Analyst Representative Group	Agenda reference	4
Global Preparers Forum	Date	10 November 2009

Project	**Financial Instruments: Replacement of IAS 39**
Topic	**Impairment methodology (Phase II) and Hedge accounting (Phase III)**

Impairment methodology – Phase II

1. The IASB are to publish an exposure draft on amortised cost and impairment with comments due by 30 June 2010. This exposure draft will propose a move from the current incurred loss impairment model to an expected loss impairment methodology.

2. The exposure draft will include proposals on disclosure that are particular to the expected loss impairment method and more general disclosure about the credit quality of an entity's financial assets.

3. A summary of the proposed disclosures is attached as Appendix A.

Question 1 – Impairment methodology – disclosures and credit quality of financial assets	
(a)	Do you think that the proposed disclosures will provide more decision-useful information?
(b)	What other information would you consider to be useful or would you like companies to disclose about the expected loss methodology, credit losses and quality of financial assets?

This paper has been prepared for discussion at a public meeting of the Analyst Representative Group and Global Preparers Forum of the IASB.

The views expressed in this paper are those of the authors.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

Hedge Accounting – Phase III

Feedback requested

Tentative approach

4. The tentative approach to hedge accounting results in:

   (i) gains and losses on the effective portion of the hedge being recognised in other comprehensive income (OCI).

   (ii) any ineffectiveness being recognised in profit or loss.

   (iii) the hedged item not being remeasured.

Question 2 – Hedge accounting – tentative approach	
(a)	Do you think the tentative approach provides more decision-useful information?
(b)	Is that more useful than the current approach where the hedged item is remeasured for the hedged risk?
(c)	Is isolation of hedge accounting effects in OCI helpful?

Economic hedges

Question 3 – Economic hedges	
(a)	Are there any economic hedges that your organisation enters into where it is currently impossible or difficult to apply hedge accounting?
(b)	How would you suggest this be dealt with?

Further simplifications

5. Appendix B sets out some possible simplifications to hedge accounting.

Question 4 – Hedge accounting - simplifications	
(a)	Which of the simplifications set out would you support and why?
(b)	What other simplifications would you suggest?

Presentation

6. The tentative approach results in the effective portion of the hedge presented in OCI and any ineffectiveness recognised in profit or loss.

Question 5 – Hedge accounting - presentation	
(a)	What information should be presented?
(b)	Would any disaggregation of the OCI amount be useful?

Disclosures

Question 6 – Hedge accounting - disclosures	
(a)	Are current disclosures in IFRS 7 Financial Instruments: Disclosures on hedging activities useful?
(b)	What additional information on hedging activities would be useful?

Next steps

Outreach

7. We are currently reaching out to interested parties with the objective to gather feedback in developing an exposure draft on hedge accounting. We are keen to further discuss the above questions with individual GPF and ARG members. We would encourage interested members to contact us directly.

Board meetings

8. The Board will be discussing hedge accounting at its upcoming meetings in November and December. Some of the topics the Board will be discussing include:

   (a) eligible hedge risks, items and instruments

   (b) simplifications of existing hedge accounting requirements (in particular effectiveness testing)

   (c) presentation and disclosures

Appendix A

The following is a summary of Board's proposed disclosures that are particular to the expected loss impairment method and other general disclosures about the credit quality of an entity's financial assts.

Presentation on the face of the primary financial statements

Statement of comprehensive income

A1. The Board proposes that on the face of the statement of comprehensive income:

(d) interest revenue is presented as follows:

	Interest revenue based on contractual cash flows
Less:	Adjustment for allocation of initial expected losses
=	Interest revenue based on ECF

(e) changes in expectations are presented as a separate line item.

Disclosures in the notes to the financial statements

A2. The Board proposes:

(a) mandatory use of a provision account for expected credit losses**;**

(b) prohibiting *direct* write-offs (ie require using the provision account even when an asset becomes impaired and is written-off in the same period);

(c) requiring reconciliation of the provision account for credit losses by class of financial asset. At a minimum the reconciliation should consist of the following line items:

TABLE 1

Opening balance of provision account for credit losses
Additions:
• Allocation of initial expected credit losses in the current period
• Increase in expected credit losses for the current period
Subtractions:
• Decrease in expected credit losses for the current period
• Write-offs
Closing balance of provision account for credit losses.

Vintage information and loss triangle

Vintage information

A3. The Board proposes in the notes to the financial statements by class of financial assets: vintage information of financial assets held at amortised cost (contractual amounts) by year of origination and maturity in table format as follows:

TABLE 2

		YEAR OF ORIGINATION				
		20X7	20X8	20X9	20X0	Total
MATURITY	20X7					
	20X8					
	20X9					
	20X0					
	Total					

Loss triangle

(a) loss triangle disclosures in table format and qualitative analysis where there are significant changes in loss estimates.

A4. The Board proposes in the notes to the financial statements by class of financial assets loss triangle disclosures in table format as follows:

TABLE 3

		YEAR OF ORIGINATION				
		20X7	20X8	20X9	20X0	Total
Credit loss provision (cumulative)						
	At the end of the origination year	xx	xx	xx	yy	
	One year later	xx	xx	yy		
	Two years later	xx	yy			
	Three years later	yy				
Gross provision for credit losses (before write-offs)		yy	yy	yy	yy	zz
Cumulative write-offs as a result of delinquencies		xx	xx	xx	xx	zz
Cumulative write-offs as a result of foreclosures		xx	xx	xx	xx	zz
Total cumulative write offs		zz	zz	zz	zz	zz
Net provision for credit losses (gross provision for credit losses less cumulative write-offs)		zz	zz	zz	zz	zz

A5. The board also proposes a qualitative analysis where there are significant changes in loss estimates.

Changes in expectations

A6. The Board proposes that entities disclose *separately* in the notes to the financial statements:

(a) the amount recognised in profit or loss resulting from changes in credit loss expectations;

(b) the amount recognised in profit or loss resulting from changes that are *not* related to credit (eg changes of expected prepayment rates); and

(c) further quantitative and qualitative analysis:

(i) if there is a significant effect on profit or loss as a result of changes in expectations; and

(ii) where there are significant positive or negative effects from a particular portfolio, vintage or geographical area.

Management's assumptions and methodology

A7. The Board proposes the following disclosures:

(a) the basis of inputs (eg historical information or rating reports) and the estimation technique used to determine initial expected losses;

(b) for changes in expectations, an explanation of what expectations have changed, the cause of the change and disclosure of new inputs and assumptions used; and

(c) if there has been a change in estimation technique, disclosure of that change and the reason for the change.

Sensitivity analysis and stress testing

A8. The Board proposes that the following disclosure be required regarding sensitivity of assumptions:

(a) if changing one or more of the inputs to reasonably possible alternative assumptions would change the initial expected loss or subsequent changes in credit loss significantly, the entity should state the fact and the effect of those changes; and

(b) the entity shall disclose how the effect of a change to a reasonable possible alternative assumption was derived.

A9. The Board proposes stress testing information be disclosed *if* management performs stress testing for their internal risk management purposes.

Credit quality of financial asset disclosures

Non-performing financial assets held at amortised cost

A10. The Board proposes:

(a) defining a financial asset is non-performing when a counterparty has failed to make a payment 90 days after it is contractually due; and

(b) disclosing reconciliation in the movement for non-performing financial assets held at amortised cost (including–if significant–a narrative explanation of the interaction between movements in the non-performing asset portfolio and the changes in the provision account) as follows:

TABLE 4

Opening balance (contractual amount) of non performing financial assets held at amortised cost
Additions:
• Increases in non performing financial assets held at amortised cost for the current period
Subtractions:
• Recoveries by way of cash from enforcing securities over the asset
• Recoveries by way of cash as result of payment from the debtor
• Renegotiations
Closing balance (contractual amount) of non performing financial assets held at amortised cost

Transition disclosures

A11. The Board proposes the following disclosures on transition:

(a) disclose the amount recognised in equity as a result of transition (ie the change in the amortised cost resulting from adopting the ECF approach); and

(b) qualitative analysis of the effect on profit or loss resulting from adoption of the ECF approach (ie the difference in the effective interest rate previously determined under the incurred loss approach and the expected effective interest rate determined under the ECF approach).

Appendix B

The following are some of the simplifications set out in the discussion paper *Reducing Complexity in Reporting Financial Instruments*:

B1. Partial hedges ('portions')

(a) Prohibit hedge accounting for portions; or

(b) Develop a principle for identifying portions eligible for hedge accounting

B2. Designation and documentation

(a) Allow management to set a general policy for effectiveness testing that would include a fallback position if the initially documented method turns out to be in error.

B3. Require irrevocable designation

B4. Effectiveness testing and recognition of ineffectiveness

(a) Eliminate some or all effectiveness qualification requirements

(b) Eliminate all effectiveness tests and simplify require actual ineffectiveness to be recognised in profit or loss immediately

(c) Eliminate either all effectiveness tests or only retrospective effectiveness test (but require a prospective qualitative effectiveness test) when an item in its entirety is designated as a hedged item

B5. Recycling of deferred gains and losses for cash flow hedges

(a) Require that an entity state at inception when a hedged transaction is expected to affect profit or loss and to recycle gains and losses at that time (whether or not the forecast transaction occurs and affects profit or loss as planned). However, this simplification can only be applied to simple hedges and would not work in many other scenarios

B6. Eliminate options and exceptions

(a) Eliminate options and exceptions, eg the ‘basis adjustment; option permitted in IAS 39.98(b) and the option of fair value or cash flow hedge accounting for a hedge of a foreign currency risk of a firm commitment.