specifically, paragraph BCE 164 says: "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) We also recommend adding an Illustrative Example to show:

        (i) Types of internal and/or external data that could be appropriate in determining ECL when historical data is not available, e.g. when an entity enters into a new market;

        (ii) How to determine when the data sources mentioned above could be appropriate – including how to determine whether they constitute 'reasonable and supportable information that is available without undue cost and effort'; and

        (iii) The type of adjustments that would need to be made to the data from the abovementioned sources, to reflect the credit risk of the debtors in the new market, etc.

Educational material on disclosures

15. We are aware of concerns that disclosures provided by corporate entities in relation to credit risk and ECL have been voluminous and 'boiler plate' – rather than focusing on relevant information.

16. In IFRS 7, paragraph 35D gives entities flexibility to consider how much detail to disclose, how much emphasis to place on the different aspects of the disclosure requirements, and the appropriate level of aggregation. However, some preparers may not be aware of the implications of paragraph 35D.

17. We recommend that the IASB develops educational material which highlights the requirements of paragraph 35D, together with the general guidance on the application of materiality in IAS 1 and the qualitative characteristics in the Conceptual Framework. This would assist preparers, and their auditors, on focusing ECL related disclosures on relevant information, rather than on every disclosure item relating to ECL and credit risk as listed in IFRS 7.

Questions 6 – 9: We have not commented on these questions.

Question 10—Other matters
(a) Are there any further matters that you think the IASB should examine as part of the post-implementation review of the impairment requirements in IFRS 9? If yes, what are those matters and why should they be examined? Please explain why those matters should be considered in the context of this post-implementation review and the pervasiveness of any matter raised. Please provide examples and supporting evidence. **(b) Do you have any feedback on the understandability and accessibility of the impairment requirements in IFRS 9 that the IASB could consider in developing its future IFRS Accounting Standards?**

Response to Question 10

Scope of the ECL requirements

18. Entities do not always appreciate the full scope of assets that the ECL requirements in IFRS 9 apply to – including the fact that operating lease receivables recognised under IFRS 16 *Leases* and contract assets recognised under IFRS 15 *Revenue from Contracts with Customers* are within the scope of the impairment requirements.

19. IFRS 9 specifically states that contract assets and lease receivables are in the scope of the ECL requirements of IFRS 9. IFRS 15 also specifically requires applying the ECL requirements of IFRS 9 to contract assets. However, in IFRS 16, the lessor accounting requirements for *operating leases* do not include a reference to the impairment requirements in IFRS 9 (while the lessor accounting requirements for finance leases includes such a reference).

20. Therefore, we recommend amending IFRS 16 so that the lessor accounting requirement for operating leases specifically refer to applying the impairment requirements in IFRS 9 to operating lease receivables. This way, when a lessor is reading IFRS 16 to determine how to account for operating leases, there will be a clear 'flag' directing the lessor to apply the impairment requirements of IFRS 9 to operating lease receivable.

21. We also recommend that the abovementioned educational material (recommended in paragraphs 5 and 6 of this letter) also includes a reminder of the scope of the ECL requirements of IFRS 9 – including:

    (a) The fact that the ECL requirements apply to certain assets that are recognised under other IFRS Accounting Standards;

    (b) A non-exhaustive list of examples of assets that the ECL requirements apply to, in addition to trade receivables – and this list of examples would include contract assets and operating lease receivables (as well as intercompany receivables); and

    (c) An explanation of whether the simplified approach must/can be applied to the abovementioned assets, or whether the general approach must be applied.

Application of the ECL requirements to intercompany balances

22. We are aware of application challenges and questions on the cost/benefit balance in relation to applying the ECL requirements to intercompany loans and receivables. For intercompany loans and receivables (other than ones that are trade receivables, etc.), ECL is usually required to be determined under the 'general approach'. However, for intercompany balances, credit losses often depend on the willingness and ability of the reporting entity's parent to reimburse the entity for the intercompany debtor's defaults. There can be uncertainty in relation to the parent entity's willingness and ability to do this – which then needs to be considered in addition to uncertainties around the debtor's ability to pay. This can be challenging and can affect the usefulness of the resulting ECL amount. Furthermore, in situations where the parent company is generally willing and able to reimburse defaults by intercompany debtors, this may mean that the ECL amount is close to nil – and performing the work required as part of the general approach to ECL to substantiate that this is the case may not be commensurate with the benefits of performing this work.

23. So that the benefits of determining ECL for intercompany balances outweighs the cost, we recommend that the IASB consider one of the following options.

    (a) Amending IFRS 9 so that it specifically allows the application of the 'simplified approach' when determining ECL for intercompany receivables and intercompany loans; or

    (b) Considering whether there is a subset of intercompany receivables and/or loans to which the ECL requirements should not apply, due to cost/benefit considerations, and to develop other requirements for impairing such assets.

24. We also recommend that the abovementioned educational material (recommended in paragraphs 5 and 6 of this letter) include a reminder that:

    (a) Intercompany receivables are in the scope of the ECL requirements of IFRS 9 if they meet the definition of a financial asset and the requirements for being classified and measured at amortised cost – which would often be the case for intercompany balances; and

    (b) If the intercompany receivable is not in the nature of 'trade receivables', then the 'general approach' to ECL applies to the intercompany receivable.

25. Given that intercompany receivables are a relatively common financial asset among corporate entities, we also recommend including in the educational material some guidance on the application of the ECL requirements to intercompany receivables – to assist corporate entities in this regard.