



Project **Accounting for Financial Instruments**

Topic **Recognition of Credit Impairment Losses**

Background

1. Following the publication of a Request for Information in June 2009, in November 2009 the IASB published the exposure draft *Financial Instruments: Amortised Cost and Impairment* (the IASB ED). In May 2010 the FASB published the proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)* (FASB ED). Both EDs proposed requirements for recognition and measurement of impairment losses. The IASB's ED also proposed requirements for amortised cost measurement.
2. In October, the FASB staff presented four fundamental issues the staff believe need to be considered during joint redeliberations, which included the timing of recognition of expected losses (EL) (i.e., immediately or allocated over a time period).
3. The agenda papers prepared for the November 10-12, 2010 Joint Board meeting on credit impairment (Agenda Paper 1B/Memorandum 69 and Agenda Paper 1C/Memorandum 70) discussed various approaches for recognition of expected credit losses. The discussion focused primarily on two models, as follows:
 - (a) *Immediate recognition of full lifetime expected losses*, the primary objective of which is to achieve earlier recognition of credit losses and

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Agenda Paper 13 (IASB) / 71 (FASB)
IASB/FASB Staff paper

consider a longer emergence period in establishing the allowance than under the current incurred loss model.

- (b) *Recognition of lifetime expected losses over the expected life of the related financial assets*, the primary objective of which is to reflect the economics of lending activities by achieving a credit-adjusted yield on loan assets while also resulting in earlier impairment recognition than under the current incurred loss model.

4. Those models represent two ends of a spectrum with differing objectives. Some FASB and IASB members presented variations of these models that could be considered to identify a model that might represent a middle ground considering the objectives of the individual Boards.

5. For this meeting, the following papers have been provided to outline the two models discussed above as well as the various alternative models for recognition of credit impairment losses that were briefly discussed by the Boards at the Joint meetings held November 10-12, 2010. For each alternative, this paper describes the basis for calculating expected losses, the recognition of credit impairment, the presentation of amounts in the balance sheet and income statement that would result from application of the alternative and potential issues and operational considerations.

- (a) Agenda Paper 13A / Memorandum 71A – written by the FASB staff to describe the following alternatives:

- (i) *Alternative 1*: Immediate recognition of lifetime expected losses
- (ii) *Alternative 2*: Immediate recognition of losses expected to occur in a shorter emergence period
- (iii) *Alternative 3*: Recognition of losses expected to occur in a shorter emergence period over the emergence period.

- (b) Agenda Paper 13B / Memorandum 71B – written by the IASB staff to describe the following alternatives:

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- (i) *Alternative 4*: Recognition of lifetime expected credit losses using a time-proportionate approach
- (ii) *Alternative 5*: Time-proportionate approach with notional sub-portfolios to accelerate recognition of expected losses
- (iii) *Alternative 6*: Recognition of credit losses using a ‘middle’ book to accelerate recognition of expected losses
- (iv) *Alternative 7*: Steven Cooper’s alternative approach.