STAFF PAPER

November 2018

IFRS® Interpretations Committee meeting

Project	**Presentation of unrecognised interest following the curing of a credit-impaired financial asset (IFRS 9)**
Paper topic	Initial Consideration

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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about how an entity presents unrecognised interest[1] when a credit-impaired financial asset (commonly referred to as a 'Stage 3' financial asset) is subsequently paid in full or is no longer credit-impaired applying IFRS 9 *Financial Instruments*. More specifically, the request asks whether an entity can present previously unrecognised interest within interest income.

2. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

[1] See paragraph 7 of this paper for the description of the term 'unrecognised interest'.

Structure of the paper

3. This paper includes:
   (a) background information (paragraphs 5–25);
   (b) staff analysis and assessment against the Committee's agenda criteria (paragraphs 26–56); and
   (c) staff recommendation (paragraph 57).
4. There are two appendices to this paper:
   (a) Appendix A—Proposed wording of the tentative agenda decision; and
   (b) Appendix B—Submission.

Background information

5. Applying the definitions in Appendix A of IFRS 9, a financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred.
6. Applying paragraph 5.4.1(b) of IFRS 9, an entity calculates interest income on financial assets that have subsequently become credit-impaired by applying the effective interest rate (EIR) to the amortised cost, which is net of any expected credit losses (ECL). As explained in paragraph BC5.74 of IFRS 9, presenting interest income on the basis of the gross carrying amount (GCA) of financial assets for which contractual cash flows may no longer be collected in full would not faithfully represent the economic return. Continuing to calculate interest on the GCA would result in the overstatement of interest income by allowing interest to accrue on the unrecoverable portion of a financial asset.
7. The application of paragraph 5.4.1(b) of IFRS 9 results in a difference between the interest calculated on the GCA and the interest income recognised for credit-impaired financial assets. The submitter says that in practice, this difference is sometimes referred to as 'interest in suspense'. In this paper, we refer to this difference as unrecognised interest.

8. The submitter describes a 'curing' of a credit-impaired financial asset as either a transfer from Stage 3 to Stage 2[2] financial assets or a recovery out of stage 3. Therefore, if the credit-impaired financial asset is subsequently paid in full or is no longer credit-impaired, it is regarded as 'cured'. The submitter asks in which line item in the income statement to present the accumulated unrecognised interest when a credit-impaired financial asset is cured.

9. The submitter says there are two views:

    (a) View 1 – present as a credit impairment gain

    (b) View 2 – accounting policy choice that permits presentation as interest income

Illustrative example

10. The submission describes a fact pattern in which an entity has an amortised cost financial asset of CU100 that is repaid in annual instalments of CU26.4 over 5 years. The EIR is 10%. The financial asset is in stage 2 at the end of Year 1 and moves into stage 3 at the beginning of Year 2. No payments are made in Years 2 and 3. The impairment loss recognised under both stages 2 and 3 is assumed to be CU66. At the beginning of Year 4, the customer repays the full contractual amount owing of CU101.20.

11. Using the numbers in the fact pattern presented, the following table summarises the amounts recognised in the statement of financial position and income statement for Years 1-4 and the amount of unrecognised interest. For ease of reference, amounts have been rounded. See Appendix B for further details on the calculations.

[2] Stage 2 financial assets are financial assets for which there has been a significant increase in credit risk since initial recognition, but which are not yet credit-impaired.

Statement of financial position

	Stage 2	*Stage 3*	*Stage 3*	*Repaid in full at the beginning of Year 4*
	Year 1	**Year 2**	**Year 3**	**Year 4**
Gross carrying amount	84	92	101	-
Less	(66)	(72)	(79)	-
Interest in suspense[3]	-	(6)	(13)	
ECL excluding the effect of the unwinding of discounting	(66)	(66)	(66)	
Net carrying amount	18	20	22	-

Income statement	**Year 1**	**Year 2**	**Year 3**	**Year 4**	
				View 1	**View 2**
Interest income	10	2	2	-	13
Recognition basis[4]	*Gross*	*Net*	*Net*		
Credit impairment (losses)/gains	(66)	-	-	79	66

[3] Supporters of View 2 suggest the use of an account called interest in suspense to record the amount of unrecognised interest, which is equal to the amount of the unwinding of discount on ECL. They consider the interest in suspense account as a separate account from ECL.

[4] Paragraph 5.4.1 of IFRS 9 requires an entity to apply the EIR to the amortised cost of a credit-impaired financial asset in subsequent reporting periods. Paragraph BC5.74 of IFRS 9 explains that if a financial asset is credit-impaired at the reporting date, an entity should change the interest revenue calculation at the beginning of the following reporting period.

12. When the customer repays the full contractual amount owing at the beginning of Year 4, the credit-impaired asset is regarded as cured. The submitter asks about the presentation of the accumulated unrecognised interest of CU13 (CU6 in Year 2 and CU7 in Year 3) upon curing.

View 1—present as a credit impairment gain

13. View 1 would result in, upon curing of a financial asset, an entity reversing the entire ECL in the statement of financial position (CU79 in the illustrative example) —which includes both the initial impairment provision (CU66) and the accumulated unrecognised interest (CU13)—in the income statement through the credit impairment line. Supporters of this view consider the nature of the unrecognised interest to be similar to the loss allowance. IFRS 9 does not include any requirement contradictory to this, and therefore it should be released as part of the credit impairment line. This presentation in profit or loss aligns with paragraph 5.5.8 of IFRS 9 (see paragraph 14 of this paper) and the presentation in the statement of financial position would be in accordance with the ITG discussion in December 2015 (see paragraph 15 of this paper).

14. Paragraph 5.5.8 of IFRS 9 states:

> An entity shall recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.

15. The Transition Resource Group for Impairment of Financial Instruments (ITG) discussed the measurement of the loss allowance for credit-impaired financial assets in December 2015 (Agenda Paper 9). ITG members noted that in accordance with IFRS 9:

    (a) ECL are required to be discounted to the reporting date using the EIR determined at initial recognition or an approximation thereof; and

    (b) GCA of a financial asset is calculated by discounting estimated contractual cash flows (without considering ECL) at the original EIR.

16. This view would result in an entity recognising a net gain in the credit impairment line with respect to the financial asset (net of a gain of CU79 recognised in Year 4 less a loss of CU66 recognised in Year 1). Supporters of View 1 say recognising a credit impairment gain is already contemplated in IFRS 9 paragraph 5.5.14 for the subsequent measurement of purchased or originated credit-impaired (POCI) financial assets.

17. Paragraph 5.5.14 states:

> At each reporting date, an entity shall recognise in profit or loss the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition.

18. Supporters of View 1 also think that the credit impairment requirements of IFRS 9 cannot be compared to the requirements in other IFRS Standards (such as IAS 2 *Inventories* and IAS 36 *Impairment of Assets*), which prohibit an impairment gain. This is because those Standards are based on historical cost measurement models and the assets are not interest bearing. IAS 2 specifically prohibits a reversal above the original cost of inventories.

19. In summary, using the numbers in the example in paragraph 10 of this paper, View 1 proposes the following journal entries upon curing of the financial asset (ignoring the use of an interest in suspense account):

Dr Cash	CU101	
Cr GCA		CU101

Recognition of cash received for the full contractual amount owing

Dr ECL	CU79	
Cr Credit impairment		CU79

Reversal of ECL

View 2—accounting policy choice that permits presentation as interest income

20. View 2 would result in the reversal of only the initial impairment provision (CU66), excluding any accumulated unrecognised interest, through the credit impairment line. The amount reversed would thus equal the amount of the loss allowance previously recognised in profit or loss through the credit impairment line. An entity would reverse the accumulated unrecognised interest (CU13) through the interest income line.

21. Supporters of View 2 think an entity does not recognise the unrecognised interest in profit or loss as a credit impairment whilst the asset is credit-impaired—instead, the entity recognises it in the statement of financial position as part of the GCA of the financial asset and through the use of the interest in suspense account. Because of this, those supporters think an entity has an accounting policy choice in determining in which line item in the income statement it presents the accumulated unrecognised interest when the asset is cured.

22. Supporters of this view further think View 1 could produce what they view as counter-intuitive results because an entity would present contractual interest received in the income statement as a credit impairment gain. In some situations, such as the curing of a large exposure, this could even result in the credit impairment line in the income statement showing a net gain.

23. Some supporters of View 2 are also of the view that an entity should reverse the unrecognised interest through the interest income line as this represents the nature of the income earned and would ensure that, over the full duration of the financial asset, all contractual interest earned is recognised within interest income. They think such a result would provide relevant information.

24. Further applying View 2 the amount of credit impairment gains or losses recognised in the income statement over the duration of the financial asset would be zero (if the financial asset cures completely). The reversal of the credit impairment is limited to the amount initially recognised in the income statement as an impairment loss consistent with other IFRS Standards e.g. IAS 2, IAS 36.

25. In summary, View 2 proposes the following journal entries upon curing of the financial asset:

Dr Cash	CU101	
Cr GCA		CU101
Recognition of cash received for the full contractual amount owing		
Dr ECL	CU66	
Dr Interest in suspense	CU13	
Cr Credit impairment		CU66
Cr Interest income		CU13
Reversal of ECL		

Summary of our research and analysis

Outreach

26. We decided not to perform outreach on this request for two reasons:

(a) We are aware through informal research and information provided by the submitter that the fact pattern is widespread. The issue would affect all entities that have interest-bearing financial assets that are credit-impaired. The ITG already discussed an interrelated issue (see paragraph 15 of this paper) about the measurement of the loss allowance for credit-impaired financial assets. This indicates that the existence of credit-impaired financial assets is widespread.

(b) Because the matter relates to the application of IFRS 9 and this is the first year in which IFRS 9 is in effect, we considered it to be urgent in nature and thus proceeded to bring it to the Committee's November 2018 meeting.

Staff analysis

27. The question the submitter asks is about the presentation in the income statement when a credit-impaired financial asset is cured—the presentation of the reversal of accumulated unrecognised interest (at the beginning of Year 4 in the example). In analysing that question we have first considered the accounting during the period in which the asset is credit-impaired (Years 2 and 3 in the example). This is because the basis for each of the views on where to present the reversal of unrecognised interest stems from the accounting for the unrecognised interest during the period in which the asset is credit-impaired.

What does IFRS 9 say?

28. The GCA of a financial asset is defined in Appendix A to IFRS 9 as 'the amortised cost of a financial asset, before adjusting for any loss allowance'. Taking into consideration the definition of amortised cost in Appendix A to IFRS 9, the GCA is in effect the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, before adjusting for any loss allowance.

29. Appendix A to IFRS 9 defines a credit loss as:

> The difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls), discounted at the original effective interest rate…

30. Based on these definitions, the amortised cost is the difference between the GCA and the ECL. Furthermore, both the GCA and the ECL are discounted amounts. Given the definition of GCA, the GCA balance changes by the amount of the unwinding of discount in each period. The amount of the unwinding of discount on the GCA in each period is the same as the amount of interest income calculated by applying the EIR to the GCA as required by paragraph 5.4.1 for financial assets that are not credit-impaired.

31. Similarly, given the definition of a credit loss, the ECL balance changes by the amount of the unwinding of discount in each period. As reproduced in paragraph 14 of this paper, paragraph 5.5.8 of IFRS 9 requires an entity to recognise all adjustments to the ECL in profit or loss, as an impairment gain or loss.

32. Further, paragraph B5.5.33 of IFRS 9 affirms that the requirement in paragraph 5.5.8 of IFRS 9 applies consistently to credit-impaired financial assets:

> For a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Any adjustment is recognised in profit or loss as an impairment gain or loss.

33. Applying paragraph 5.4.1(b) of IFRS 9, the amount of interest income recognised for credit-impaired financial assets is calculated by applying the EIR to the amortised cost.

The presentation of unrecognised interest during the period that the financial asset is credit-impaired

34. When an asset becomes credit-impaired, the amount of the unwinding of discount on GCA is more than the interest income recognised, which is based on the amortised cost balance as required by paragraph 5.4.1(b) of IFRS 9. This difference is the unrecognised interest as described in paragraph 7 of this paper. In other words, unrecognised interest represents a part of the unwinding of discount on the GCA that is required to ensure the GCA balance at the end of the reporting period is as defined in IFRS 9. Using the numbers from the example, in Year 2, an entity records the following journal entry:

DR GCA	CU8 (GCA of CU84*EIR of 10%)
CR Interest income	CU2 (Amortised cost of CU18*EIR of10%)
CR [a credit entry required]	CU6 ((CU84-18)*10% or CU8-CU2)

35. For a credit-impaired financial asset, the amount of unrecognised interest is equal to the amount of the unwinding of discount on the ECL. Using our example, in Year 2, the unrecognised interest of CU6 equals the unwinding of the discount on the ECL balance (CU72-CU66). Assuming no changes in expected cash flows, this relationship will always hold. This is because the ECL is the difference between the GCA and amortised cost and, therefore, the unwinding of the discount on the difference between the GCA and amortised cost (which is unrecognised interest) will always be equal to the unwinding of the discount on the ECL. The question that arises is where to present the credit entry when the GCA is increased by the unrecognised interest, as required by IFRS 9.

36. Because ECL is also a discounted amount, the unwinding of discount on the ECL also increases the ECL. As required by paragraph 5.5.8 of IFRS 9, an entity recognises this unwinding of discount in profit or loss as a credit impairment loss because it is an amount that is required to adjust the ECL to the discounted amount. Using the numbers from the example, in Year 2, the entity records the following journal entry:

DR Credit impairment	CU6	
CR ECL		CU6

37. In the Staff's view, applying the definitions and requirements in IFRS 9 as reproduced in paragraphs 28−33, an entity recognises the unrecognised interest in profit or loss and recognises the unwinding of the discount on the ECL by increasing ECL and by recognising a credit impairment loss as illustrated in paragraph 36. Given this requirement, if an entity uses an interest in suspense account (as View 2 suggests) recording the unwinding of discount on the GCA for the amount of unrecognised interest, the net carrying amount of the financial asset would be understated and would not be consistent with the definition of amortised cost. Using the numbers from the example, at the end of Year 2, the statement of financial position would show the GCA of CU92, a credit balance of CU6 in the interest in suspense account and ECL of CU72. The net carrying amount of the financial asset would be CU14 instead of CU20, and therefore would be inconsistent with the definition of amortised cost.

38. Recognition of the unwinding of discount on the ECL (as discussed in paragraph 36 of this paper) and the unrecognised interest (as discussed in paragraph 37 of this paper) in profit or loss would also align with the requirements in paragraph 5.4.1(b) of

IFRS 9, which reflect the net interest approach discussed at the July 2012 Board meeting (Agenda Paper 5D)—the submitter also refers to that paper in Appendix A to the submission. In that paper, the staff identified the alternatives for calculating interest income to be presented for credit-impaired financial assets, including the following:

(a) Net interest approach - Require interest income to be calculated on the basis of the net carrying amount; or

(b) Nil interest approach - Reduce the interest income presented to nil. Under this approach an entity would be required to offset interest income on the subset of assets with an equal amount of impairment loss.

39. As shown in the table in Appendix A of the submission (which is an extract from Agenda Paper 5D), the net interest approach ensures that the net effect in the credit impairment line prior to the curing of the financial assets is the initial impairment provision (CU66 in Years 1–3 in the example). This net interest approach is reflected in the requirement in paragraph 5.4.1(b) of IFRS 9 for recognising interest on the amortised cost for credit-impaired financial assets.

40. The unrecognised interest of CU6 discussed in paragraphs 34–35 therefore needs to be recognised in profit or loss. However, an entity cannot present that unrecognised interest as interest income because IFRS 9 requires interest income on a credit-impaired financial asset to be calculated by applying the EIR to the amortised cost. This means the corresponding entry for increasing the GCA by the amount of unrecognised interest should also be made to the credit impairment line. This credit entry to the credit impairment line offsets the debit entry recorded for the unwinding of the discount on the ECL, resulting in no net effect in the credit impairment line. This accounting treatment is therefore in line with the net interest approach and addresses the submitter’s concern discussed in paragraph 38 of this paper. Using the example, the income statement for Year 2 reflects the following:

(a) interest income of CU 2 (calculated as amortised cost of CU18*EIR of 10%); and

(b) net credit impairment of zero (a credit impairment loss of CU6 for the unwinding of discount on the ECL offset by CU6 of unrecognised interest).

41. Consequently, an entity recognises both the unrecognised interest—which is part of the unwinding of the discount on the GCA—and the unwinding of the discount on the ECL in profit or loss as credit impairment. The Staff are of the view the result of recognising both items in the credit impairment line would be consistent with the requirements in paragraphs 5.4.1(b), 5.5.8 and B5.5.33 of IFRS 9 as well as with the definitions of GCA, amortised cost and credit losses in Appendix A of IFRS 9. The need for an interest in suspense account as proposed by the submitter does not arise. Furthermore, the presentation of GCA, ECL and amortised cost is consistent with the ITG discussion in December 2015.

The reversal of unrecognised interest upon curing

42. When the financial asset is cured (in Year 4 in the example), an entity reverses the ECL on the financial asset through the credit impairment line because it is also an adjustment required by paragraph 5.5.8 of IFRS 9 to bring the loss allowance at the reporting date to the amount that is required to be recognised applying IFRS 9 (zero if the credit-impaired asset cures fully). This reversal represents the reversal of the previous unwinding of the discount on the ECL, which is equal in amount to the unrecognised interest of the credit-impaired financial asset.

43. Applying IFRS 9, the entity recognises the unwinding of discount on the ECL and the unrecognised interest as credit impairment during the period that the asset is credit-impaired (Years 2–3) as discussed in paragraph 41. Therefore, the entity also reverses the unwinding of discount on the ECL through the same line in which it was initially presented. When the asset cures, the entity records the following journal entries, which in our view faithfully reflect that all impairment losses previously recognised are now fully reversed:

DR Cash	CU101	
CR GCA		CU101
DR ECL	CU79	
CR Credit impairment		CU79

44. Similar considerations apply if a Stage 3 financial asset becomes a Stage 2 financial asset. Applying paragraph 5.4.2 of IFRS 9, when a financial asset is no longer credit-

impaired, interest income is again recognised on the GCA in subsequent reporting periods. However (regardless of whether there is a change in the expected cash flows) there is no requirement to reclassify to the interest income line the amount that was previously recognised as an unwinding of discount on the ECL.

Why an entity does not present the reversal of accumulated unrecognised interest as interest income

45. View 2 says an entity can recognise the reversal of accumulated unrecognised interest in profit or loss as interest income when the asset is cured.

46. Supporters of View 2 think in the case of credit-impaired financial assets, an entity cannot recognise the unrecognised interest or the unwinding of the discount on the ECL in profit or loss because of the interest recognition requirements for such assets applying paragraph 5.4.1(b) of IFRS 9. In their view, an entity therefore needs to recognise any such unwinding using an 'interest in suspense' account in the statement of financial position and not in profit or loss through the credit impairment line.

47. Applying View 2, during the period the asset is credit-impaired, the entity does not recognise the unwinding of the discount on the ECL in profit or loss, but instead recognises these amounts directly in the statement of financial position using an interest in suspense account.

48. Using the same example as above, View 2 supporters would record the following entry in Year 2:

DR GCA	CU8	
CR Interest income		CU2
CR Interest in suspense (statement of financial position)		CU6

49. Therefore, supporters of View 2 think an entity is not required to present any reversal in the credit impairment line when the credit-impaired financial asset is cured. In other words, they think because the unwinding of discount on the ECL and unrecognised interest were never recognised in profit or loss as credit impairment, any reversal does not represent a reversal of impairment losses and can instead be presented as interest income.

50. However, in the Staff's view, the accounting applying View 2 during the periods when the financial asset is credit-impaired is inconsistent with the requirements in IFRS 9. In Year 2, the entity must increase the ECL balance by CU6 for the unwinding of discount, because otherwise the ECL balance will not represent the difference between the GCA and the amortised cost as defined in IFRS 9. Applying paragraph 5.5.8 of IFRS 9, the entity recognises the corresponding debit of CU 6 in profit or loss as a credit impairment loss. Therefore, in the Staff's view, applying View 2 of not recognising the unwinding of the discount on the ECL in profit or loss would not comply with the requirements in paragraphs 5.5.8 of IFRS 9 and would also result in an inconsistent treatment of the unwinding of discount between Stage 3 and other financial assets.

51. In addition, an entity recognises in profit or loss as credit impairment the difference between the unwinding of discount on GCA of CU8 and the interest income of CU2 in Year 2 in the example as well as an impairment loss of CU6 representing the unwinding of discounting on the ECL as discussed in paragraphs 40–41.

52. Consequently, the Staff are of the view that View 2 is inconsistent with the requirements in IFRS 9. This is because, applying IFRS 9, an entity recognises the unwinding of the discount on the ECL as a credit impairment loss during the period that the asset is credit-impaired, so the reversal of that amount is presented as a reversal of credit impairment when the asset is cured.

53. In addition, supporters of View 2 think that the reversal of the credit impairment should be limited to the amount of provision initially recognised in profit or loss as an impairment loss to be consistent with other IFRS Standards e.g. IAS 2, IAS 36. In the Staff's view, the requirements in other Standards for impairment of non-financial assets cannot be analogised to when accounting for financial instruments within the scope of IFRS 9.

Staff conclusion

54. In our view, applying IFRS 9, when a credit-impaired financial asset is cured, an entity reverses the unwinding of the discount on the ECL (which is equal in amount to the unrecognised interest) and presents it in the credit impairment line in the income statement.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the requirements in IFRS 9, set out in paragraphs 25-43 of the paper?

Should the Committee add this matter to its standard-setting agenda?

Is it necessary to add to or change IFRS Standards to improve financial reporting?[5]

55. Based on our analysis, we think the requirements in IFRS 9 provide an adequate basis for an entity to recognise and present the unwinding of the discount on the ECL (which is equal in amount to the unrecognised interest) following the curing of a credit-impaired financial asset the fact pattern described in the submission.

Staff recommendation

56. Based on our assessment of the Committee's agenda criteria in paragraphs 5.16–5.17 of the Due Process Handbook (discussed in paragraph 44 of this paper), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead, we recommend it publish an agenda decision that explains how an entity applies the requirements in IFRS 9 to the fact pattern described in the submission.

[5] Paragraph 5.16(b) of the *Due Process Handbook*

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording of the tentative agenda decision

Presentation of unrecognised interest following the curing of a credit-impaired financial asset (IFRS 9)

The Committee received a request about how an entity presents unrecognised interest when a credit-impaired financial asset is subsequently paid in full or is no longer credit-impaired (cured) applying IFRS 9 *Financial Instruments*. Specifically, the request asked whether, in the statement of profit or loss, an entity can present previously unrecognised interest as interest revenue or, instead, is required to present it as a reversal of impairment losses. Unrecognised interest is the difference between the interest calculated on the gross carrying amount (GCA) of the financial asset and the net interest recognised applying paragraph 5.4.1(b) of IFRS 9 during the period that the asset is credit-impaired.

Appendix A to IFRS 9 defines a credit loss as the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls), discounted at the original effective interest rate. Appendix A also defines the GCA as the amortised cost of a financial asset, before adjusting for any loss allowance. The Committee noted that, based on the definitions in Appendix A to IFRS 9, the GCA, amortised cost and expected credit loss allowance (ECL) are discounted amounts and changes in these amounts during a reporting period include the effect of the unwinding of the discount.

Paragraphs 5.5.8 and B5.5.33 of IFRS 9 require an entity to recognise any adjustments to the ECL in profit or loss as an impairment gain or loss.

Applying the requirements of IFRS 9 described above, the Committee concluded that the unwinding of the discount on the ECL needs to be recognised in profit or loss, as an impairment loss, because it is an amount that is required to adjust the ECL to the discounted amount.

When the financial asset becomes credit-impaired, applying IFRS 9 the amount of the unwinding of the discount on the GCA (that increases the GCA) is more than the interest revenue recognised (which is calculated based on the amortised cost of the asset)—this difference is the unrecognised interest. The amount of unrecognised interest is equal to the unwinding of the discount on the ECL for credit-impaired financial assets.

The Committee concluded that to be consistent with the requirements in paragraph 5.4.1(b) of IFRS 9 and with the definition of GCA and amortised cost, the GCA needs to be adjusted by the amount of unrecognised interest and that the unrecognised interest should also be recognised in profit or loss as credit impairment.

Because the unwinding of the discount on the ECL is recognised in profit or loss as credit impairment during the period the financial asset is credit-impaired, when the financial asset is no longer credit-impaired, an entity reverses the unwinding of the discount on the ECL through the credit impairment line. Any reversal of the ECL should be recognised in profit or loss as credit impairment because it is also an adjustment required by paragraph 5.5.8 of IFRS 9 to bring the loss allowance at the reporting date to the amount that is required to be recognised in accordance with IFRS 9 (zero if the credit-impaired asset cures fully).

The Committee concluded that the requirements in existing IFRS Standards provide an adequate basis for an entity to recognise and present unrecognised interest (unwinding of the discount on the ECL) following the curing of a credit-impaired financial asset as in the fact pattern described in the request.

Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Appendix B—Submission

We have reproduced the submission below, and in doing so deleted details that would identify the submitter of this request.

Suggested agenda item: interpretation differences relating to where within the income statement contractual interest should be presented in terms of IFRS 9 *Financial Instruments* (IFRS 9) following the curing of a credit impaired financial asset

In response to a current interpretation difference (with respect to IFRS 9) attached is a submission.

We thank you for the opportunity to consider this interpretation difference.

Please do not hesitate to contact us should you wish to discuss the submission.

Yours faithfully,

…

Interpretation issue

IFRS 9 *Financial Instruments* (IFRS 9) does not provide any clear guidance with regard to the concept of suspended contractual interest when a financial asset is credit impaired. The suspension of contractual interest is commonly applied by the banking industry where financial assets are credit impaired. IFRS 9 further does not provide explicit guidance relating to where within the income statement an entity should present contractual interest received and earned (but previously unrecognised) following the curing or recovery (hereafter collectively referred to as curing) of credit impaired financial assets (stage 3 non-performing financial assets), i.e. transfers from stage 3 to stage 2 and recoveries out of stage 3.

Paragraph of IFRS guidance

IFRS 9 Extracts

Paragraph 5.4.1 states that: *"Interest revenue shall be calculated by using the effective interest method (see Appendix A and paragraphs B5.4.1–B5.4.7). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:*

(a) purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit-adjusted effective interest rate to the amortised cost of the financial asset from initial recognition.

(b) financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods."

Paragraph 5.4.2 further states that: *"An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the amortised cost of a financial asset in accordance with paragraph 5.4.1(b), shall, in subsequent reporting periods, calculate the interest revenue by applying the effective interest rate to the gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 5.4.1(b) were applied (such as an improvement in the borrower's credit rating)."*

Paragraph 5.5.8 explains that: *"An entity shall recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard."* Paragraph 5.5.14 states that: *"An entity shall recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition."*

Appendix A of IFRS 9 provides the following relevant definitions:

- the amortised cost of a financial asset or financial liability is defined as: *"The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance."*
- an expected credit loss is defined as: *"The weighted average of credit losses with the respective risks of a default occurring as the weights"*
- the gross carrying amount of a financial asset is defined as: *"The amortised cost of a financial asset, before adjusting for any loss allowance."*
- a loss allowance is defined as: *"The allowance for expected credit losses on financial assets measured in accordance with paragraph 4.1.2, lease receivables and contract assets, the accumulated impairment amount for financial assets measured in accordance with paragraph 4.1.2A and the provision for expected credit losses on loan commitments and financial guarantee contracts."*

Furthermore the Basis of Conclusions (BC) paragraph 5.75 explains that: "*The IASB received feedback on the 2013 Impairment Exposure Draft that showed the majority of respondents agreed that the interest revenue calculation should change to a calculation on a net basis for some financial assets, because it best supported faithful representation.* ***These requirements only affect the calculation and presentation of interest revenue and not the measurement of the loss allowance.****"* [Emphasis added]

Extract from IAS 36 Impairment of Assets (IAS 36)

IAS 36 paragraph 116 states that: *"An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore,* ***an impairment loss is not reversed just because of the passage of time*** *(sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount."* [Emphasis added]

Extract from IAS 2 Inventories (IAS 2)

IAS 2 paragraph 33 states that: *"A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed (****ie the reversal is limited to the amount of the original write-down)*** *so that the new carrying amount is the lower of the cost and the revised net realisable value. This occurs, for example, when an item of inventory that is carried at net realisable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased."* [Emphasis added]

Extract from IAS 1 Presentation of financial statements (IAS 1)

The amended IAS 1 paragraph 82(a) requires that an entity disclose separately within profit or loss in the income statement the amount of interest revenue calculated utilising the effective interest method. Furthermore, IAS 1 paragraph 29 states that: *"An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial."*

***Extract from IFRS 15 Revenue from Contracts with Customers* (*IFRS 15*)**

IFRS 15 paragraph 9(e) states that: *"An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met: ... it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due…"*

Analysis of the issue

Measurement of interest revenue for credit impaired financial assets

Interest revenue is measured in accordance with IFRS 9 paragraph 5.4.1 such that interest revenue is recognised on:

- the gross carrying amount for financial assets that are not purchased or originated credit impaired or financial assets that subsequently have cured from classification as creditimpaired financial assets (stage 1 and 2 financial assets),
- the net carrying amount (gross carrying amount less loss allowance) for financial assets that have subsequently been classified as credit-impaired financial assets (stage 3 financial assets).

Issue: Whilst IFRS 9 provides guidance on the measurement of interest revenue for credit impaired financial assets in the income statement, it does not provide explicit guidance on how the difference between the contractual interest earned and net interest recognised for credit impaired financial assets (stage 3) (hereafter referred to as interest in suspense) should be presented within the income statement following the curing of credit impaired financial assets (stage 3).

Presentation of interest in suspense on curing out of Stage 3

Under IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) and IAS 18 *Revenue* (IAS 18), a number of … banks [in our jurisdiction] suspended the recognition of contractual interest from the point that a financial asset was classified as specifically impaired. In addition, upon the curing of the non-performing financial asset, those entities elected an accounting policy for the line item within the income statement in which such previously unrecognised interest is presented. The majority of the … banks [in our jurisdiction] recognised this suspended contractual interest within interest revenue as an accounting presentation policy. This policy was elected on the basis that the presentation best represented the nature of the amount in terms of IAS 1.

Currently, … there are 2 views regarding where within the income statement the release of interest in suspense, following the curing of credit impaired financial assets (stage 3), should be presented in terms of IFRS 9. This is best explained by way of the following illustrative example:

An amortised cost financial asset of CU100 is repaid in annual instalments over 5 years. The effective interest of the financial asset is 10% and each instalment is approximately CU26.

The amortisation table would be as follows for this financial asset:

	Opening balance	**Interest**	**Repayment**	**Closing balance**
Year 1	100	10	(26.4)	83.6
Year 2	83.6	8.4	(26.4)	65.6
Year 3	65.6	6.6	(26.4)	45.8
Year 4	45.8	4.6	(26.4)	24.0
Year 5	24.0	2.4	(26.4)	-

Assume the following for purposes of this illustrative example:

- Financial asset is in stage 2 from an impairment perspective at the end of year 1
- Financial asset moves into stage 3 (i.e. is credit impaired) at the beginning of the year 2
- No payments are made on the financial asset in years 2 and 3
- Impairment loss recognised under both stage 2 and stage 3 is assumed to be CU66
- Suspended contractual interest is presented separately from the loss allowance to illustrate the difference in nature between the loss allowance and the suspended contractual interest. The gross presentation of the financial asset is in line with the ITG paper and the separation of interest in suspense from the loss allowance is in accordance with the view outlined in Appendix A. In absence of the separation of interest in suspense, this suspended interest would be recognised in the loss allowance.
- At the beginning of year 4, the customer repays CU101.20, which is payment of the full contractual amount owing.

The updated amortisation table based on expected cash flows is as follows:

	Opening balance	Interest	Repayment	Closing balance
Year 1	100	10	(26.4)	83.6
Year 2	83.6	8.4	-	92.0
Year 3	92.0	9.2	-	101.2
Year 4	101.2	-	(101.2)	-

The resultant accounting treatment in terms of IFRS 9 for this financial asset in years 1 to 3 is as follows:

- ***Year 1***
  - Contractual interest recognised of CU10 using the effective interest rate method.
  - Stage 2 impairment provision of CU66 recognised.
- ***Year 2***
  - No change recognised in the impairment provision.
  - Interest of CU2 recognised in interest income on the net carrying amount of CU18 (CU84 (contractual value) – CU66 (impairment loss)) at 10%.
  - CU6 (being the contractual effective interest of CU8 (10% of the gross carrying amount of CU84) less the CU2 which is the portion of interest in suspense recognised on the net carrying amount) recognised against the gross carrying amount and the interest in suspense balance sheet account.
- ***Year 3***
  - No change recognised in the impairment provision.
  - Interest of CU2 recognised on the net carrying amount of CU20 (CU92 (contractual value) – CU66 (impairment loss) – CU6 (interest in suspense)) at 10%.
  - CU7 (being the contractual effective interest of CU9 (10% of the gross carrying amount of CU92) less CU2 which is the portion of interest in suspense recognised on the net carrying amount) recognised against the gross carrying amount and the interest in suspense balance sheet account.

The accounting treatment is illustrated in the table below:

	Stage 2	*Stage 3*	*Stage 3*
	Year 1	**Year 2**	**Year 3**
Gross carrying amount	84	92	101
<u>Less:</u>	(66)	(72)	(79)
Interest in suspense	-	(6)	(13)
Impairment provision	(66)	(66)	(66)
Net carrying amount	**18**	**20**	**22**
<u>Income statement</u>			
Interest income	10	2	2
Recognition basis	*Gross*	*Net*	*Net*
Credit impairments	(66)	-	-

The resultant accounting treatment for this financial asset in year 4, following the payment of the full contractual amount owing, is to release the credit impairment provision and the cumulative interest in suspense (IIS) as the financial asset has been fully repaid.

There are 2 views on how to release the interest in suspense.

View 1 – Release within credit impairment line item

The impairment provision of CU 66 is reversed in the income statement through the credit impairment line. Supporters of this view consider the nature of the interest in suspense to be akin to the loss allowance, as IFRS 9 does not provide any guidance contradictory to this, and therefore the interest in suspense released should be combined as part of credit impairment line item. This would be in accordance with IFRS 9's credit loss definition which states that the loss allowance is calculated as all cash shortfalls discounted at the effective interest rate. The release of this amount should therefore be recognised within the credit impairments' line item within the income statement (in line with paragraph 5.5.8 of IFRS 9). This recognition would be in accordance with the presentation (Approach A) of the Impairment Transition Group (ITG) paper (refer to the Appendix view A for more detail), with the interest in suspense of CU 13 (being CU 6 from year 2 and CU 7 from year 3) being recognised as part of credit impairments. This view will result in a credit impairment gain of CU 13 being recognised within the income statement over the duration of the financial asset.

Supporters of view 1 argue that recognising a credit impairment gain is already contemplated in IFRS 9 paragraph 5.5.14 for the subsequent measurement of purchased or originated credit-impaired financial assets and that IFRS 9's credit impairments cannot be compared to other IFRS standards (such as IAS 2 and IAS 36) which disallow a credit impairment gain as those standards are based on historical cost measurement models (and hence are not interest bearing). IAS 2 further contains a specific prohibition against reversal above cost.

View 1 would result in the following accounting entries:

Dr	*Stage 3 impairment provision*	*SFP*	*CU66*	
Cr	*Credit impairments*	*IS*		*CU66*
Dr	*IIS balance sheet*	*SFP*	*CU13*	
Cr	*Credit impairments*	*IS*		*CU 13*

The table below illustrates the income statement presentation over the life of the financial asset:

	Stage 2	*Stage 3*	*Stage 3*	*Loan repaid*	
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Cumulative I/S**
Interest income	10 *Gross*	2 *Net*	2 *Net*	- *Gross*	14
Credit impairments	(66)	-	-	79	13

View 2 – Accounting policy choice

The impairment provision of CU 66, excluding any interest in suspense, is reversed in the income statement through credit impairments, being the amount of the loss allowance previously recognised in profit or loss.

Supporters of view 2 believe that as the interest in suspense has not been recognised through the income statement within credit impairments as required by IFRS 9 paragraph 5.5.8, but has rather been recognised through the balance sheet increasing the gross carrying amount of the financial asset in line with the ITG decision, that an accounting policy is required to be adopted to determine which line item in the income statement the CU 13 interest in suspense is recognised. The accounting policy choice would be required in terms of IAS 1 to explain to users how the entity has recognised the contractual interest, as IFRS 9 does not specifically address the line item recognition of this interest in suspense in the income statement.

Supporters of this view further believe that any interest which is recovered, but which was previously unrecognised, should be treated in accordance with a preparer's accounting policy election as applying view 1 could produce counterintuitive results, as contractual interest received would be reflected within the income statement as a credit impairment gain. These credit impairment gains could have unintended commercial consequences if they are not correctly factored into pricing models and in certain instances, such as a large exposure curing, could even result in the overall entity's income statement loss allowance reflecting a credit.

Notwithstanding the fact that this view states that the release of the interest in suspense is an accounting policy choice as IFRS 9 does not address the line item recognition of interest in suspense in the income statement, there is a strong view from the … banking industry [in our jurisdiction] that the interest in suspense should be released to interest income as this represents the nature of the income earned and would ensure that over the full duration of the financial asset, all contractual interest earned is recognised within interest income and would provide more relevant information when disclosed as part of net interest income, i.e. interest income after associated funding costs. Further the amount of the loss allowance recognised within the income statement over the duration of the financial asset would be zero (where the financial asset cures completely), i.e. the reversal of the credit impairment is limited to the amount initially recognised in the income statement as an impairment loss consistently with other IFRS as follows:

- **IAS 2:** states that the reversal of a write-down is limited to the amount of the original write-down

- **IAS 36**: an impairment loss is not reversed just because of the passage of time (sometimes called the ‘unwinding’ of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount and a time value unwind cannot be recognised as a reversal of an impairment. Therefore, the reversal of the IAS 36 impairment is limited to the amount originally recognised in the income statement

- **IAS 37:** states that a reimbursement can be netted against the original expense relating to the provision. This netting would be limited to the amount of the original expenditure.

- **IFRS 15:** states that revenue is recognised when it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer

- **IAS 1:** requirement to present items by nature

Supporters of this view do not believe that the income statement treatment of credit impaired financial assets can be supported by guidance surrounding purchased or originated credit impaired financial assets as IFRS 9 explicitly provides different guidance for these purchased or originated credit impaired financial assets in paragraph 5.5.14. IFRS 9 does not provide any guidance of this sort for credit impaired financial assets which are not purchased or originated.

The above accounting presentation will, hence not understate the credit impairments within a financial reporting period as compared to view 1.

View 2, with an accounting policy choice to recognise interest in suspense within interest income, would result in the following accounting entries:

Dr	*Stage 3 impairment provision*	*SFP*	*CU66*	
Cr	*Credit impairments*	*IS*		*CU66*
Dr	*IIS balance sheet*	*SFP*	*CU13*	
Cr	*Interest income*	*IS*		*CU 13*

The table below illustrates the income statement presentation over the life of the financial asset:

	Stage 2	*Stage 3*	*Stage 3*	*Loan repaid*	
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Cumulative I/S**
Interest income	10	2	2	13	27
	Gross	*Net*	*Net*	*Gross*	
Credit impairments	(66)	-	-	66	-

Some supporters of view 2 believe that interest in suspense cannot be included within the loss allowance as was indicated in the ITG Paper. The rationale for this view has been included in Appendix A. This supplementary argument concludes that the loss allowance should not be adjusted for the interest in suspense, but rather the interest in suspense adjusts the gross carrying amount and a separate reconciling line item in determining the net carrying value. Therefore, on curing the interest in suspense should not be presented as part of credit impairments within the income statement.

Conclusion: We do not believe that IFRS 9 provides sufficient guidance relating to the accounting presentation of interest in suspense on curing out of Stage 3. There is currently divergences among the constituents regarding which view is the appropriate accounting treatment for the recognition of interest in suspense within the income statement.

Reasons for the Committee to address the issue

This issue is resulting in divergent views in the … banking industry [in our jurisdiction], for which the impact is material both from an income statement presentation perspective as well as in the disclosure of key financial ratios that include the net interest margin and the cost to income ratio. In addition, our discussions with entities from other jurisdictions… has indicated that this issue would be relevant in emerging markets (which typically have high interest rates) and is likely to result in divergent views in practice. Our constituents have also heard views from users of financial statements (such as analysts) that interest income would be considered to be the more logical line item within the income statement to present the interest in suspense following the curing of credit impaired financial assets.

View 1 has been formulated through documented discussions from the ITG meetings held in December 2015. However, a few constituents do not believe that the ITG, in discussing the matter, considered the impact of their discussions on the curing of a financial asset and the subsequent treatment of interest in suspense.

We believe that there is divergence on this matter and therefore believe that it would be appropriate for this matter to be a policy election in which an entity can select the line item in the income statement which is most appropriate to present interest in suspense following the curing of the financial asset. Further, the amount of interest in suspense recognised in the income statement should be disclosed separately either on the face of the income statement or in the notes to the financial statements.

Importantly … this issue should affect all preparers of financial statements that have interest bearing financial assets. This is because all such entities would need to consider how to treat the recognition of such interest income following the classification of such exposures out of stage 3.

We therefore believe that the Committee can provide guidance surrounding the presentation of interest in suspense on curing (taking into consideration the measurement of the loss allowance for credit impaired financial assets as discussed in the appendix A).

In addition, we believe that, by the Committee addressing these issues, financial reporting would be improved as preparers and users of financial statements would understand how interest in suspense is treated and will hence result in the improvement in the comparability and understandability of financial statements.

Appendix A

In developing IFRS 9, the IASB staff identified three alternatives to presenting interest revenue for exposures which are credit impaired. These three alternatives comprised the gross interest approach (referred to as 'tentative decisions to date' below) the net interest approach and the nil interest approach. The three approaches were represented by the following example (IASB working paper dated 16-20 July 2012, Agenda ref 5D):

		Y1	Y2	Y3	Y4
Gross carrying amount					
Opening		1,000	1,100	1,210	1,331
Payments		-	-	-	(570)
Interest	(a)	100	110	121	133
write off					(894)
Closing		1,100	1,210	1,331	-
Impairment allowance					
Opening		-	(672)	(739)	(813)
New impairment	(c)	(611)	-	-	-
Unwind of disount	(b)	(61)	(67)	(74)	(81)
Write-off		-	-	-	894
Closing		(672)	(739)	(813)	-
Net carrying amount		428	471	518	-
Presentation alternatives					
Tentative decisions to date *					
Interest revenue	(a)	100	110	121	133
Impairment (loss)	(b) + (c)	(672)	(67)	(74)	(81)
Net interest approach					
Interest revenue	(a) - (b)	39	43	47	52
Impairment (loss)	(c)	(611)	-	-	-
Nil interest approach					
Interest revenue		-	-	-	-
Impairment (loss)	(a)-(b)-(c)	(511)**	43	47	52

*Tentative decision to date at that point in the IFRS 9 project represented the gross interest approach
** The (511) as per the IASB example should rather be (572)

Subsequent to the above IASB working paper being drafted, the net interest approach depicted above was selected as the most appropriate accounting approach and implemented into the final issued IFRS 9 standard. Whilst IFRS 9 provides guidance on the measurement of interest revenue for credit impaired financial assets in the income statement, it does not provide explicit guidance on how the difference between the contractual interest earned and net interest recognised for credit impaired financial assets (stage 3) should be presented within the statement of financial position or the income statement.

Furthermore, the calculation of the loss allowance needs to be considered to determine whether contractual interest should be recognised within the loss allowance and to ensure that the loss allowance is calculated in a manner consistent with the net interest approach depicted above.

In terms of IFRS 9, entities are required to disclose a reconciliation of the gross carrying amount to the net carrying amount for financial instruments either on the face of the statement of financial position or in the notes of the financial statements. Under IAS 39, there was divergent practice regarding the disclosure of suspended interest. However, the majority of banking organisations in [our jurisdiction] did not recognise contractual interest (i.e.: those entities suspended the recognition of contractual interest in terms of IAS 18) once the financial asset was identified as being specifically impaired.

During December 2015, the IASB's ITG debated a paper entitled *'Measurement of the loss allowance for credit-impaired financial assets'*. This paper **only** explored how the contractual interest should be presented for credit impaired financial assets (stage 3) within the statement of financial position. ITG members observed that only one of the approaches, being the contractual effective interest rate approach (which stated that the gross carrying amount would include contractual interest and the loss allowance would be calculated as the balancing figure between the gross carrying amount and the amortised cost) would meet the requirements of IFRS 9. Some ITG members observed that the requirements in IFRS 9 were more specific in this area than those in IAS 39 and that this should provide consistency of application. [ITG meeting summary – para 71 and 72].

Utilising the IASB working paper example above, the presentation required under the contractual effective interest rate approach is depicted below:

Y1	Y2	Y3	Y4 (before write off)
1 100	1 210	1 331	1 464
(428)	(471)	(518)	(570)

	672	**739**	**813**	**894**

Gross carrying value

Less: amortised cost value *(being payments discounted at effective interest rate)*

Loss allowance

The IASB working paper example indicates that, for the net interest approach, no additional impairment should be recognised for any increase in loss allowance within profit or loss, i.e.:

Net interest approach	**Y1**	**Y2**	**Y3**	**Y4**
Interest revenue	39	43	47	52
Impairment (loss)	(611)	-	-	-
Profit or loss	**(572)**	**43**	**47**	**52**

The presentation approach depicted in the first table above, however indicates that there is an increase in the loss allowance. This increase is represented by the difference between the contractual interest rate and the net interest recognised in terms of IFRS 9.

An alternative view to the contractual effective interest rate approach would be to separately disclose the interest in suspense within the reconciliation between the gross carrying amount and the amortised cost amount. This difference in approaches and the impact of stage 3 on the loss allowance is discussed further in the section below.

Implication of net interest approach on the loss allowance

IFRS 9 defines the loss allowance as the allowance for expected credit losses measured at either amortised cost or fair value through other comprehensive income (FVOCI) and the provision for expected credit losses on in scope off-balance sheet exposures.

Credit losses are defined as *"the difference between all contractual cash flows that are due to an entity in accordance with the contract and all cash flows that the entity expects to receive (ie all cash shortfalls) discounted at the effective interest rate"*.

Paragraph 5.5.8 states that *"an entity shall recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss* *allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard"*.

Paragraph B5.5.33 clarifies the above and states that *"for a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the financial asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate.* ***Any adjustment is recognised in profit or loss as an impairment gain or loss.****"* [Emphasis added]

Utilising these definitions within IFRS 9, the cumulative credit losses would be calculated as follows for the IASB example:

	Y1	Y2	Y3	Y4 (before write off)
Gross carrying value	1 100	1 210	1 331	1 464
Less: amortised cost value *(being payments discounted at effective interest rate)*	(428)	(471)	(518)	(570)
Cumulative credit loss	**672**	**739**	**813**	**894**
Less: prior year credit loss	(611)	(672)	(739)	(813)
Yearly credit loss	**61**	**67**	**74**	**81**

The credit losses calculated above are consistent with the gross interest approach and not the net interest approach within the IASB working paper. By utilising the definition above, additional yearly credit losses should be recognised. This recognition would however result in double counting as these yearly credit losses represent the interest in suspense which has not yet been recognised in terms of the net interest approach for Stage 3 financial assets. The difference is as follows:

	Y1	Y2	Y3	Y4
Contractual interest	100	110	121	133
Less: Net interest on amortised cost balance	(39)	(43)	(47)	(52)
Difference	**61**	**67**	**74**	**81**

BC5.75 states that the net interest recognition method should *"only affect the calculation and presentation of interest revenue and not the measurement of the loss allowance"*. Therefore,

it is clear from the IASB worked example and the basis of conclusions that it would be incorrect to increase the loss allowance for the interest in suspense.

There are two potential views on how to recognise the interest in suspense:

View A: The interest in suspense should be recognised within the statement of financial position directly against the loss allowance and the gross carrying amount (this is consistent with Approach A from the ITG paper entitled "Measurement of the loss allowance for credit-impaired financial assets")

View B: The loss allowance is not adjusted for the interest in suspense, rather the interest in suspense adjusts the gross carrying amount and a separate reconciling line item in determining the net carrying value.

View A above would be inconsistent with IFRS 9's principles as there is no allowance for changes in the loss allowance to be recognised directly to the statement of financial position. Paragraph 5.5.8 and B5.5.33 both state that any changes in the loss allowance should rather be recognised within profit or loss.

View B would achieve the correct income statement recognition as changes in the loss allowance from credit losses should be recognised in the income statement. View B requires changes in the interest in suspense to be separately disclosed from the loss allowance and therefore the interest in suspense would not be recognised in the income statement and hence not adjust the credit impairment allowance in the statement of financial position.

There is currently divergence among the constituents regarding which view (A or B) represents the correct accounting treatment.