



Project	Financial Instruments: Impairment
Topic	Discounted versus undiscounted expected losses

Introduction and purpose of paper

1. In January 2011, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) issued the joint supplementary document *Financial Instruments: Impairment (SD)* – a supplement to their original exposure drafts (original EDs) which addressed the impairment of financial assets¹. The comment period for the SD ended 1 April, 2011.
2. In March 2011, the boards tentatively agreed on the measurement of expected losses. This paper discusses whether expected losses should be measured as a discounted or undiscounted amount. However, this paper does not deal with what discount rate should be used if expected losses are discounted. The question of what discount rate should be used will be addressed in a subsequent paper for a future meeting with the boards.
3. When redeliberating the time proportional allowance amount that was included in the SD, the boards will also need to consider feedback received on the SD related to the flexibility permitted in that document for discounting versus not

¹ The original IASB ED *Financial Instruments: Amortised Cost and Impairment* (original IASB ED), was issued in November 2009. The FASB Proposed Accounting Standard Update *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (original FASB ED) was issued in May 2010, and included proposals for the impairment of financial assets.

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

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discounting when calculating the time-proportional allowance amount and the discount rate to be used².

4. The issue of using a discounted amount or an undiscounted amount is closely related to the notion of amortised cost and whether non-accrual guidance is needed. These matters are addressed separately in IASB Agenda Papers 4A and 4C, FASB Memorandums 83 and 85, also discussed at this meeting.
5. This paper does not address accounting for impairment of purchased credit-deteriorated financial assets, which are being addressed separately as part of deliberations on how to recognise and measure impairment on all purchased loans. At the joint meeting on 29 March 2011, the boards tentatively decided that, unlike other assets, these loans would have an EIR calculated considering expected losses at the date of initial recognition.

Background

Existed IFRS guidance

6. The amortised cost measurement under both current IFRS and the original IASB ED provides information about the effective return of financial instruments by allocating interest revenue/expense over the expected life of the instrument. The EIR is the rate that exactly discounts estimated future cash flows through the expected life of the instrument to the net carrying amount of the financial asset – thus inherent in the amortised cost measurement is a discounted future cash flow concept.
7. As a result, IAS 39 requires an entity to measure impairment as the difference between the asset's carrying amount and the present value of all estimated future cash flows (excluding future credit losses that have not been incurred) when impairment needs to be recognised. The cash flows are discounted using the

² The proposal to allow both discounted and undiscounted expected loss estimates as a basis for the time proportional calculation and to allow the discount rate when used to be between the risk free rate and the discount rate calculated in accordance with IAS 39 was proposed in the SD. This was only deliberated by the IASB and was not deliberated by the FASB as noted in the SD.

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financial asset's original effective interest rate (EIR) – ie, the effective interest rate that was calculated at initial recognition of the asset.³

8. The original IASB ED proposed that all changes in expected cash flows be considered and that the carrying amount of the financial asset always equal expected cash flows (taking account of cash flows not expected to be collected) discounted at the originally determined EIR⁴.
9. From the IASB staff perspective (and current IASB requirements), expected losses have always been considered as all cash flow shortfalls and those cash flows have always been discounted at the financial asset's original effective interest rate.

Current US GAAP

10. Under current US GAAP, when *assessing* whether impairment exists, entities are required to consider whether it is probable that the creditor will be unable to collect all contractual interest and principal payments. However, when analyzing financial assets on a collective (pooled) basis for purposes of *recognizing* credit impairment, incurred losses are, in practice, generally only considered to be related to the 'principal' amount at a given point in time. The 'principal' amount is considered to be consistent with the outstanding balance of a pool of loans at a given point in time as generally, it represents the original amount funded plus accrued interest less both payments and charge-offs (acknowledging that this amount inevitably is consistent with contractually owed cash flows discounted at the appropriate EIR). ASC 310-10-35 paragraphs 5-11, is applicable for determining impairment for assets evaluated for impairment on a pooled basis and does not require discounting for measuring impairment.
11. For financial assets evaluated on an individual basis, ASC paragraph 310-10-35-22 requires that the measurement of impairment shall be based on a present value amount, based on the expected future cash flows of the asset discounted at the

³ See IAS 39.63.

⁴ In this case the EIR would have been calculated by discounting the cash flows expected on the asset over its life including consideration of cash shortfalls expected at the date of initial recognition.

asset's effective interest rate, except that, as a practical expedient, measurement can be based on an asset's observable market price, or the fair value of the collateral if the asset is collateral dependent. The FASB ED generally did not propose to amend this guidance.

Proposals in and feedback on SD

12. The SD proposed that entities would have flexibility in whether they used a discounted or undiscounted measure when estimating expected losses. The SD asked a specific question as to whether entities agreed with permitting such flexibility. The feedback received thus far indicates that some constituents believe that a discounted measure is conceptually correct. However, there is concern at the level of difficulty in using a discounted measure, especially for smaller institutions. Therefore, many respondents believe that a undiscounted measure should be permitted, or required if comparability is desired.

Alternatives

13. The staff has identified two alternatives for the boards to consider related to discounting cash flows⁵:
 - (a) Alternative A: Measure expected losses as **principal only** on an **undiscounted** basis; or
 - (b) Alternative B: Measure expected losses as **all shortfalls** in cash flows (both principal and interest) on a **discounted** basis.

Alternative A – Undiscounted principal only

14. Some constituents, through outreach activities or responses to the EDs, stated their preference for an undiscounted approach for measuring expected losses. They

⁵ The staff notes that it would be economically inconsistent to propose measurement of expected losses as a discounted principal amounts only or undiscounted principal and interest amounts. Therefore, these alternatives are not included in the discussion nor explored any further.

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expressed that this approach would be aligned with how they analyze and manage credit risk associated with financial assets. Others, particularly preparers, asserted that an undiscounted approach is more operational, and therefore, easier to apply. In the US, many constituents indicated preference for an undiscounted approach while retaining the practice of 'nonaccrual'. Nonaccrual of interest will be further discussed in IASB agenda paper 4C/FASB memo 85.

15. Some constituents were unclear how to apply a discounted approach for measuring expected losses for a pool of assets. They argue that being able to accurately predict the timing and individual amounts of losses would be necessary to calculate the discounted cash flows and that this process would be operationally challenging. More specifically, these constituents argue that identifying the timing of the emergence of all expected losses in a portfolio is simply not achievable and, thus, discounting expected losses would provide an estimate that may be unreliable and not relevant to users. Some constituents, particularly in the US, also asserted that they only consider principal losses and accrued interest when calculating and analyzing expected losses.
16. Some constituents contend that there would often be little difference between using discounted principal and interest to measure expected losses versus using only undiscounted shortfalls in principal (including accrued interest when applicable) to measure expected losses. However, the staff acknowledge that this will not be the case in all circumstances. Therefore, it cannot be assumed in all cases to approximate the same measure. For example, consider an instrument where interest-only payments are due annually, but the borrower has defaulted on these payments and does not have the ability to pay these amounts for the asset's remaining life. However, the entire principal is still expected to be repaid as due at maturity (for example, the collateral will sufficiently cover the balance). If using an undiscounted measure based only on principal, there would be no expected losses. A discounted measure of all cash flow shortfalls, would result in an impairment charge in this fact pattern.

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17. Continuing with the example in the previous paragraph, an undiscounted approach would result in a carrying amount unadjusted for the economic impact of expecting to receive no current and future interest payments. In other words, because no principal losses are expected, no impairment loss is recognised, and the carrying value is unchanged as a result of the anticipated cash flow shortfalls. While non-accrual guidance could address the income statement effect of this situation (by no longer recognising the interest revenue), some argue that an undiscounted measure results in an inappropriate balance sheet representation because the loan would have a carrying amount equivalent to a fully performing loan with the same contractual terms. Others would argue that the balance sheet would reflect the cash flows expected to be collected and that the loss, or reduction of, interest would be addressed if an entity is required to cease accruing interest on the asset.
18. Some staff believe that the example provided above illustrates the complexities in deciding whether to use a discounted or undiscounted measure. In this example, if an entity were to cease accruing interest on the asset and reverse through a charge to earnings any accrued interest, it effectively would recognise the loss through no future recognition of interest income.
19. Some staff have additional concerns with using an undiscounted measure of only principal amount as the expected loss estimate. These staff view the original carrying value of a financial asset as at amortised cost inherently representing the present value of contractually owed principal and interest (also equal to the fair value of the instrument). Deducting undiscounted principal amounts from that original carrying value would be combining inconsistent amounts (ie a discounted and undiscounted amount as well as cash flows based on principal and interest versus cash flows based on principal only). Thus, some staff believe that it would create measurement inconsistency between the original carrying value and any subsequent impairment adjustments.
20. Other staff acknowledge that the carrying amount of a financial asset at a given point in time inherently represents the present value of outstanding contractually

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due cash flows. However, these staff believe that this amount reflects the outstanding principal and accrued interest at a given point in time. In other words, future interest related to the contractually due cash flows has not been earned or recognised at the time impairment is being measured (and therefore should not be included in the impairment measurement). These staff think that many consider the outstanding balance of a financial asset (such as a loan) to represent principal due at a given point in time and the associated allowance is the cash flows not expected to be collected on that principal (outstanding) balance.

21. Another concern that some staff have of measuring expected losses as the undiscounted amount of anticipated shortfalls in principal is that an entity would need to be able to **identify** the cash flows that relate to principal. For example, consider a zero coupon bond or an instrument with an annuity payment. What is the principal versus the interest component of those instruments? Further, even if the instrument was a simple bullet loan where principal and interest are due at maturity, does an expected shortfall represent principal or does it relate to interest? In practice in the case of a shortfall in a bullet amount, the allocation of principal and interest would vary by transaction (dependent on the terms of the deal) and by jurisdiction. This would mean that economically identical events could be treated different by focussing on the form of a payment. If expected losses were required to be determined based solely on shortfalls in principal losses, there would likely need to be additional guidance to assist preparers in estimating which portion of the total losses relates solely to principal shortfalls.
22. Other staff do not believe that the issue of identifying the principal amount exists. These staff believe that the principal amount, in all circumstances, represents the outstanding balance of the financial asset at a given point in time, which is the funded amount less principal payments or chargeoffs.
23. Those staff supporting an undiscounted measure of expected losses note that discounting expected losses is operationally burdensome for preparers when evaluating credit impairment on a pooled basis. For example, a discounted cash flow analysis, which inherently requires determining the timing of losses, is very

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difficult to apply on a pooled basis. In the US, such a continuous re-estimation of cash flows expected to be collected for pools of loans is required under Subtopic 310-30 (formerly SOP 03-3) where the pool is the unit of account. Preparers indicate that this continuous re-estimation of expected cash flows is very operationally burdensome. Some constituents, including users, assert that because the measurement of expected losses is inherently difficult and reliant on numerous estimates and judgments that requiring discounting would be inappropriate. Within this context, some respondents question whether there is sufficient benefit from requiring discounting relative to the increased quality of the information that results.

24. In some cases (for example where shortfalls in payments are anticipated to occur rateably across principal and interest amounts due) there may in fact be no material difference between the estimate that would result from using Alternative A or Alternative B. In those circumstances all staff agree that using a simpler analysis should be accepted.
25. In addition, the staff understands that in the US, there is pervasive practice for entities to utilise loss rates based on historical data and other analyses to determine credit impairment losses for pools of assets for financial reporting purposes. The staff understands that these loss rates represent net charge off rates, that is, charge offs of principal amounts net of recoveries. Therefore, from a practical standpoint, permitting the continued practice of using such loss rates is inherently generating impairment losses based on principal losses only. Some staff believe that in order to allow this practice to continue it is appropriate to allow losses to be measured as undiscounted principal amounts.
26. Those who support Alternative A understand the conceptual view of amortised cost described under Alternative B. However, some believe there are two ways to think about the amortised cost measure. While amortised cost can clearly and accurately be described as the discounted amounts of all future cash flows (both principal and interest) receivable, these staff believe that it is also simply an expression of the initial outflow associated with a financial asset (with certain

adjustments such as amortization and accretion). Over time, this amount is reduced by principal repayments and any charge offs. It is this amount (what is remaining of the amount initially funded) that represents the outstanding balance of the loan and the amount that many, including many credit risk professionals, believe is subject to credit loss.

27. Finally, some staff believe that, based on outreach performed in certain jurisdictions, users are focused on the collectability of the amount outstanding at a given date, which they believe represents outstanding principal due to the holder of the asset. Therefore, they assert that discounting expected uncollectible cash flows may distort their analysis of the future cash flows expected to be received on a particular pool of financial assets. However, they believe that this measurement requires a robust nonaccrual policy.

Alternative B – Discounted expected losses (principal and interest)

28. Alternative B is based on the notion that amortised cost is inherently a discounted cash flow measure and the EIR is determined as the discount rate that equates the total undiscounted cash flows on an instrument (whether they are principal or interest) to the initial carrying amount of the financial asset. Staff supporting this alternative believe that assessing impairment losses based on a discounted measure would be consistent with this amortised cost notion.
29. The IASB has consistently attempted to reflect the relationship between the pricing of assets and an entity's initial expectations of credit losses, which inherently reflects a discounting notion. Even with the simplifications proposed from the original ED in the SD, the IASB continues to believe that this relationship should be reflected.
30. Staff supporting Alternative B believe that, economically, the return on an asset requires consideration of all cash flows. Therefore, in order to be able to reflect the relationship between pricing and loss expectations expected losses must reflect all shortfalls in cash flows.

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31. As mentioned above, IAS 39 already requires that **all** shortfalls in cash flows be considered in applying impairment accounting and that those amounts be discounted. Therefore, the staff that support Alternative B view an undiscounted measure as a step backwards from the current IFRS guidance. For example, these staff believe that if an undiscounted measure was applied to a 'bad book', considering that many financial assets in the 'bad book' would have been considered to have 'incurred losses' in accordance with IAS 39, the existing practice of measuring impairment for loans would be amended and would be inconsistent with the overall measurement objectives in IFRS.
32. Some staff believe there is no need to distinguish between principal and interest. These staff note that not making that distinction alleviates the need to determine which portion of the shortfall in cash flows relate to principal or interest. Furthermore, these staff note that by not differentiating, all cash flow shortfalls are treated the same. These staff believe that by not distinguishing between principal and interest, the balance sheet always reflects changes in expected cash flows.
33. By measuring expected losses by discounting all cash flow shortfalls there is no need for non-accrual guidance. When considering interest as part of the impairment calculation, also ceasing to accrue interest would double count losses attributable to interest. For example, using the bullet loan example from above, when measurement is based on discounted cash flows, the impairment amount represents the present value of the interest not expected to be collected. Therefore, the interest shortfall is already recognised as an impairment loss. If interest accrual were then stopped there would be an additional charge to the income statement that relates to that same interest amount.
34. As mentioned above, some are concerned with having to estimate the timing and amounts of the expected short falls in cash flows in order to calculate a discounted expected loss amount. The staff that support Alternative B, note that determining the amount and timing of expected shortfalls in cash flows is the ideal way to measure losses. However, they also acknowledge that it could be possible to approximate this discounted amount using an appropriate loss rate (ie if the loss

rate considers the loss of all cash flows). However, the staff that support Alternative B note that guidance would need to be provided in the final standard to explain that using a loss rate is appropriate if it appropriately estimates the discounted amount of all shortfalls. This is consistent with the boards' tentative decision on 22 March 2011 to require that expected losses should be estimated with the objective of an expected value. The boards also tentatively decided at that meeting that the final standard would acknowledge that other appropriate methods could be used as a reasonable way to achieve the objective of an expected value. An example of a suitable method would be a loss rate method. It is however acknowledged that in some jurisdictions entities may face a substantial burden of proof to show that such methods satisfy the objective of measuring the discounted value of all expected shortfalls in cash flows.

35. The staff believe that, conceptually, the basis for measuring impairment should not differ based on whether assets are evaluated for impairment collectively or individually. The staff also believes that having separate measurement requirements would add complexity and make it more difficult for users to ascertain which portions of the credit impairment allowance are undiscounted versus discounted. Some staff believe that identifying the timing of when losses are expected to emerge is operationally more difficult and provides more subjectivity in the discounting process for assets evaluated for impairment on a pooled basis than for loans evaluated individually. Consequently, discounting cash flows expected to be uncollectible may be less reliable for pooled assets than individual assets. In contrast, others do not share this concern due to information available about loss patterns on portfolios.
36. Some constituents responding to the original IASB ED asserted that when assets are evaluated collectively in a pool and are generally performing, they analyse impairment of the assets' principal balance and that this should form the basis for the measurement of expected losses. Others assert that when an asset is not performing, and thus, would probably be in a 'bad book', the period in which losses will occur may be short enough that the effect of discounting expected uncollectible cash flows may be immaterial. However, this is not always the case.

The period of time that an asset may remain in the ‘bad book’ depends on a number of factors, including the nature of the asset, the severity of potential loss, and the timing of measures to be taken to recover a portion or all of the outstanding cash flows related to the asset. For example, a mortgage loan may remain in the ‘bad book’ for a longer period of time, such as two years, due to the extensive effort and time needed to modify or recover cash flows of the loan. In these situations, the effect of discounting expected losses may not be immaterial.

Staff recommendation and question to the boards

37. Some staff recommend Alternative B for all items subject to impairment accounting (other than purchased ‘bad book’ loans) because they believe that the concept of discounting is so fundamental to the notion of amortised cost that this has to be how expected losses are measured. These staff also recommend that a final standard specifically acknowledge that in some cases the measures may not be significantly different and, thus, using an undiscounted measure of expected losses could be acceptable (eg when losses are expected to rateably occur over both principal and interest). Similar to the tentative decision made by the boards related to the measure of expected losses, the staff also recommends the final standard would acknowledge that a range of methods could be used provided they seek to measure the discounted amount of expected losses.
38. Other staff support Alternative A. These staff believe that the amortised cost balance of an asset effectively represents the principal amount at a given point in time (the outstanding funded amount). These staff support this alternative contingent upon establishing guidance for nonaccrual for reasons stated in the staff analysis above.
39. Other staff support Alternative A for pools of assets, and Alternative B for individual assets.

Question: Discounted versus undiscounted

<p>Do the boards want to require expected losses to be measured as undiscounted principal or discounted shortfalls in all cash flows, or a combination?</p>

- 40. The rest of this paper is only relevant if the boards decide to require the use of discounted amounts of all cash flows when measuring expected losses for some or all assets.**
- 41. If the boards decide that an undiscounted principal-only amount is to be required, the discussion of non-accrual guidance in agenda paper 4C, memorandum 85, is instead relevant.**

Unwinding of discount (only relevant if using a discounted amount)

- 42. When using a discounted amount of all cash flows, the discount has to be ‘unwound’ over the life of the instrument to be consistent with the notion of discounting in the first place and to avoid a discrepancy in the ending balance causing a large catch-up upon maturity of the instrument. This is also consistent with reflecting the overall yield on the financial asset which the staff supporting the discounting of expected losses viewed as fundamental to that analysis.
- 43. However, when using a decoupled approach and when considering expected losses, the unwinding of the discount could be treated in different ways. Currently, under IAS 39, because amortised cost includes a reduction for an allowance for incurred losses, interest revenue is calculated as the original EIR multiplied by the amortised cost (which includes the incurred losses). Therefore, the discount related to the impairment loss (difference between undiscounted amount and present value of losses) is unwound through interest revenue. This would also have been the case with the original IASB ED.
- 44. However, when decoupling interest revenue recognition from the allocation of expected losses, the EIR does not include an expectation for credit losses. Therefore, assuming that the EIR is applied to a carrying amount that is not

reduced by an impairment allowance there is no impact on the interest revenue line from impairment. A decision has to be made on whether to unwind the discount on the impairment allowance through interest revenue (either separately presented or in a net presentation), or through impairment losses.

45. The staff has identified three possible alternatives for treating the unwinding of the discount for the boards to consider:
- (a) **Alternative 1** – include in the impairment losses line item;
 - (b) **Alternative 2** – show interest revenue line based purely on the originally calculated EIR and the carrying amount of asset *ignoring any losses* and show unwinding of the discount on the impairment amount (ie interest on the impairment amount) separately below the interest revenue line arriving at a net interest revenue amount; or
 - (c) **Alternative 3** – show interest revenue as a single *net* item (combining the interest revenue and the unwind of the interest on the impairment amount) in the income statement and disclose the components (as described in Alternative 2) in the notes to the financial statements.

Alternative 1 – Impairment losses line item

46. Those who support alternative 1 view the unwinding of the discount as an impairment expense because when impairment is recognised initially on a discounted basis the full effect of the cash flows not expected to be collected has not yet been recognised. Arguably, to ‘fully’ reflect the effect of impairment the interest amount would also need to be recognised as an impairment. This alternative would recognise the entire (ie undiscounted) amount through the impairment loss line over the life of the asset.
47. Others believe that this alternative would be potentially confusing. Using this alternative would result in an impact to profit or loss in future periods without a further impairment event or change in estimate. If no further impairment is necessary on that loan, then the expense recognised in future years in the

impairment line item only reflects that unwinding of the discounting, not a new impairment event

48. Many respondents to both the IASB and the FASBs' original EDs felt that it was important that the interest revenue line be unaffected by impairment. Arguably, by including the interest unwind on a discounted impairment amount in the impairment line, this is more clearly achieved. Also, the staff supporting this alternative believe that, under the SD, the amount reflected as the allowance for credit impairment for the 'good book' is not based on all expected losses. Rather, it is either based on the 'floor' or remaining expected losses under the time proportional approach. Under the time proportional approach, and potentially the 'floor', only a portion of remaining expected losses is recognised at a given date. Certain staff question whether an adjustment to interest income or expense provides an appropriate credit-adjusted yield as the yield is only adjusted for a portion of the total expected losses on a financial asset for the 'good book'. Therefore, these staff question whether any adjustment to interest revenue portrays the economics sought by Alternatives 2 and 3 for the 'good book'.

Alternative 2 – Two interest revenue lines

49. This alternative would present interest revenue using the contractual EIR multiplied by the carrying amount (not including losses). Then the unwinding of the discount (ie the interest on the impairment expense) would be presented as a debit balance in an adjacent line in interest revenue to calculate a net interest revenue amount. Some who support this alternative would view the unwinding of the discount as economically similar to interest revenue. They believe the additional information provided on the income statement is more transparent for users in that they can easily see net interest margin on the face of the financial statements.
50. Also, some view this approach as consistent with the recent decision by the boards in the revenue recognition project to recognise gross revenue with the effects of credit risk separately reflected in an adjacent line item. However, others note that

like the impairment loss itself (ie the discounted amount) the unwinding of the discount (ie the interest) is better reflected as an impairment loss separate from revenue. Those people may support Alternative 1 more because they view both credit risk components as related to impairment losses.

51. However, some staff are concerned that adding another line item to the profit or loss statement would clutter the face of the financial statements. They highlight the concerns raised by users of the financial statements about the importance of the transparency of interest income independent of the effect of impairment losses. Therefore, these constituents propose that the components of the interest revenue line item be shown in notes to the financial statements.

Alternative 3 – Net interest revenue line item

52. Alternative 3 would recognise interest revenue as a net amount (interest income based on the EIR applied to amortised cost and then adjusted for the unwinding of the discount effect) in the income statement and include disclosures of the components. This approach is similar to what was proposed in the original FASB ED, but was highly criticised by users. Users stated they preferred interest revenue be based on the EIR applied to amortised cost (not including the effects of expected credit losses). However, some staff believe that this information could be provided through disclosure.
53. The staff supporting this alternative believe that recognising the unwinding of the discount separately does not faithfully represent the economic yield realised on a financial asset. This net presentation is also similar to existing IFRS (although the carrying amount to which the EIR is applied today relates only to incurred losses rather than expected losses). As mentioned above, in IFRSs today the interest revenue recognition is based on the EIR applied to the carrying amount which includes an adjustment for an allowance for impairment⁶. The staff are not aware of any concerns from users about the current presentation in IAS 39.

⁶ Agenda paper 4A discusses whether the decoupled EIR should be applied to the carrying amount including or excluding an adjustment of impairment. The staff note that agenda paper 4A recommends that

54. Staff supporting this alternative believe that this approach best reflects the current yield on the asset given the expected losses recognised.

Staff recommendation and question to the boards

55. Some staff believe that all three alternatives are valid approaches and note that the decision depends on whether the boards view the unwinding of the discount as additional impairment expense to be recognised during the life of a financial asset or as related to the overall yield on a financial asset.
56. On balance, some staff believe the unwinding of the discount is similar to interest revenue and unwinding of discounts under IFRSs and US GAAP. These staff believe that this approach reflects the yield on the asset given recognised expected losses consistent with amortised cost measurement. Also, in order to minimise the number of line items on the income statement, some staff recommend a single net interest revenue line item with disclosure of the components in the notes (Alternative 3).
57. Other staff support Alternative 1. These staff believe that the discount associated with a measurement based on discounting expected credit losses should be reflected as an impairment expense during the life of a financial asset. These staff believe that this presentation is aligned with user feedback to measure interest income separate from credit impairment. Moreover, these staff believe that Alternatives 2 or 3 may not truly reflect the desired economic portrayal sought by reflecting the discount in interest income as the allowance established to which the discount is applied is not total expected losses in the case of the ‘good book’.

Question: Unwinding of discount

Which alternative do the boards support?

because the EIR is decoupled from expected credit losses, the EIR should be applied to the carrying amount excluding an adjustment for expected credit losses.