Staff Paper

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| Project | **Accounting for Financial Instruments: Impairment** |
| Topic | **Addendum to Agenda Paper 1 / Memorandum 75** |

## Addendum

***Alternative 4 with 1-year floor: Time-proportionate approach with floor***

*Objective*

1. The objective of this approach would be the same as Model 4, but also to ensure that the allowance balance in the good book was always sufficient to cover expected losses (EL) in the upcoming year. (The bad book already requires recognition of 100% of all EL for the bad book).

*Description*

2. The model would be the same as Model 4, with one add-on feature for the good book. A 12-month expected loss estimate would be calculated (similar to current requirements for entities that apply the Basel II Advanced Internal Rating-Based Approach). That 12-month EL estimate is compared to the allowance balance calculated under Model 4 for the good book, and the higher of those two amounts is recognised in the financial statements.

*Financial statement presentation*

3. This model would be reflected in the financial statements similar to Model 4, but the allowance account would also include the higher of the 12-month EL estimate for the good book or the time-proportionate calculation (in addition to 100% of the EL estimate for the bad book). In certain situations (eg, when the

12-month EL estimate reflects a change in estimate), the outcomes of this approach could be closer to the outcomes of the IASB ED. This is because the 12-month EL estimate would be taken in full in one period, as would have happened with a change in EL estimate under the IASB ED.

*Pros*

4. *Same pros as Model 4* Because this only adds a floor, it has the same pros as Model 4.

5. *Responds to concern about deferring losses* In addition, this model responds to the concerns about deferring losses because a minimum balance is maintained representing a one year EL estimate.

*Cons*

6. *Potential operational complexity* This model would have the same potential operational complexity as model 4. However, the staff does not believe that comparing a one-year EL estimate to the model 4 outcome creates significant incremental operational complexity.

## Example

7. Assume an allowance of 90 CU is calculated on a good book, but the 12-month EL estimate is 100 CU. An entity would record 100 CU as the allowance in the current period for the good book. Assume the next period, the allowance under Model 4 is calculated as 85 CU on the good book, with a 60 CU 12-month EL estimate. The allowance for this period would be recorded at 85 CU.