



Staff Paper

Project **Financial Instruments: Impairment**

Topic **Definition of 'write-off'**

Introduction

1. In January 2011, the International Accounting Standards Board (IASB) and US-based 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 ends 1 April, 2011.
2. During the comment period, the boards will discuss issues related to their original EDs that are not within the scope of the SD using feedback to the original EDs. Decisions made by the boards during the comment period will be updated, if necessary, based on feedback received and the outcome of other redeliberations, including those related to the topics in the SD.
3. This paper discusses the definition of the term 'write-off'.

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.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

Definition of 'write-off'

4. The original EDs included similar definitions and guidance related to the term 'write-off'. The original IASB ED defines 'write-off' in Appendix A *Defined Terms* as:

A direct reduction of the carrying amount of a financial asset measured at amortised cost resulting from uncollectibility. A financial asset is considered uncollectible if the entity has no reasonable expectations of recovery and has ceased any further enforcement activities.

5. The original FASB ED defines 'writeoff' in paragraph 7, as part of the terms to be added to the Master Glossary, as:

A reduction of the amortized cost of a financial asset because of its uncollectibility.

6. The original FASB ED also provides the following guidance (similar to the second sentence of the IASB definition) related to 'writeoff' in paragraph 83:

An entity shall write off a financial asset or part of a financial asset in the period in which the entity has no reasonable expectation of recovery of the financial asset (or part of the financial asset).

Feedback from constituents

7. Prior to publishing the IASB original ED, staff had received feedback from users that they wanted information about balances that could still 'reverse' (ie be paid) after they were recognised as a use of the allowance. They were concerned that once a financial asset was written off that no further information about those assets was provided. This meant that any recoveries were essentially a surprise from an accounting perspective.
8. As a result, the phrase 'ceased any further enforcement activities' was included in the original definition to ensure that information was provided about financial assets for as long as possible and to ensure disclosure was provided about those assets where proceeds from recovery might still be possible.
9. However, in the responses to the user questionnaire related to the original IASB ED, users also indicated that they believed a loss is considered 'actual' and should

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be recognised when it is incurred (as in IAS 39) or written off, even if the legal means of recovering the asset have not expired. It appears they are willing to accept the trade off that recognising losses before all legal enforcement activities have ceased may result in a higher number of recoveries, as long as they can understand whether assets that are written off can be reversed, and to what extent, if possible.

10. Feedback on the original IASB ED supported the proposed definition with the exception of the final phrase, ‘and has ceased any further enforcement activities’. Some respondents viewed this as an attempt to mandate accounting policy. They explained that management may decide to write off a financial asset when there is no reasonable expectation of recovery, but may continue further enforcement activities beyond this point in order to indicate a commitment to strong collection procedures or because even a small prospect of recovery may justify the ongoing costs.
11. Respondents also said that the timing of write-offs can be affected by various factors other than recovery attempts, including local bankruptcy laws, local regulation or other legal requirements and tax ramifications. In certain jurisdictions, lengthy legal processes must be followed even if an entity has no reasonable expectation of recovery of the financial asset. As a result, entities may have different write-off policies for accounting purposes which link into these other notions of write-off. This level of variation underlines the importance of disclosing the write-off policy. In addition, some were concerned that if the boards determine the point at which an asset should be written off, this may limit regulators’ abilities to provide jurisdiction-specific guidance on the issue.
12. Feedback on the original FASB ED did not focus on the definition of the term ‘write-off’. Therefore, it seems that many of the respondents to the original FASB ED were generally in agreement with the proposed definition and guidance therein.

Analysis and recommendation

13. The staff notes that the definition of ‘write-off’ was included in the original IASB ED because of the requirement to disclose the entity’s write-off policy, in order to provide disclosures about movements in the allowance account and to compare the development of the credit loss allowance over time with cumulative write-offs². The original FASB ED also proposed a disclosure of allowance activity, including write-offs against the allowance.
14. Currently, ‘write-off’ is not defined in either IFRSs or US Generally Accepted Accounting Principles (GAAP). US GAAP does require disclosure of the accounting policy for charging off uncollectible financing receivables (see ASU 2010-20, *Receivables (Topic 310), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*). The staff continues to believe that the disclosure of an entity’s write-off policy is important. The IASB will discuss this issue further in the IASB-only agenda paper 8, including how to address users’ concerns outlined in paragraph 7 above. The FASB will discuss how to address recoveries (whether through disclosure or different means) at a future meeting³. Based on all feedback received (both from users and other constituents) staff believe that addressing the concern about the lack of information about loans that are written off but for which enforcement activities are ongoing via disclosure is more appropriate than through the actual definition of a ‘write-off’.
15. The staff agrees with the feedback received on the last phrase of the IASB’s definition, ‘and has ceased any further enforcement activities’, and recommend removing this phrase from the definition. This would permit an entity to write off an asset in accordance with its accounting policy, which may reflect differences in legal, regulatory and tax requirements in varying jurisdictions.

² See original IASB ED paragraphs 15, 19, B22, B23, B24 and B27.

³ Note that the original FASB ED proposed disclosing the activity in the allowance for credit losses by class and in the aggregate, including write-offs charged against the allowance and recoveries of amounts previously written off (see paragraph 104(a) in the original FASB ED).

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16. With the removal of that phrase from the IASB definition, the definitions included in the original EDs become even more similar. One difference between the two definitions is the location:

- (a) The FASB included the first sentence of the definition in the Master Glossary, while the second sentence was included in the standard.
- (b) The IASB included both sentences in Appendix A *Defined Terms*.

Staff believe the intention of the boards was the same.

17. Given that the definitions and guidance are similar, staff recommend the following common definition for 'write-off' be included in the Defined Terms/Master Glossary:

A direct reduction of the amortised cost of a financial asset resulting from uncollectibility.

18. Staff also recommend the standard include the following as guidance:

A financial asset is considered uncollectible if the entity has no reasonable expectation of recovery. Therefore, an entity shall write off a financial asset or part of a financial asset in the period in which the entity has no reasonable expectation of recovery of the financial asset (or part of the financial asset).

Question 1: Definition of 'write-off'

Do the boards agree with the staff recommendations in paragraphs 17 and 18 related to the definition and guidance for the term 'write-off'? If not, why?