Project: **Financial Instruments: Replacement of IAS 39**

Topic: **Amortised Cost and Impairment – Cover paper**

Background and purpose

1. The Board has started to consider how to address the comments and other feedback received on the exposure draft *Financial Instruments: Amortised Cost and Impairment* (the ED). In summary, the feedback received was that most respondents agreed with a more forward-looking impairment approach, but that the expected cash flow model proposed in the ED was operationally difficult.

2. As noted in previous papers, the staff (as well as some respondents) believe that the model proposed in the ED faithfully represents the underlying economics included in the pricing of financial instruments and is consistent with the amortised cost measurement in IFRSs. However, the staff believe the Board needs to consider how the proposed approach should be altered to address the significant operational challenges identified. Most notably, with open portfolios. That is the starting point for the Board discussions. Any specific issues for individual financial assets will be addressed after a general impairment model for open portfolios has been developed.

3. Based on the feedback received, the following 'roadmap' has been prepared for use during redeliberations. The Board has already discussed the top portion of the diagram and various aspects of the 'Allocation of initial EL estimate' layer.

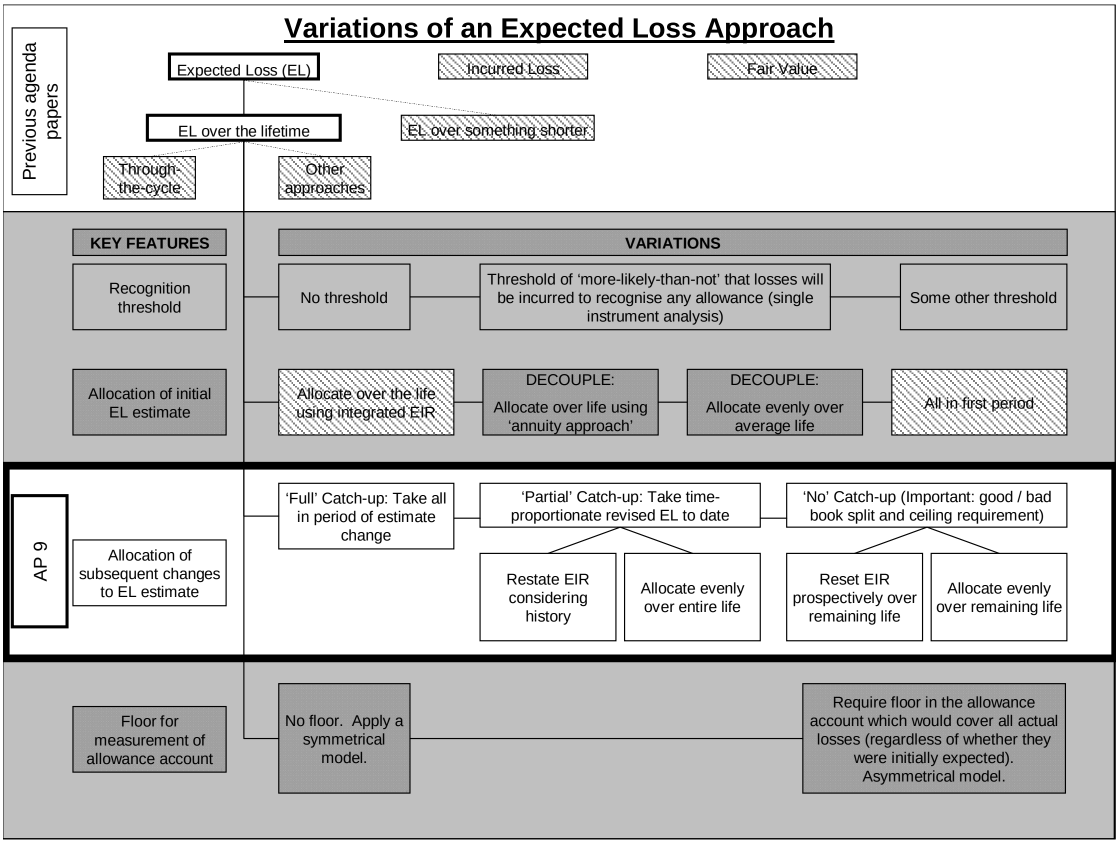
4. To date, tentative decisions made during redeliberations are to proceed with developing an approach that:

   (a) is based on lifetime expected loss (EL);

(b) considers all reasonable and supportable information (including forecasts of future conditions) when calculating EL (ie 'full scope' EL);

(c) allocates the initial EL estimate over the lifetime; and

(d) uses a non-integrated (ie 'decoupled') approach when allocating the lifetime EL and recognising interest revenue.



5. The Board has already discussed the *mechanics* and particular unique implications of several decoupling methods for allocating EL estimates[1].

6. The two agenda papers for this meeting focus on the 'Allocation of subsequent changes to EL estimate' layer above:

(a) Agenda paper 9A provides a diagram that summarises the make up of the statement of financial position and profit or loss for the 'partial' and 'no' catch-up methods. As a reference point, the paper does likewise

[1] See agenda paper 3 of the 5 October 2010 meeting, which focused on the 'Decouple' boxes and the 'Allocation of subsequent changes to El estimate' layer of the roadmap.

for the approach in IAS 39 *Financial Instruments: Recognition and Measurement* and the approach proposed in the ED.

(b) Agenda paper 9B expands the overview in agenda paper 9A and provides further analysis supporting and challenging two methods.

7. No decisions are requested.