STAFF PAPER

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REG IASB Meeting

Project	**Impairment**
Paper topic	Summary of decisions to date (information only)

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Summary of tentative decisions to date (Background information only)

1. **The following is a summary of the tentative decisions to date for the recognition and measurement of expected losses. This paper has been prepared by the staff for information only and is not meant to be exhaustive.**

Objective and scope

2. The objective of the proposed requirements is to reflect deterioration in credit quality.

3. These tentative decisions will apply to:

   (a) the recognition and measurement of the allowance for expected losses for financial assets measured at amortised cost under IFRS 9 *Financial Instruments*;

   (b) the measurement of the accumulated impairment amount and related gains and losses for financial assets classified as measured at fair value through other comprehensive income under the tentative decisions in the Classification and Measurement project;

   (c) the recognition and measurement of a liability for expected losses for:

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(i) loan commitments, except for loan commitments that are accounted for at fair value through profit or loss under IFRS 9;

(ii) financial guarantee contracts to which IFRS 9 is applied and that are not accounted for at fair value through profit or loss; and

(d) the recognition and measurement of the allowance for expected losses for lease receivables within the scope of IAS 17 Leases or for the right to receive lease payments under the tentative decisions in the Leases project.

Recognition

4. Unless a financial asset is credit-impaired on initial recognition, an entity shall measure the allowance for expected losses at:

(a) 12 months expected losses; or

(b) lifetime expected losses if, at the reporting date, the probability of not fully collecting the principal and interest under the contract:

(i) has increased more than insignificantly since initial recognition; and

(ii) is at least reasonably possible.

5. An entity's assessment shall be based on the likelihood of not collecting some or all of the contractual cash flows as opposed to incorporating the "loss given default" in the assessment. The model will include indicators for when the recognition of lifetime expected losses may be appropriate.

6. In applying the model to publicly traded debt instruments (that is, debt securities), the boards decided against a bright-line presumption resulting in recognition of lifetime expected losses (for example, when the fair value of a security is less than a specified percentage of the amortized cost basis for some specified time period). In applying the credit deterioration model to commercial and consumer loans, the boards decided against a presumption resulting in recognition of lifetime expected losses based on an explicit bright line (for example, reaching a particular delinquency status). The boards emphasized that robust disclosures will be

critical to support the principle-based impairment model and to ensure comparability between entities.

7. Additionally, the boards have directed the staff to develop examples to illustrate that the “reasonably possible” criterion differs from how it may currently be interpreted in GAAP (particularly in the U.S.) and primarily refers to when the likelihood of cash shortfalls begins to increase at an accelerated rate as an asset deteriorates.

Credit-impaired on initial recognition

8. If there is objective evidence of impairment as a result of one or more events that occurred on or before the initial recognition of the asset, an entity shall:

   (a) include lifetime expected losses in the estimated cash flows when computing the effective interest rate on initial recognition; and

   (b) recognise subsequent changes in lifetime expected losses in profit or loss.

9. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following:

   (a) significant financial difficulty of the issuer or obligor;

   (b) a breach of contract, such as a default or delinquency in interest or principal payments;

   (c) the lender, for economic or legal reasons relating to the borrower’s financial difficulty, having granted to the borrower a concession that the lender would not otherwise consider;

   (d) its becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or

   (e) the disappearance of an active market for that financial asset because of financial difficulties.

Simplified approach for Trade Receivables and Lease Receivables

10. The decisions relating to trade receivables and lease receivables interact with the Revenue Recognition and Leases projects.

Trade Receivables with a Significant Financing Component

11. An entity may apply a policy election to fully apply the model to trade receivables accounted for as having a significant financing component or to apply a simplified approach in which those trade receivables would have a lifetime expected loss allowance measurement objective at initial recognition and throughout the trade receivables' life. The simplified approach provides relief because an entity would not be required to track credit deterioration.

Trade Receivables without a Significant Financing Component

12. An entity shall measure the allowance for expected losses at lifetime expected losses at initial recognition and throughout the trade receivables' life for trade receivables that do not have a significant financing component. As a practical expedient a provision matrix could be used to estimate expected credit losses for these trade receivables.

13. In addition to the above, the IASB tentatively decided that, for trade receivables accounted for as not having a significant financing component in accordance with the Revenue ED, the receivable shall be measured at the transaction price as defined in the Revenue ED (ie the invoice amount in many cases) on initial recognition in IFRS 9 *Financial Instruments*.

Lease Receivables

14. For lease receivables recognized as a result of the joint leases project an entity could elect either to fully apply the model or to apply a simplified approach in which those lease receivables would have a lifetime expected loss allowance measurement objective at initial recognition and throughout the lease receivables' life.

15. The simplified approach would reduce complexity in practice because an entity would not be required to track credit deterioration.

16. The cash flows and the discount rate used in the measurement of the lease receivables would be used as the contractual cash flows and effective interest rate when assessing the lease receivables' expected loss allowance.

17. To address potential timing differences between the finalization of the proposed leases and impairment standards, the Boards tentatively decided that the same approach described above would apply for lease receivables recognized by a lessor under the existing guidance in IAS 17, *Leases*, and FASB Accounting Standards Codification® Topic 840, Leases.

Loan commitments and financial guarantee contracts

18. A liability for expected losses should be recognised for instruments that create a present legal obligation to extend credit. When estimating expected losses an entity shall consider the maximum contractual period over which it is exposed to credit risk.

19. The usage behaviour shall be estimated over the lifetime of a loan commitment when estimating expected lifetime losses.

20. The discount rate to be applied to discounting the expected losses arising from a loan commitment or a financial guarantee contract shall be the rate that reflects:

    (a) current market assessments of the time value of money (ie risk free rate); and

    (b) the risks specific to the cash flows (but only if, and to the extent that, the risks are taken into account by adjusting the discount rate rather than by adjusting the cash shortfalls being discounted).

21. The accounting for revenue arising from loan commitments or financial guarantee contracts shall not be changed as part of the impairment project.

Estimating Expected Losses

22. Lifetime expected losses are the present value of the expected cash shortfalls over the life of the financial asset.

23. 12 months expected losses are all cash shortfalls expected over the lifetime (that is, the full loss content) that are associated with the likelihood of a loss event in the next 12 months; that is, the losses being measured are not only the cash

shortfalls over the next 12 months. Various approaches can be used to estimate the expected losses, including approaches that do not include an explicit "12-month probability of a loss event" as an input.

24. An entity's estimate of expected losses shall reflect:

    (a) the best available information;

    (b) an unbiased and probability-weighted estimate of cash flows associated with a range of possible outcomes; and

    (c) the time value of money.

25. Estimating lifetime losses should not require a detailed estimate for periods far in the future, but the degree of detail necessary in forecasting estimated losses decreases as the forecast period increases.

26. An entity should consider information that is reasonably available without undue cost and effort in estimating expected credit losses.

27. An entity is permitted to use a current discount rate between, and including, the risk-free rate and the effective interest rate when discounting expected losses. The choice of rate must be applied consistently in the accounting for the impairment allowance of an asset over its life. This decision would also be relevant in determining the discount rate used to discount expected losses for trade receivables and lease receivables (see below).

Presentation

28. An entity shall present in the statement of profit or loss and other comprehensive income separate line items for the following amounts:

    (a) interest revenue, calculated using the effective interest method on the gross carrying amount unless paragraph 29 applies; and

    (b) gains and losses resulting from changes in expected losses.

29. An entity shall calculate interest revenue using the effective interest method on the net carrying amount (gross carrying amount less allowance for expected losses) if:

(a) as at the reporting date, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset; or

(b) the asset was credit impaired on initial recognition.

Application of the Model to Modified Financial Assets

30. Modified financial assets (that do not result in derecognition) should be considered in the same way as other (non-modified) assets within the model.

31. When an entity evaluates whether a lifetime expected loss allowance should be recognised, it should:

(a) evaluate the current credit quality against the credit quality at initial recognition in determining whether there has been more than an insignificant deterioration in credit quality, and

(b) consider the cash flows of the modified instrument when evaluating whether the likelihood that some or all of the contractual cash flows may not be recoverable is at least reasonably possible.

32. The gain or loss upon modification should be recognised against the gross carrying amount of the financial asset.

Uncollectibility

33. A financial asset is considered uncollectible if the entity has no reasonable expectation of recovery. Therefore, an entity would write off a financial asset or part of a financial asset in the period in which the entity has no reasonable expectation of recovery of the financial asset (or part of the financial asset).

34. A *write-off* would be defined as “a direct reduction of the amortized cost of a financial asset resulting from uncollectibility.”

Disclosure

35. The boards considered the disclosure requirements for the proposed expected loss model in the context of the following disclosure objectives:

(a) To enable a user to understand an entity’s estimate of expected losses.

(b) To enable a user to understand the credit quality migration of financial assets.

36. In meeting the above objectives, the boards tentatively decided to require an entity to disclose:

(a) The inputs, assumptions and techniques used in:

(i) estimating expected losses; and

(ii) assessing whether the recognition of lifetime expected losses have been met.

(b) Information regarding the quality of collateral.

(c) Quantitative information related to collateral for financial assets for which lifetime expected losses are recognised. The IASB decided at the IASB-only meeting to limit this disclosure to financial assets that are credit-impaired (see Presentation of Interest Revenue in IASB only meeting for criteria).

(d) A reconciliation of the beginning and ending balances, disaggregated by whether the impairment allowance is measured using12 months expected losses and lifetime expected losses, of:

(i) gross carrying amounts; and

(ii) impairment allowance balances.

(e) A narrative discussion of changes in the impairment allowance balance.

(f) A disaggregation of the gross carrying amount by credit quality for both financial assets with an impairment allowance measured at 12 months expected losses and lifetime expected losses (including a description of how the entity determines the categories of credit quality). For the IASB, these disclosures would be required only if other more granular disclosures related to credit risk profiles are not already required by regulators (e.g., Basel III). For the FASB, the Board directed the staff to explore how this would be integrated into existing disclosures of credit quality information, including disclosures relating to credit quality indicators.

(g) Amounts related to purchased credit-impaired assets.

(h) The balance of financial assets evaluated on an individual basis and for which impairment is measured at lifetime expected losses and the allowance balance related to these financial assets.

37. In addition to the decisions at the joint board meeting, the Board tentatively decided to require that an entity disclose:

(a) qualitative information related to the discount rate elected;

(b) information regarding financial assets for which an impairment allowance of lifetime expected losses is required that have been modified at any time in their life.

(c) the gross carrying amount and related allowance, if any, of financial assets measured under the impairment model if a default has occurred;

(d) the balance of financial assets 90 days past due with an impairment allowance measured at 12 months' expected losses; and

(e) the amount of interest revenue and by how it is calculated (ie gross, net, credit-adjusted EIR).

38. The IASB noted that if the disclosures above are satisfied by disclosures required by other applicable regulations (such as prudential regulations), an entity will be permitted to cross-refer to those disclosures.

39. The boards asked the staff to consider the application of the disclosures to non-financial institutions (including entities applying the simplified model for trade receivables and lease receivables) when drafting the proposals.

Transition

40. An entity shall use the credit quality at initial recognition for existing financial assets when initially applying the new impairment model, unless obtaining such credit quality information requires undue cost or effort.

41. If the credit quality at initial recognition is not used at the date of initial application (per the relief outlined above), the transition provisions should require these financial assets to be evaluated only on the basis of the second criterion in

the transfer notion: the likelihood that contractual cash flows may not be collected is at least reasonably possible.

42. The restatement of comparative periods should be permitted but not required if the information is available without the use of hindsight.

43. The disclosures in paragraph 28(f) of IAS 8 should not be required but should be permitted for prior periods if the information is available without the use of hindsight.

44. On the date of initial application of IFRS 9, the IASB tentatively decided to require a disclosure that would permit reconciliation of the ending impairment allowances under IAS 39 to the opening impairment allowances under IFRS 9 by measurement category, showing separately the effect of reclassifications on the allowance balance at that date.