Project: **Financial Instruments: Impairment**

Topic: **Confirmation of direction provided**

1. At an IASB-only meeting on 1 December 2010, the Staff asked the Board for further direction on how to continue to develop the model. The Board discussed the scope of the upcoming ED, allocation of lifetime expected losses under 'decoupling' and how the 'good book' and the 'bad book' could be defined or identified. The Board did not formally vote at this meeting, but directed the staff as described in the next few paragraphs. The purpose of this paper is to ask the Board to confirm the direction previously provided, as described below.

Scope [agenda paper 1A from 1 December meeting]

2. The Board indicated that short-term trade receivables should be excluded from the scope of the upcoming ED. Once the revenue recognition project is completed and the initial measurement for revenue (which should align with the corresponding trade receivable amount) is decided, the Board would then consider how impairment of short-term trade receivables should be treated.

Impairment model for open portfolios [agenda paper 1D]

3. The Board continued its discussion on the development of the time-proportionate approach (based on lifetime expected loss) for the 'good' book

combined with a 'bad' book as the possible basic impairment model for open portfolios for the purpose of the upcoming ED[1].

4. The board's discussions to date have focussed on open portfolios. The Board discussed the scope of the upcoming ED indicating that it should focus on open portfolios, but should not specifically exclude any instruments (other than short-term trade receivables). The Board also suggested that the upcoming ED should include a question asking whether the proposals would give rise to operational concerns for any specific instruments or a closed portfolio. The upcoming ED would also provide an indication of the direction of the Board's thinking on the other topics in the original ED that still need to be redeliberated before a final standard can be issued.

Allocation of lifetime expected losses under 'decoupling' [agenda paper 1B]

5. The Board considered that a straight-line approach for undiscounted EL is best suited to address operational concerns in allocating lifetime EL under a 'decoupled' approach for the 'good' book.

6. However the Board also discussed other approaches (a straight-line approach for discounted EL and an annuity approach). The Board considered that these allocation approaches are at least *as* appropriate and hence should also be available to entities that use more sophisticated systems. Consequently, the Board directed the staff to include a question in the upcoming ED as to whether all three approaches should be permitted, or if one method should be required.

7. The Board also agreed that, to provide operational relief when using an approach that involves a discounted EL, entities should be allowed use a discount rate that would lie between (and include) the risk free rate and the effective interest rate (as calculated under IAS 39).

[1] The staff notes that, as described in paragraph 3, the Boards will also be jointly discussing Alternative 4A which is a time-proportionate approach with a 'good' book / 'bad' book and a possible floor in the 'good' book.

'Good' book / 'bad' book [agenda paper 1C]

8. In determining when to transfer loans from the 'good' to the 'bad' book, the Board indicated that using a principle-based approach that is based on the internal credit risk management of an entity in defining the 'bad' book would be appropriate. This would convey information about the loans which management regards as still collectible and the loans that are no longer collectible for which losses should be recognised immediately. Guidance would be provided for determining the appropriate 'bad book' criteria through an objective that the bad book encompasses loans where the uncertainty about collectability has taken precedence over the profitability from the interest margin.

Question 1
Does the Board confirm the previous direction provided to the staff, described in paragraphs 2-8? If not, what would the Board like to do and why?

Projected timing for issuance

9. We expect that this will be the final board meeting before issuing an exposure draft. At the end of this meeting the staff will request permission to begin drafting the upcoming ED and ask if any Board members intend to dissent from the upcoming ED. We aim to issue the upcoming ED in early 2011.