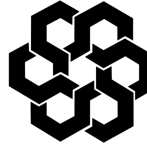

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International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**November 2008, London**
Project:	**Financial Instruments**
Subject:	**Impairment: Comparison of US GAAP and IFRSs (Agenda paper 11C)**

PURPOSE OF THIS MEMORANDUM

1. The purpose of this memorandum is to provide FASB and IASB Board members with a comparison of US GAAP and IFRSs from the perspective of impairment guidance for financial instruments.

2. The discussion in this memorandum is comprised of two main topics: (a) the scope of existing impairment guidance for financial instruments (that is, the types of financial instruments covered) and (b) the application of impairment guidance (recognition, measurement, and disclosure). Because US GAAP does not have one standard that covers the accounting for impairment for all financial instruments, the discussion related to US GAAP has been separated into three sections: Receivables, Loans, and Investments in securities. Appendices A and B provide the relevant accounting literature and key definitions, respectively, for impairment guidance for financial instruments under US GAAP. The accounting literature and definitions in these appendices provide the basis for the discussion about US GAAP in this

memorandum. Appendix D provides a summary table for the US GAAP impairment requirements discussed in this paper.

3. IFRSs have two standards, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures*, that cover the accounting and disclosures for impairment of all financial assets other than some specifically excluded from their scopes. The discussion of the IFRS requirements in this memo follows the structure chosen for US GAAP in order to facilitate a comparison. Appendix E provides a summary table for the IFRS impairment requirements discussed in this paper.

BACKGROUND

US GAAP

4. Impairment guidance for financial instruments has existed for over 30 years and has continued to evolve over those years. As is common in US GAAP and as evident in Appendix A, multiple pieces of accounting guidance have been issued based on the type of financial instrument and/or entity issuing the financial instrument. The most often referenced accounting guidance for impairments of financial instruments is found in FASB Statements No. 5, *Accounting for Contingencies*, No. 114, *Accounting by Creditors for Impairment of a Loan*, and No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

5. Statement 5 provides guidance for the recognition of an impairment for all receivables (including loans not accounted for under Statement 114) unless those receivables are specifically addressed by other accounting literature (such as debt securities). Statement 114 provides more specific guidance about measurement and disclosure of a subset of loans. Statement 115 provides accounting guidance for other-than-temporary impairments related to certain investments in debt and equity securities. Both Statements 114 and 115 contain scope paragraphs which identify the loans and investments, respectively, which are subject to their provisions. Accordingly, the "Scope" subsections that follow describe these loans and investments.

6. For purposes of this memorandum, the context of the discussion related to investments pertains to investments that are within the scope of Statement 115 and EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets" and subject to an other-than-temporary impairment analysis. Statement 115 uses "certain" to highlight that not all investments in debt and equity securities are within the scope of Statement 115 (for example, an investment in an equity security that does not have a readily determinable fair value is not within the scope of Statement 115). EITF 99-20 provides impairment guidance for purchased beneficial interests and beneficial interests that continue to be held by a transferor in securitized financial assets. The scope of EITF 99-20 includes beneficial interests that are either debt securities under Statement 115 or required to be accounted for like debt securities under Statement 115 pursuant to paragraph 14 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, (financial assets that can be contractually prepaid or otherwise settled in such a manner that the holder would not recover substantially all of its recorded investment). Accordingly, the use of the term "securities" and the discussion of other-than-temporary impairment related to those securities are intended to include only those investments in debt and equity securities included in the scope of Statement 115 and EITF 99-20.

7. In respect of IFRSs this memo only discusses the accounting for impairment of financial assets in the scope of IAS 39. Thus, it does not cover the following financial assets that are excluded from the scope of IAS 39:

    a. those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures* and that are therefore subject to IAS 36 *Impairment of Assets*.

    b. employers' rights under employee benefit plans accounted for in accordance with IAS 19 *Employee Benefits*.

c. rights under insurance contracts accounted for in accordance with IFRS 4 *Insurance Contracts*.

d. financial assets arising from contracts between an acquirer and a vendor in a business combination to buy or sell a business at a later date.

e. financial assets that are a reimbursement for expenditure in relation to a provision in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

8. Financial assets at fair value through profit or loss (whether they are designated into that category or are held for trading) are not subject to a separate impairment test because any impairment is an implicit integral part of the fair value changes that are recognized in profit or loss. Thus, they are excluded from the discussion of the impairment requirements.

DISCUSSION

9. The following discussion of impairment guidance for financial instruments in US GAAP and IFRSs is presented in three sections: (a) Receivables (under US GAAP that includes loans not accounted for under Statement 114), (b) Loans, (c) Investments in Securities. Each section includes subsections that address scope and the application of guidance (recognition, measurement, and disclosure).

Receivables—US GAAP

Scope

10. As noted above in paragraph 5, Statement 5 provides guidance for the recognition of an impairment for all receivables unless those receivables are specifically addressed by other accounting literature (such as debt securities). Examples of the type of receivables include those arising from credit sales, loans, or other transactions.

Recognition

11. Statement 5 requires that an estimated loss from a contingency should be recognized in earnings when the following conditions are both met: (a) it is probable that an asset is impaired and (b) the amount of the loss is reasonably estimable. Consideration of these conditions may be for individual receivables or a group of similar receivables. If these conditions are met, a loss is recognized in earnings even though particular receivables that are uncollectible cannot be identified.

12. Paragraph 23 of Statement 5 provides additional guidance in assessing whether the two conditions are met, stating:

> If, based on current information and events, it is probable that the enterprise will be unable to collect all amounts due according to the contractual terms of the receivable, the condition in paragraph 8(a) is met. As used here, *all amounts due according to the contractual terms* means that both the contractual interest payments and the contractual principal payments will be collected as scheduled according to the receivable's contractual terms. However, a creditor need not consider an insignificant delay or insignificant shortfall in amount of payments as meeting the condition in paragraph 8(a). Whether the amount of loss can be reasonably estimated (the condition in paragraph 8(b)) will normally depend on, among other things, the experience of the enterprise, information about the ability of individual debtors to pay, and appraisal of the receivables in light of the current economic environment. In the case of an enterprise that has no experience of its own, reference to the experience of other enterprises in the same business may be appropriate. Inability to make a reasonable estimate of the amount of loss from uncollectible receivables (i.e., failure to satisfy the condition in paragraph 8(b)) precludes accrual and may, if there is significant uncertainty as to collection, suggest that the installment method, the cost recovery method, or some other method of revenue recognition be used…

13. Question 6 of FASB *View Points*, "Application of FASB Statements 5 and 114 to a Loan Portfolio", provides additional insight into the meaning of reasonably estimated stating:

> Whether the amount of loss can be reasonably estimated will normally depend on, among other things, the experience of the creditor, information about the ability of individual debtors to pay, and appraisal of the receivables in light of the current economic environment. In the case of a creditor that has no experience of its own, reference to the experience of other enterprises in the same business may be appropriate. In all cases, Statement 5 requires a reasonable basis for quantifying the amount of loss.

Measurement

14. Statement 5 does not provide guidance about the measurement of an impairment of a receivable.

Disclosure

15. The disclosure requirements in Statement 5 include the nature of the impairment and the amount (subject to whether that disclosure is necessary for the financial statements not to be misleading). In instances where no impairment is recognized because one or both of the conditions described in paragraph 11 above are not met (or an exposure to loss exceeds the impairment recognized), paragraph 10 of Statement 5 states that "disclosure should be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred." That disclosure should include the nature of the contingency and either provide an estimate of the possible loss, a range of possible losses, or state that an estimate cannot be made.

Receivables—IFRSs

Scope

16. As noted above in paragraph 7, IAS 39 sets out the requirements for the recognition of an impairment for all receivables in the scope of IAS 39.

17. Assuming a financial instrument meets the definition of loans and receivables (for example, it is not quoted in an active market) it can fall into one of the following two categories that are subject to impairment testing in accordance with IAS 39:

    a. loans and receivables.

    b. available-for-sale financial assets.

Recognition

18. The first step of impairment testing is the assessment of whether there is any objective evidence of impairment. Paragraph 59 of IAS 39 (refer paragraph C2 of Appendix C of this paper) sets out examples of loss events that result in such objective evidence (general triggers).

19. This test is performed for receivables classified as loans and receivables:

    a. on an individual asset basis for financial assets that are individually significant or that an entity chooses to assess individually.

    b. collectively for financial assets that are either not individually assessed or for which the individual assessment did not reveal objective evidence of impairment. The collective assessment is performed for a group of financial assets with similar credit risk characteristics. Financial assets that have been individually evaluated for impairment and found not to be impaired and those that have not been individually evaluated may require different amounts of impairment as their loss statistics are different. Entities that do not have a group of assets with similar risk characteristics do not make the additional assessment.

20. Impairment losses on receivables classified as loans and receivables are reversed through profit or loss provided that both:

    a. the decrease of the impairment loss can be related objectively to an event occurring after the impairment was recognized; and

    b. the reversal does not increase the carrying amount above what it would have been absent any impairment.

21. For receivables classified as available-for-sale financial assets an impairment loss is recognized if both:

    a. a decline in fair value has been recognized in other comprehensive income; and

    b. there is objective evidence of impairment (refer to paragraph 18 of this paper); however, a decline in the fair value of a debt instrument is not necessarily evidence of impairment (for example, if it results from an increase in the risk-free interest rate).

22. Impairment losses on a receivable classified as available-for-sale financial assets is reversed through profit or loss provided that both:

    a. the receivable's fair value increases; and

    b. the increase in fair value can be related objectively to an event occurring after the impairment loss was recognized.

Measurement

23. For receivables classified as loans and receivables an impairment loss is measured as the difference between its carrying amount and the present value of the estimated future cash flows (reflecting the impairment but no future credit losses not yet incurred), discounted using the receivable's:

    a. original effective interest rate for fixed rate receivables (which may be zero if the effect of discounting is immaterial).

b. current effective interest rate for receivables with a variable rate.

24. For collectively assessed receivables the impairment loss is estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Peer group data for comparable groups of financial assets is used where there is no or insufficient entity-specific loss experience. Historical loss experience updated for the effects of current conditions. Moreover, changes in cash flow estimates must reflect and be directionally consistent with changes in related observable data. The methodology and assumptions used for cash flows estimates are back-tested in order to reduce any differences between loss estimates and actual loss experience.

25. For receivables classified as available-for-sale financial assets an impairment loss is measured as the difference between the amortized cost of the receivable and its current fair value. Thus, the entire loss previously recognized in other comprehensive income is reclassified to profit or loss irrespective of whether that amount reflects:

    a. only an impairment related fair value decline (eg the same decline that would be determined for a debt investment measured at amortized cost); or

    b. other aspects that resulted in a decline of fair value but do not reflect impairment (eg changes in the risk free interest rate).

Disclosure

26. The disclosure requirements in IFRS 7 related to impairment of receivables are:

    a. if allowance accounts are used to record credit related impairment losses, a reconciliation of changes in these accounts by class of financial assets (IAS 39 allows reducing the carrying amount of an asset either directly or using an allowance account).

    b. the amount of any impairment loss recognized in profit or loss by class of financial asset.

    c. interest income on impaired financial assets.

27. IFRS 7 includes further disclosure requirements in relation to credit risk, collateral held and accounting policies.

Loans—US GAAP

Scope

28. Statement 114 applies to all creditors and addresses the accounting for impairment of a loan. Paragraph 4 of Statement 114 defines a loan as "…a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position." The following are the financial instruments and entities that are **within the scope** of impairment guidance for certain loans:

    a. Accounts receivable (with terms exceeding one year) and notes receivable

    b. Loans restructured in a troubled debt restructuring involving a modification of terms of a receivable (except for those loans that are subject to the accounting in paragraph 29 b through d)

29. The following are the financial instruments and entities **specifically excluded** from impairment guidance for certain loans:

    a. Large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment such as loans related to credit cards, residential mortgages, and consumer installment loans (these types of loans are addressed under Statement 5)

    b. Loans that are measured at fair value or at the lower of cost or fair value, for example, in accordance with FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*

    c. Leases as defined in FASB Statement No. 13, *Accounting for Leases*

    d. Debt securities as defined in Statement 115

30. There are several key areas that Statement 114 does not cover for creditors:

a. How to identify loans for evaluation of impairment (defers to judgment and normal loan review procedures of the creditor)

b. When to recognize a direct write-down of an impaired loan

c. How to assess the overall adequacy of the allowance for credit losses

Recognition

31. Paragraph 8 of Statement 114 requires that an impairment on a loan be recognized "when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement." *All amounts due according to the contractual terms* means both contractual principal and interest payments of a loan will be collected as scheduled. In a troubled debt restructuring, that phrase refers to the contractual terms of the original agreement. No guidance is provided about how a creditor determines the probability of collection and states that the creditor should use its normal loan review procedures in making that judgment.

32. Statement 114 also provides relief for temporary impairments. A loan is not considered impaired if there are insignificant shortfalls or delays in payment on the loan. In addition, if the creditor expects to collect all amounts due, including accrued contractual interest, during a period of delay, no impairment exists.

33. Under Statement 114, if it is determined that a loan is not impaired, that loan may be included in the assessment of an allowance for losses under Statement 5. However, this situation only occurs if specific characteristics of the loan indicate that it is probable that an incurred loss exists in a group of loans with those characteristics.

34. AICPA Statement of Position No. 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*, requires that, for entities within its scope, credit losses related to off-balance sheet financial instruments should be recorded separately from an allowance account for recognized financial instruments.

Measurement

35. The measurement of impairment for loans may be applied on a loan-by-loan basis or, if a group of loans have common characteristics, on an aggregate basis for a group of common loans. For loans that are aggregated, paragraph 12 of Statement 114 states that "historical statistics, such as average recovery period and average amount recovered, along with a composite effective interest rate" may be used as a means for measuring the impairment of those loans.

36. Statement 114 allows three methods to measure the impairment (the last two are described as practical expedients). Statement 114 clarifies that, regardless of the measurement method chosen, the measurement of the impairment is based on the fair value of the collateral when foreclosure is probable. The methods are:

    a. The present value of expected future cash flows discounted at the loan's effective interest rate

    b. The loan's observable market price

    c. The fair value of the collateral if the loan is collateral-dependent

    Estimated costs to sell (on a discounted basis), if it is determined that these costs will reduce the cash flows available to satisfy the loan, are included in the measurement of the impairment.

37. In instances where the measurement of the impairment is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a valuation allowance is created with a corresponding charge to bad-debt expense. The *recorded investment in the loan* does not include the valuation allowance but does include any direct write-down of the investment.

38. Additional information regarding allowance practices is included in EITF Topic D-80, "Application of FASB Statements No. 5 and No. 114 to a Loan Portfolio,":

    > There are already emerging points of agreement between the SEC and the Federal Reserve on important aspects of allowance practices. For example, there is agreement that:

- Arriving at an appropriate allowance involves a high degree of management judgment and results in a range of estimated losses.

- Institutions should maintain prudent, conservative, but not excessive, loan loss allowances that fall within an acceptable range of estimated losses. Consistent with GAAP, an institution should record its best estimate within the estimated range of credit losses, including when the best estimate is at the high end of the range.

- When determining the level for the allowance, management should always ensure that the overall allowance appropriately reflects a margin for the imprecision inherent in most estimates of expected credit losses. [2]

- Simply because a portion of the allowance is designated as "unallocated," it is not thereby inconsistent with GAAP. The important consideration is whether the allowance reflects an estimate of probable losses, determined in accordance with GAAP, and is appropriately supported.

- Allowance estimates should be based on a comprehensive, well-documented, and consistently applied analysis of the loan portfolio.

[2]More guidance, including the level of support needed for this margin for imprecision, should be forthcoming from the JWG and AICPA projects. When reflecting the margin for imprecision and supporting such estimates, an institution should take into account all available information existing as of the balance sheet date, including credit quality, current trends, existing environmental factors (e.g., industry, geographical, economic, and political factors), and the range of estimated losses on loans.

39. Specific guidance is included in paragraphs 14 and 15 of Statement 114 when the measure of loan impairment is based on the present value of expected future cash flows discounted at the loan's effective interest rate. Those paragraphs are as follows:

> 14. …The effective interest rate of a loan is the rate of return implicit in the loan (that is, the contractual interest rate adjusted for any net deferred loan fees or costs, premium, or discount existing at the origination or acquisition of the loan). [3] The effective interest rate for a loan restructured in a troubled debt restructuring is based on the original contractual rate, not the rate specified in the restructuring agreement. If the loan's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate (for example, the prime rate, the London interbank offered rate, or the U.S. Treasury bill weekly average), that loan's effective interest rate may be calculated based on the factor as it changes over the life of the loan or may be fixed at the rate in effect at the date the loan meets the impairment criterion in paragraph 8. The creditor's choice shall be applied consistently for all loans whose contractual interest rate varies based on subsequent changes in an independent factor. Projections of changes in the factor should not be made for purposes of determining the effective interest rate or estimating expected future cash flows. [footnote omitted]

> 15. If a creditor bases its measure of loan impairment on a present value calculation, the estimates of expected future cash flows shall be the creditor's best estimate based on reasonable and supportable assumptions and projections. All available evidence, including estimated costs to sell if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan, should be considered in developing the estimate of expected future cash flows. The weight given to the evidence should be commensurate with the extent to which the evidence can be verified objectively. If a creditor estimates a range for either the amount or timing of possible cash flows, the likelihood of the possible outcomes shall be considered in determining the best estimate of expected future cash flows.

40. Question 16 of the *Viewpoints* Article provides additional information in considering the measurement of an impairment using the present value of expected future cash flows under Statement 114. That article states that all available evidence should be considered including environmental factors such as existing industry, geographical, economic, and political factors.

41. In subsequent periods after the initial measurement of the impairment, significant changes in the measurement of the impairment results in a recalculation of the impairment. Accordingly, the valuation allowance is adjusted based on the new impairment amount. However, the net carrying amount of the loan (that is, the carrying amount net of the valuation allowance) should not exceed the recorded investment in the loan.

Disclosure

42. The disclosure requirements of Statement 114 related to impairment on loans focus on the amount of the allowance for credit losses compared to impaired loans and a rollforward of the allowance. Specifically, the disclosures are:

    a. The total recorded investment in impaired loans at the end of each period

    b. The amount of recorded investment for which there is a related allowance

    c. The amount of recorded investment for which there is not a related allowance

    d. The amount of the allowance

    e. The average recorded investment in impaired loans during each period

f. The activity in the total allowance for credit losses related to loans (determined in accordance with both Statement 5 and Statement 114), including

    i. Beginning and ending balance in the allowance

    ii. Additions charged to operations

    iii. Direct write-downs charged against the allowance

    iv. Recoveries of amounts previously charged off

43. SOP 01-6 requires the following disclosures related to credit losses for entities within its scope:

    a. A description of the accounting policies and methodology the entity used to estimate the:

        i. Allowance for loan losses

        ii. Allowance for doubtful accounts

        iii. Any liability for off-balance sheet credit losses and related charges

    The description should identify factors that influenced management's judgment (such as historical losses and existing economic conditions) and may include a discussion of risk elements for a specific type of financial instrument.

Loans—IFRSs

Scope

44. As noted above in paragraph 7, IAS 39 sets out the requirements for the recognition of an impairment for loans in the scope of IAS 39. A loan can fall into one of the following three categories that are subject to impairment testing in accordance with IAS 39:

    a. loans and receivables.

b. available-for-sale financial assets.

Recognition

45. The recognition requirements are the same as for receivables (refer paragraphs 18-22 of this paper).

Measurement

46. The measurement requirements are the same as for receivables (refer paragraphs 23-25 of this paper). As a practical expedient, impairment of a financial asset carried at amortized cost may be measured on the basis of the instrument's fair value using an observable market price.

Disclosure

47. The disclosure requirements are the same as for receivables (refer paragraphs 26-27 of this paper).

Investments in Securities—US GAAP

Scope

48. The following are the financial instruments and entities that are **within the scope** of other-than-temporary impairment guidance for investments in securities (a parenthetical reference after each item has been included):

    a. Investments in equity securities that have readily determinable fair values and all investments in debt securities (Statement 115, par. 3)

    b. Cooperatives and mutual entities, including credit unions and mutual insurance companies (Statement 115, par. 4)

    c. All equity securities held by an insurance entity (FASB Staff Position FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, par. 4)

    d. Investments in debt and equity securities that are within the scope of FASB Statement No. 124, *Accounting for Certain Investments Held by Not-For-*

Profit Organizations and that are held by an investor that reports a "performance indicator" (FAS FSP 115-1/124-1, par.4)

e. Cost-method investments (equity securities not within the scope of Statements 115 or 124 and not accounted for under the equity method) (FAS FSP 115-1/124-1, par.4)

f. Investments in derivative instruments that require bifurcation and separate accounting for the host instrument (and that host instrument meets the scope requirements in a through e above) (Statement 115, par. 4 and FAS FSP 115-1/124-1, par. 4)

g. Purchased beneficial interests and beneficial interests that continue to be held by a transferor in securitized financial assets which include beneficial interest that (EITF Issue 99-20, par. 5):

    i. Are debt securities under Statement 115 or required to be accounted for like debt securities under Statement 115 pursuant to paragraph 14 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*

    ii. Involve securitized financial assets that have contractual cash flows (for example, loans, receivables, debt securities, and guaranteed lease residuals)

    iii. Are not beneficial interests in securitized financial assets that (1) are of high credit quality (for example, guaranteed by the U.S. government, its agencies, or other creditworthy guarantors, and loans or securities sufficiently collateralized to ensure that the possibility of credit loss is remote) and (2) cannot contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment. Instead, interest income on such beneficial interests should be recognized in accordance with the provisions of Statement 91, and determining whether an other-than-temporary

impairment of such beneficial interests exists should be based on SAB 59, SAS 92, and the Statement 115 Special Report.

h. Forward contracts and purchased options that are not derivative instruments subject to Statement 133 but involve the acquisition of securities that will be accounted for under Statement 115 (EITF Issue No. 96-11, "Accounting for Forward Contracts and Purchased Options to Acquire Securities Covered by FASB Statement No. 115")

49. The following are the financial instruments and entities **specifically excluded** from other-than-temporary impairment guidance for investments in securities (a parenthetical reference after each item has been included):

a. Investments in equity securities that, absent the election of the fair value option under FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, would be required to be accounted for under the equity method (Statement 115, par. 4)

b. Investments in equity securities of a consolidated subsidiary (Statement 115, par. 4)

c. Entities whose specialized accounting requires substantially all debt and equity securities to be carried at fair value with changes in fair value recognized in earnings (such as brokers and dealers in securities, defined benefit pension plans, and investment companies) (Statement 115, par. 4)

d. Not-for-profit organizations, except as noted above in paragraph 27.d. (Statement 115, par. 4)

e. Investments in derivative instruments that are subject to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (unless the investment requires bifurcation and separate accounting for the host instrument) (Statement 115, par. 4 and FAS FSP 115-1/124-1, par. 4)

f. Beneficial interests that (EITF 99-20, par. 5):

i. Result in consolidation of the entity issuing the beneficial interest by the holder of the beneficial interest

ii. Are within the scope of AICPA Practice Bulletin 6, *Amortization of Discounts on Certain Acquired Loans* (Practice Bulletin 6 applies to acquired loans where it is not probable that the undiscounted future cash collections will be sufficient to recover the face amount of the loan and contractual interest)

iii. Are hybrid beneficial interests measured at fair value pursuant to paragraph 16 of Statement 133 for which the transferor does not report interest income as a separate item in its income statement

iv. Are within the scope of AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3 applies to a loan with evidence of deterioration of credit quality since origination acquired by completion of a transfer for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable)

Recognition

50. Statement 115 was issued in May of 1993. Statement 115 required that, at acquisition, an entity should classify debt and equity securities (within its scope) into one of three categories: held-to-maturity, available-for-sale, and trading. Securities classified as held-to-maturity are carried at amortized cost (as long as the entity has the positive intent and ability to hold those securities to maturity). Securities classified as available-for-sale and trading are carried at fair value in the statement of financial position. Unrealized gains and losses for securities classified as available-for-sale are excluded from earnings and reported in other comprehensive income until realized. Unrealized gains and losses for securities classified as trading are included in earnings as they occur.

51. The Board concluded that, regardless of the classification of the security, "a loss inherent in that security should be recognized in earnings even if that security has not

been sold." Accordingly, an impairment test was necessary for securities classified as held-to-maturity and available-for-sale when the decline in fair value is below the cost of the security and that decline is other than temporary.

Determining Whether an Investment in Securities is Impaired

52. The determination of whether an investment in securities is impaired is described in Statement 115 and expanded on in FAS FSP 115-1/124-1 (and referenced to by EITF 99-20 and Opinion 18, respectively). Generally, if the fair value of a security is less than cost, that security is considered impaired.

53. Paragraph 16 of Statement 115 describes how to determine whether a security is impaired stating:

> For individual securities classified as either available-for-sale or held-to-maturity, an enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary…

54. Paragraphs 7 through 12 of FAS FSP 115-1/124-1 expands on paragraph 16 of Statement 115 and provides guidance for cost-method investments in determining whether a security is impaired stating:

> 7. Impairment shall be assessed at the individual security level (herein referred to as "an investment").[1] An investment is impaired if the fair value of the investment is less than its cost.[2] Except as provided in paragraph 10, an investor shall assess whether an investment is impaired in each reporting period. For entities that issue interim financial statements, each interim period is a reporting period.
>
> 8. An investor shall not combine separate contracts (a debt security and a guarantee or other credit enhancement) for purposes of determining whether a debt security is impaired or can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost.
>
> 9. For investments other than cost-method investments (see paragraph 4(c)), if the fair value of the investment is less than its cost, proceed to Step 2.
>
> 10. Because the fair value of cost-method investments is not readily determinable, the evaluation of whether an investment is impaired shall be determined as follows:
>
> > a. If an investor has estimated the fair value of a cost-method investment (for example, for disclosure under FASB Statement No. 107, *Disclosures*

about Fair Value of Financial Instruments), that estimate shall be used to determine if the investment is impaired for the reporting periods in which the investor estimates fair value. If the fair value of the investment is less than its cost, proceed to Step 2.

b. For reporting periods in which an investor has not estimated the fair value of a cost-method investment, [3] the investor shall evaluate whether an event or change in circumstances has occurred in that period that may have a significant adverse effect on the fair value of the investment (an "impairment indicator"). Impairment indicators include, but are not limited to:

(1) A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee

(2) A significant adverse change in the regulatory, economic, or technological environment of the investee

(3) A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates

(4) A bona fide offer to purchase (whether solicited or unsolicited), an offer by the investee to sell, or a completed auction process for the same or similar security for an amount less than the cost of the investment

(5) Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

11. In addition, if an investment was previously tested for impairment under Step 2 and the investor concluded that the investment was not other-than-temporarily impaired, the investor shall continue to evaluate whether the investment is impaired (that is, shall estimate the fair value of the investment) in each subsequent reporting period until either (a) the investment experiences a recovery of fair value up to (or beyond) its cost or (b) the investor recognizes an other-than-temporary impairment loss.

12. If an impairment indicator is present, the investor shall estimate the fair value of the investment. If the fair value of the investment is less than its cost, proceed to Step 2.

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[1]Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt and equity securities. (For example, equity securities of an issuer bearing the same CUSIP number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the securities of the issuer).

[2]Cost includes adjustments made to the cost basis of an investment for accretion, amortization, previous other-than-temporary impairments, and hedging.
[3]For example, an investor may not estimate the fair value of a cost-method investment during a reporting period for Statement 107 disclosure because (a) Statement 107 requires disclosure only for annual reporting periods; (b) the investor determined that, in accordance with paragraphs 14 and 15 of Statement 107, it is not practicable to estimate the fair value of the investment; (c) the investor is exempt from providing the disclosure under FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Non-Public Entities*.

55. AICPA Statement on Auditing Standards No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, describes factors to assist auditors in their analysis of other-than-temporary impairment of securities. Paragraph .47 of SAS 92 states:

> *Impairment Losses*. Regardless of the valuation method used, generally accepted accounting principles might require recognizing in earnings an impairment loss for a decline in fair value that is other than temporary. Determinations of whether losses are other than temporary often involve estimating the outcome of future events. Accordingly, judgment is required in determining whether factors exist that indicate that an impairment loss has been incurred at the end of the reporting period. These judgments are based on subjective as well as objective factors, including knowledge and experience about past and current events and assumptions about future events. The following are examples of such factors.
>
> • Fair value is significantly below cost and—
>
> — The decline is attributable to adverse conditions specifically related to the security or to specific conditions in an industry or in a geographic area.
>
> — The decline has existed for an extended period of time.
>
> — Management does not possess both the intent and the ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.
>
> • The security has been downgraded by a rating agency.
>
> • The financial condition of the issuer has deteriorated.
>
> • Dividends have been reduced or eliminated, or scheduled interest payments have not been made.
>
> • The entity recorded losses from the security subsequent to the end of the reporting period.

56. EITF Issue 99-20 provides additional guidance for beneficial interests in determining whether an impairment exists. This guidance focuses on whether there has been "an adverse change in estimated cash flows." Paragraph 12(b) of EITF Issue 99-20 states:

> …Determining whether there has been a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected (taking into consideration both the timing and amount of the estimated cash flows) involves comparing the present value of the remaining cash flows as estimated at the initial transaction date (or at the last date previously revised) against the present value of the cash flows estimated at the current financial reporting date. The cash flows should be discounted at a rate equal to the current yield used to accrete the beneficial interest. If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is less than the present value of the current estimated cash flows, the change is considered favorable (that is, an other-than-temporary impairment should be considered to have not occurred under the consensus in this Issue). If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is greater than the present value of the current estimated cash flows, the change is considered adverse (that is, an other-than-temporary impairment should be considered to have occurred under the consensus in this Issue). However, absent any other factors that indicate an other-than-temporary impairment has occurred, changes in the interest rate of a "plain-vanilla," variable-rate beneficial interest generally should not result in the recognition of an other-than-temporary impairment (see footnote 2, Exhibit 99-20A) (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater).

Evaluating Whether An Impairment is Other Than Temporary

57. Once an entity determines that an impairment exists, the evaluation of whether an impairment is other than temporary requires significant judgment and is based on the facts and circumstances surrounding the impairment. Simply stated, if a holder of a security does not expect that security to recover in the near term, than that financial instrument is other-than-temporarily impaired. Numerous accounting literature has been issued to assist preparers and auditors with the necessary considerations and judgments in evaluating whether an impairment is other than temporary.

58. Paragraph 16 of Statement 115 provides an example to clarify whether an impairment is other than temporary:

> …For example, if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred.[4]…. [footnote omitted]

59. SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities* (and FSP FAS 115-1/124-1) states that *other than temporary* does not mean *permanent* and provides the following examples of factors to consider in an entity's evaluation: (a) the length of time and extent that market value is below cost, (b) the financial condition and near-term prospects of the issuer, (c) the intent and ability of the holder to retain its investment in a security to allow for any anticipated recovery in fair value.

60. Another consideration in evaluating whether an impairment is other than temporary for available-for-sale securities is whether an investor intends to sell a security at a loss shortly after the balance sheet date. FSP FAS 115-1/124-1 (originally this guidance was included in EITF Topic D-44, "Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value") states that an other-than-temporary impairment has occurred when the decision to sell is made if the investor does not expect the fair value to recover prior to the expected time of the sale.

61. For investments accounted for under the equity method of accounting, specific guidance is provided as to how to evaluate whether an other-than-temporary impairment exists. Paragraph 6 of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, states that "a series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred which is other than temporary and which should be recognized even though the decrease in value is in excess of what would otherwise be recognized by application of the equity method." Paragraph 19 of APB Opinion 18 provides further guidance about the evaluation:

> Evidence of a loss in value might include, but would not necessarily be limited to, absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment. However, a

> decline in the quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is other than temporary. All are factors to be evaluated.

62. [Paragraph omitted from Observer Notes].

63. [Paragraph omitted from Observer Notes].

Measurement of An Impairment Loss

64. In instances where the impairment of a security is other-than-temporary, a loss should be recognized in earnings. The loss is measured based on the difference between the fair value and the cost of the security. As stated in paragraph 15 of FSP FAS 115-1/124-1, "…the measurement of the impairment shall not include partial recoveries subsequent to the balance sheet date." The fair value becomes the new cost basis of the security and that new cost basis is not changed for subsequent recoveries of fair value.

65. Paragraph 16 of FSP FAS 115-1/124-1 provides additional guidance for the accounting for debt securities subsequent to an other-than-temporary impairment as follows:

> In periods subsequent to the recognition of an other-than-temporary impairment loss for debt securities, [5] an investor shall account for the other-than-temporarily impaired debt security as if the debt security had been purchased on the measurement date of the other-than-temporary impairment. That is, the discount or reduced premium recorded for the debt security, based on the new cost basis, would be amortized over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows.
>
> ---
>
> [5]This FSP does not address when a holder of a debt security would place a debt security on nonaccrual status or how to subsequently report income on a nonaccrual debt security.

Disclosures

66. Disclosures related to other-than-temporary impairment include both quantitative and qualitative information. For example, for all securities in an unrealized loss position as of the balance sheet date, the aggregate fair value and unrealized loss position by security type or grouping are required. These securities with an unrealized loss position must be segregated by the length of time that the security has been in a

continuous unrealized loss position (less than 12 months and greater than 12 months). Finally, an entity is required to disclose the information used and considerations made in analyzing investments in an unrealized loss position at the balance sheet date.

67. The specific disclosures in paragraphs 17 and 18 of FSP FAS 115-1/124-1 are as follows:

> 17. For all investments in an unrealized loss[6] position, including those that fall within the scope of Issue 99-20, for which other-than-temporary impairments have not been recognized, an investor shall disclose the following in its annual financial statements:
>
> a. As of each date for which a statement of financial position is presented, quantitative information, aggregated by category of investment-each category of investment that the investor discloses in accordance with Statements 115 and 124 (see paragraph 4(b)) and cost-method investments-in tabular form:
>
> (1) The aggregate related fair value of investments with unrealized losses
>
> (2) The aggregate amount of unrealized losses (that is, the amount by which cost exceeds fair value).
>
> The disclosures in (1) and (2) above shall be segregated by those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer. The reference point for determining how long an investment has been in a continuous unrealized loss position is the balance sheet date of the reporting period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point would be the annual balance sheet date of the period during which the impairment was identified. The continuous unrealized loss position ceases upon either (a) the recognition of an other-than-temporary impairment or (b) the investor becoming aware of a recovery of fair value up to (or beyond) the cost of the investment during the period.
>
> b. As of the date of the most recent statement of financial position, additional information (in narrative form) that provides sufficient information to allow financial statement users to understand the quantitative disclosures and the information that the investor considered (both positive and negative) in reaching the conclusion that the impairment(s) are not other than temporary. The application of Step 2 shall provide insight into the investor's rationale for concluding that unrealized losses are not other-than-temporary impairments. The disclosures required may be aggregated by investment categories, but individually significant unrealized losses generally shall not be aggregated. This disclosure could include:
>
> (1) The nature of the investment(s)

(2) The cause(s) of the impairment(s)

(3) The number of investment positions that are in an unrealized loss position

(4) The severity and duration of the impairment(s)

(5) Other evidence considered by the investor in reaching its conclusion that the investment is not other-than-temporarily impaired, including, for example, industry analyst reports, sector credit ratings, volatility of the security's fair value, and/or any other information that the investor considers relevant.

18. For cost-method investments, an investor shall disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

a. The aggregate carrying amount of all cost-method investments

b. The aggregate carrying amount of cost-method investments that the investor did not evaluate for impairment

c. The fact that the fair value of a cost-method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment, and

(1) The investor determined, in accordance with paragraphs 14 and 15 of Statement 107, that it is not practicable to estimate the fair value of the investment, or

(2) The investor is exempt from estimating fair value under FASB Statement No. 126, Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities.

Investments in Securities—IFRSs

Scope

68. As noted above in paragraph 7, IAS 39 sets out the requirements for the recognition of an impairment for all securities in the scope of IAS 39.

69. A security can fall into one of the following categories that are subject to impairment testing in accordance with IAS 39:

    a. loans and receivables.

    b. held-to-maturity investments.

c. available-for-sale financial assets.

d. investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured (including derivatives linked to and to be settled by delivery of such unquoted equity instruments), which are measured at cost.

70. Financial assets classified as loans or receivables or held-to-maturity investments are subject to the same impairment requirements in accordance with IAS 39 as they are accounted for at amortized cost, ie they have the same recognition and measurement requirements.

Recognition

71. The recognition requirements for debt securities are the same as for receivables (refer paragraphs 18-22 of this paper). Again, note that a decline in the fair value of a debt instrument is not necessarily evidence of impairment (for example, if it results from an increase in the risk-free interest rate).

72. For equity securities there are additional triggers to those for debt securities (ie the general triggers – refer paragraph 18 of this paper). These are:

a. a 'significant or prolonged' decline of fair value below cost (however, not determinable for equity securities measured at cost); and

b. significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates indicating that the asset's cost may not be recovered.

73. Impairment losses on equity securities cannot be reversed through profit or loss. For equity securities classified as available-for-sale investments any subsequent fair value increase is recognized in other comprehensive income.

Measurement

74. The measurement requirements for debt securities are the same as those set out for in paragraphs 23-25 of this paper for receivables. Note that depending on their

classification debt securities can be accounted for at amortized cost (loans and receivables, and held-to-maturity investments) or at fair value (available-for-sale), which impacts how impairment losses are measured.

75. For equity securities classified as available-for-sale financial assets an impairment loss is measured as the difference between the cost of the equity investment and its current fair value. Thus, the entire loss previously recognized in other comprehensive income is reclassified to profit or loss irrespective of whether that amount reflects:

    a. only an impairment related fair value decline; or

    b. other aspects that resulted in a decline of fair value but do not reflect impairment.

76. For equity securities measured at cost an impairment loss is measured as the difference between the carrying amount of the asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. If the measurement basis of an equity investment changes from fair value to cost because a reliable measure of fair value is no longer available then the impairment loss includes any amounts previously recognized in other comprehensive income that must then be reclassified to profit or loss.

Disclosure

77. The disclosure requirements are the same as for receivables (refer paragraphs 26-27 of this paper).

Appendix A

Relevant Accounting Literature—US GAAP

A1. The following accounting literature provides the basis for the discussion about impairment guidance in US GAAP.

A2. FASB Statement No. 5, *Accounting for Contingencies*, provides guidance for the recognition of an impairment for all receivables unless those receivables are specifically addressed by other accounting literature (such as debt securities).

A3. The following list includes the relevant impairment guidance for loans included in US GAAP:

a. FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*

b. FASB Statement No. 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures*

c. FASB *Viewpoints*, "Application of FASB Statements 5 and 114 to a Loan Portfolio"

d. AICPA Practice Bulletin No. 4, *Accounting for Foreign Debt/Equity Swaps*

e. AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*

f. AICPA Statement of Position No. 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*

g. AICPA Statement of Position No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*

h. EITF Topic D-80, "Application of FASB Statements No. 5 and No. 114 to a Loan Portfolio"

A4. The following list includes the relevant other-than-temporary impairment guidance for investments in securities included in US GAAP:

i. FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

j. FASB Special Report, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*

k. SEC Staff Accounting Bulletin Topic 5M (previously SAB No. 59), *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*

l. AICPA Statement on Auditing Standards No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

m. APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

n. EITF Topic D-44, "Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value" (superseded by FSP FAS 115-1/124-1)

o. EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets"

p. EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (FSP FAS 115-1/124-1 nullified paragraphs 10–18 and carried forward paragraphs 8,9, 21, and 22)

q. FASB Staff Position FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*

Appendix B

Key Definitions—US GAAP

B1. The following definitions are used throughout the discussion of impairment guidance for financial instruments in US GAAP.

B2. Statement 115, paragraph 137, defines *security* as follows:

> A share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that (a) either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer, (b) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (c) either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

B3. Statement 115, paragraph 137, defines *equity security* as follows:

> Any security representing an ownership interest in an enterprise (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants, rights, and call options) or dispose of (for example, put options) an ownership interest in an enterprise at fixed or determinable prices. However, the term does not include convertible debt or preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor.

B4. Statement 115, paragraph 137, defines *debt security* as follows:

> Any security representing a creditor relationship with an enterprise. It also includes (a) preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor and (b) a collateralized mortgage obligation (CMO) (or other instrument) that is issued in equity form but is required to be accounted for as a nonequity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position. However, it excludes option contracts, financial futures contracts, forward contracts, and lease contracts.
>
> - Thus, the term *debt security* includes, among other items, U.S. Treasury securities, U.S. government agency securities, municipal securities, corporate bonds, convertible debt, commercial paper, all securitized debt instruments, such as CMOs and real estate mortgage

investment conduits (REMICs), and interest-only and principal-only strips.

- Trade accounts receivable arising from sales on credit by industrial or commercial enterprises and loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions are examples of receivables that do not meet the definition of *security*; thus, those receivables are not debt securities (unless they have been securitized, in which case they would meet the definition).

B5. Statement 140, paragraph 364, defines *beneficial interests* as:

> Rights to receive all or portions of specified cash inflows to a trust or other entity, including senior and subordinated shares of interest, principal, or other cash inflows to be "passed-through" or "paid-through," premiums due to guarantors, commercial paper obligations, and residual interests, whether in the form of debt or equity.

Appendix C

Key Definitions and Impairment Triggers—IFRSs

C1. The following categories of financial assets are defined in paragraph 9 of IAS 39:

a. *Loans and receivables* are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:

   (a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;

   (b) those that the entity upon initial recognition designates as available for sale; or

   (c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

   An interest acquired in a pool of assets that are not loans or receivables (for example, an interest in a mutual fund or a similar fund) is not a loan or receivable.

b. *Held-to-maturity investments* are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity (see Appendix A paragraphs AG16–AG25 [of IAS 39]) other than:

   (a) those that the entity upon initial recognition designates as at fair value through profit or loss;

   (b) those that the entity designates as available for sale; and

   (c) those that meet the definition of loans and receivables.

c. *Available-for-sale financial assets* are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

C2. Paragraph 59 of IAS 39 includes the general triggers of impairment:

> A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised. 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 loss events:
>
> (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, granting to the borrower a concession that the lender would not otherwise consider;
>
> (d) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
>
> (e) the disappearance of an active market for that financial asset because of financial difficulties; or

(f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

(i) adverse changes in the payment status of borrowers in the group (eg an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or

(ii) national or local economic conditions that correlate with defaults on the assets in the group (eg an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

C3. Paragraph 61 of IAS 39 includes additional triggers of impairment:

> In addition to the types of events in paragraph 59, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

Appendix D – Summary table for US GAAP

	All receivables (except those specifically addressed by other accounting literature) (Statement 5)	Loans (Statement 114)	Investments in securities (Statement 115)	
			Held-to-maturity / Available-for-sale	Trading
Recognition	Probable and reasonably estimable	Probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement (Statement 114, paragraph 8)	Fair value is below cost and is other-than-temporary (by reference to management's intent and facts and circumstances)	None
Measurement	None	Three options: • Present value of expected future cash flows discounted at the loan's effective interest rate • Observable market price • Fair value of collateral if loan is collateral-dependent	Difference between fair value and cost (fair value becomes new cost basis)	By reference to fair value
Reversal	Reversal permitted but cannot exceed the recorded investment	Reversal permitted but cannot exceed the recorded investment	No reversal	Automatic reversal

Appendix E – Summary table for IFRSs

	Loans and receivables/ held-to-maturity	Available for sale			At fair value through profit or loss*
		Fair value		Cost	
		Debt investment	Equity investment		
Recognition (triggers)	General triggers related to default or financial difficulties (paragraph 59)	General triggers related to default or financial difficulties (paragraph 59)	General triggers plus 'significant or prolonged' decline of fair value and adverse changes to environment of the issuer (paragraphs 59 and 61)	General triggers plus adverse changes to environment of the issuer (paragraphs 59 and 61)	None
Measurement	By reference to the present value of the revised cash flow estimate	By reference to fair value	By reference to fair value	By reference to the present value of the revised cash flow estimate	By reference to fair value
Reversal	Only if related to event after impairment	Only if related to event after impairment	No reversal	No reversal	Automatic reversal

* Fair value through profit or loss: no explicit, separate impairment test but it is an implicit part of fair value measurement.