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Managing risk, enabling trade

Change ahead

Trade credit risk accounting in the new world of IFRS9

From January 2018, companies reporting under the International Financial Reporting Standards (IFRS) will be required to upgrade their current credit risk provisioning processes to comply with the requirements of the new 'expected credit loss impairment principles'.

What will this mean for your business? Where will special attention be needed in order to comply with this new requirement?

In this brief factsheet you can find a simple explanation of the new standard, as well as main challenges particularly faced by non-financial corporates.

What will change?

Stimulated by the recent global financial crisis, the International Accounting Standards Board (IASB) has introduced the Expected Credit Loss (ECL) principle as a part of the new IFRS9 Financial Instruments standard with the ambition of increasing the accuracy and transparency of how credit risk is managed by businesses.

Apart from the direct impact on how businesses calculate provisions, the standard also increases the disclosure requirements that companies will have to include in their financial statements in the future. The concept of expected credit loss will also be introduced in the Financial Accounting Standards Board's (FASB) new US GAAP standard; commonly referred to as the Current Expected Credit Loss model (CECL), which will come into effect in the coming years.

Both standards will demand a more dynamic approach to credit risk management and it is expected that the new practices will require companies to modify not only accounting policies but also credit management systems.

Who is affected?

The new standard will apply to a wide range of entities, as its scope is not industry specific. To comply with the new standard entities will be required to collect and collate credit information, which for many businesses, is likely to result in the need to significantly modify current credit information systems and processes.

The requirements will be particularly challenging for financial institutions to apply. Financial institutions are complex and have a high exposure to credit risk. As a result, IFRS9 can have a major impact on their capital. Accordingly, much of the reported commentary on IFRS9 is heavily focused on the financial industry. However, non-financial companies will also need to prepare to comply with the new regulation and, for corporations with large portfolios of trade receivables and credit risk provisions the changes to systems and processes will be considerable, although the financial impact on this sector is not expected to be as high.

In this paper, we focus especially on the implications of the new standards for non-financial corporations, particularly in the area of trade receivables.

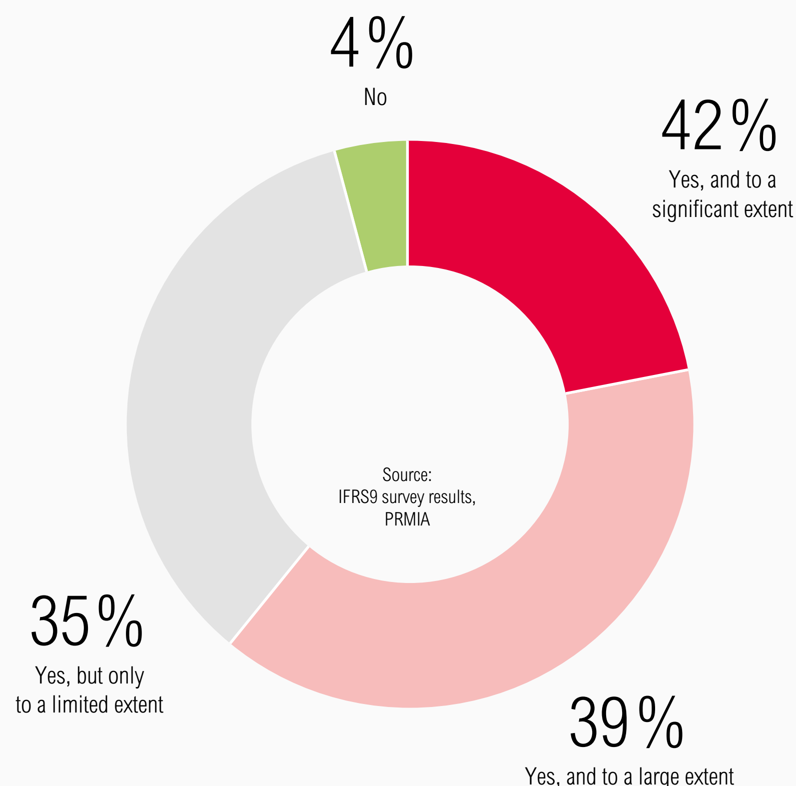
Where is the challenge?

Compared to the current provisioning regime, the main changes relevant for non-financial corporations include:

- The measurement of provisions under IFRS9 (CECL) should reflect a probability-weighted estimate of the Expected Credit Losses (ECL). Instead of the current practice where companies make very limited provisions, or no provisions at all, for receivables that are not yet overdue (i.e. there is no evidence of an incurred loss), companies will in the future need to recognize expected credit losses in their financial statements on all of their receivables. The new regulation puts emphasis on evaluating information about the creditworthiness of buyers when making ECL calculations. The estimation of the ECL should be 'forward looking', taking into account both the current and forecasted information and not rely solely on historical data as is currently the norm.
- ECL estimates must be updated at each reporting date to assimilate new information and to include any changes in expectations.

Whereas banks and other financial organisations may be more familiar with the concepts above, for some non-financial corporations the requirements are new and present an additional challenge.

Do you believe that non-financial corporates can by careful considerations and assessment of available alternative methodologies influence the impact of IFRS 9 Impairment / CECL on their Balance Sheet and P&L?



However, there is one main challenge that banks and non-financial corporations have in common. Since the regulation is 'principle based' it doesn't provide clear definitions and processes to follow in order to be compliant. This leads to various possible interpretations of the principles, multiple alternative methodological choices and a number of decisions to be made.

With the expected financial impact and volatility that comes with the new standards, each of the alternatives can have financial consequences and therefore should be assessed and considered carefully. According to a recent survey more than 60% of the participants believe that the financial impact of IFRS9 (CECL) can be influenced significantly or to a large extent by considering and assessing alternative methodologies.
A further consideration is that because IFRS9 (CECL) estimates fall under the scope of the statutory audit, such interpretations and methodological choices will have to be backed up by robust documentation.

All in all, in order to become IFRS9 (CECL) compliant non-financial corporations will have to deal with a number of challenges, with the key areas being credit information, ECL calculations, methodological choices and last but not least, potential financial implications.

It is in no way easy to handle these new sets of requirements solely by relying on internal information and processes. External solutions are available to support non-financial corporations in gaining relevant insight into the quality of the buyer portfolio, adjusting internal models and limiting the negative impact on the balance sheet.

How can Atradius help?

By leveraging the global credit risk management services and expertise of Atradius, non-financial corporations can limit their exposure to credit risk and therefore decrease the amount of provisions (ECL). Credit insurance can significantly reduce expected credit losses in the receivables portfolio because non-performance of a buyer is covered by Atradius. Moreover, the debt collections services offered worldwide significantly increase the efficiency of debt recoveries from problematic customers. With local presence and knowledge of the markets across the world, Atradius is close to its customers as well as their buyers to provide the best solutions tailored to local needs.

These solutions will result in a major decrease in the ECL and can have a positive impact on P&L volatility. Moreover, high-quality credit risk information on millions of companies globally offered by Atradius to its existing credit insurance customers can contribute to streamlining ECL calculation, reducing investments in creating expensive and complex processes internally and can provide an alternative / benchmark to internal estimates, increasing the robustness of the ECL methodology.

In the next paper we will further explore the added value of Atradius in IFRS9 (CECL) implementation programs of corporations around the world.

As a specialist in tailor-made solutions Atradius can prepare a tailored offer to best fit your needs and challenges. Contact us and find out how Atradius can help your business.

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