
Project	Financial Instruments: Replacement of IAS 39 Amortised Cost and Impairment –
Topic	Expected Loss (EL) estimate allocation diagrams

Purpose of this paper

1. The Board has discussed the *mechanics* and implications of several decoupling methods for allocating EL estimates¹. This paper 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.
2. As a reference point, this paper does likewise for the approach in IAS 39 *Financial Instruments: Recognition and Measurement* and the approach proposed in the ED *Amortised Cost and Impairment*.
3. As a reminder for you, Appendix A provides an excerpt from agenda paper 3 at the 5 October 2010 meeting which describes why in a ‘full’ catch-up approach it is not operationally feasible to allocate EL estimates over the life of an **open** portfolio.
4. Further analysis of the time-proportionate (ie ‘partial’ catch-up) and single period allocation (ie ‘no’ catch-up) approaches is presented in agenda paper 9B, including arguments for supporting and challenging the methods. This paper does not ask the Board to make any decisions.

¹ See agenda paper 3 of the 5 October 2010 meeting.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

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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.

IASB Staff paper

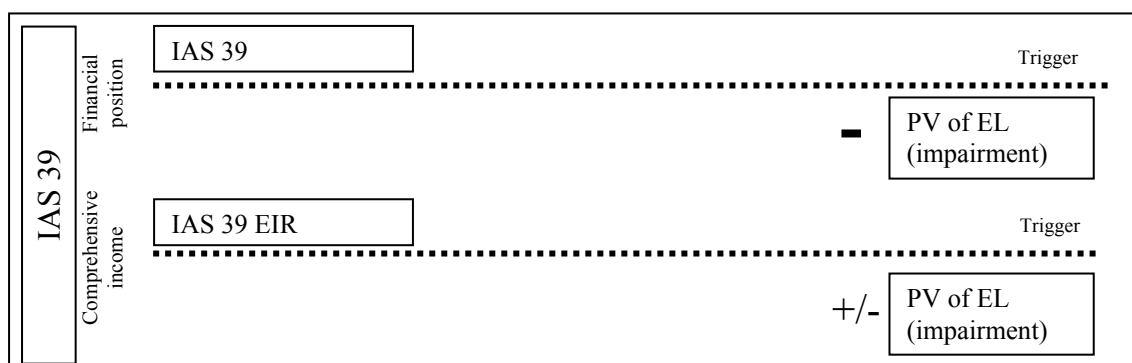
Key to diagrams

5. IAS 39 PV = Present value (PV) of expected future cash flows (ECF), **excluding** all EL.
6. IAS 39 EIR = Effective interest rate (EIR) calculated based on ECF, excluding all EL.
7. Note: In the following diagrams ‘estimate change’ only relates to EL. All other factors affecting ECF (eg prepayments, etc.) are assumed to remain constant.

Approaches diagrams

8. The following diagrams summarise the components included in the statement of financial position and profit or loss under the different allocation approaches. Each diagram includes a brief explanation.

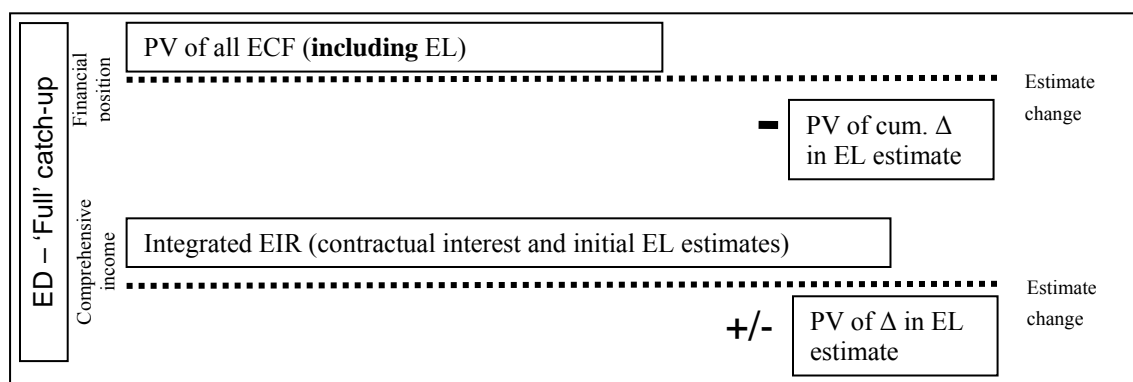
IAS 39 approach (for reference)



9. **Statement of financial position:** Present value of all expected cash flows, excluding all expected credit losses until a loss event recognition trigger is identified (IAS 39 PV). From that point, the measurement is the present value of all expected cash flows including expected credit losses.
10. **Profit or loss:** Includes effects of all events arising in current reporting period, excluding effects of any credit events (IAS 39 EIR) - unless a loss event recognition trigger is identified. In such cases, also includes the cumulative effects of expected credit losses that have become incurred.

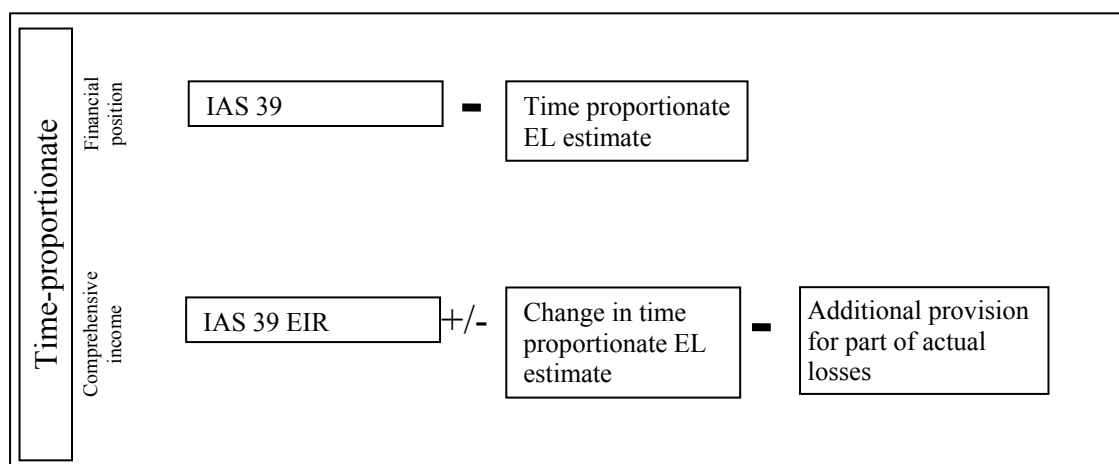
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ED – ‘Full’ catch-up approach (for reference)



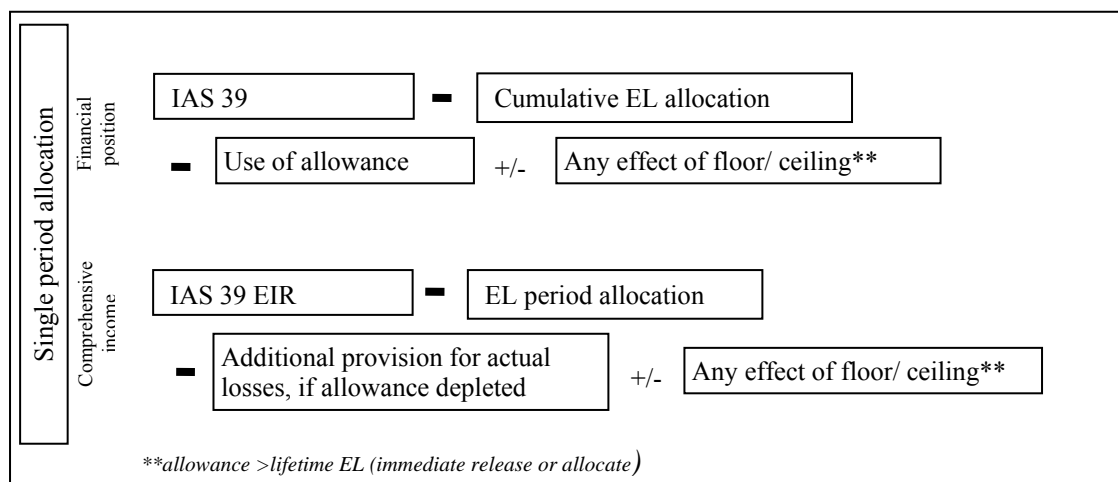
11. **Statement of financial position:** Present value of **all** expected cash flows.
12. **Profit or loss:** Includes effects of all information arising in current reporting period.

Time-proportionate approach (‘Partial’ catch-up)



13. **Statement of financial position:** Present value of all expected cash flows, excluding all expected credit losses (IAS 39 PV). Less allowance account – made up of expected credit losses as estimated at the reporting date apportioned to time period that has passed.
14. **Profit or loss:** Includes effects of all events arising in current reporting period, excluding effects of any credit events (IAS 39 EIR) plus/less (1) amount necessary to ensure allowance in balance sheet is at required amount (reflecting some effects of changes in EL estimates/portfolio composition and tenor), plus (2) any actual loss in excess of cumulative allowance previously built up (reflecting some effects of actual losses in period).

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Single period allocation approach ('No' catch-up)



15. **Statement of financial position:** Present value of all expected cash flows, excluding all expected credit losses (IAS 39 PV). Less accumulated allowance account – made up of cumulative prior and current period allocations of expected credit losses, less any use in current or prior periods of allowance account, plus/less any effect of ceiling/floor in current period.
16. **Profit or loss:** Includes effects of all events arising in current reporting period, excluding effects of any credit events (IAS 39 EIR) plus (1) EL period allocation (reflecting some effects of changes in EL estimates/portfolio composition and tenor) (2) less/plus any effect of ceiling or floor in current period² (reflecting some effects of actual losses in period), plus (3) any actual loss in excess of cumulative allowance previously built up (reflecting some effects of actual losses in period).

Closing

17. This paper summarises the components included in the statement of financial position and profit or loss under the different allocation approaches.
18. Agenda paper 9B provides more detailed analysis.

² When using the allowance balance, the amount recognised in profit or loss and the ending allowance balance is dependent on whether an entity first records the period EL allocation or first depletes the allowance balance. This is further discussed agenda paper 9B.

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Appendix A – Extract from AP 3 – paragraphs 24-28

24. As mentioned above, when using an open portfolio, it is not possible to distinguish between (a) EL estimates on new assets, and (b) the effects of changes in EL estimates for old assets (at least not in an operationally viable way). Unless a ‘day-1 loss’ is recognised for the initial EL estimate, all forms of a ‘full’ catch-up approach for the effects of subsequent changes in EL estimates would require distinguishing between (a) and (b).
25. So, if we wish to permit the use of open portfolios (in an operationally viable way), we need to find some way other than a ‘full’ catch-up to deal with EL estimates at each reporting date.
26. There are two broad approaches that were discussed by the EAP and suggested by respondents to the ED:
 - (a) ‘Partial’ catch-up; or
 - (b) ‘No’ catch-up.
27. From the outreach activities, we were advised that both broad approaches are operationally feasible when using an open portfolio.
28. Both approaches could use either of the ‘decoupling’ methods discussed previously:
 - (a) straight-line approach (ie a linear method); or
 - (b) ‘annuity’ approach (ie a non-linear method).