

STAFF PAPER

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REG IASB Meeting

| Project | Financial Instruments: Impairment | | |
|-------------|---|--|---------------------|
| Paper topic | Due process considerations: Re-exposure Draft | | |
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Introduction

1. In November 2012, the IASB finalised its technical discussions on developing the current impairment proposals. This paper analyses the IASB's compliance with its due process requirements and considers if the IASB should proceed to publish a re-exposure document for the impairment project. In doing so, it will cover:
 - (a) the background of the impairment project;
 - (b) the major technical proposals;
 - (c) compliance with due process requirements; and
 - (d) the staff's view on whether compliance was achieved.
2. The IASB's due process requirements, as put forth in the *IFRS Foundation Due Process Handbook* (updated as of 8 May 2012), describe the mandatory and optional steps to be taken before the publication of an IASB document. In considering an Exposure Draft (ED), the objective of due process is to ensure that the IASB is satisfied that it has undertaken sufficient consultation and analysis in developing the ED.

Project background

3. The impairment project is part of our broader project to improve the accounting for financial instruments by replacing IAS 39 *Financial Instruments: Recognition and Measurement*.
4. In March 2008 the IASB published for comment the discussion paper *Reducing Complexity in Reporting Financial Instruments*, which asked for responses on measuring financial instruments not measured at fair value and the accounting for impairment losses. Comments on the discussion paper indicated varying preferences for impairment models. After considering these responses, the IASB published a *Request for Information* in June 2009 that solicited feedback on the feasibility of an expected cash flow (ECF) approach. Many respondents to the *Request for Information* expressed agreement with the conceptual merit of the ECF approach; however, many stated that it would impose significant operational challenges. The IASB acknowledged those concerns, but concluded that it should proceed with the ECF approach.
5. In November 2009 the first Exposure Draft *Financial Instruments: Amortised Cost and Impairment* was published with responses requested by 30 June 2010. During the comment period the IASB established an Expert Advisory Panel to consider the operational considerations of the ECF approach. The panel's summary findings and proposed solutions were presented in June 2010.
6. As a result of concerns surrounding the operational complexities of the original ED, the IASB decided to further refine the impairment model to address those operational concerns while retaining the concepts of the original exposure draft as much as possible. At the same time, because of the importance of convergence, the IASB and the FASB started working on the impairment project jointly. The joint project culminated in the January 2011 publication of the Supplementary Document (SD) *Financial Instruments: Impairment* which sought to incorporate both the objective of the IASB's original ED and the FASB's May 2010 ED *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*.

7. In April 2011 the staff presented a preliminary SD comment letter analysis to the boards. The staff noted in the May 2011 board meeting that feedback on the SD was geographically split, with those in the US generally preferring the FASB approach and respondents elsewhere preferring the IASB approach. The most common and consistent message we received was that the IASB and FASB must reach a common solution. In May 2011 the staff presented to the boards an analysis of four different ways forward—the first two either exclusively the IASB’s (time proportionate) or FASB’s (foreseeable future floor) SD approach, the third the joint SD approach, and the fourth the development of a new alternative.
8. The boards rejected the first three approaches (the SD or specific portions of the SD) in favour of developing a new alternative—the three bucket model.
9. In July 2012 the IASB and FASB finished deliberations on all joint matters on the general framework of the three bucket model. In August 2012, based on feedback received from US constituents, the FASB decided to diverge from the joint three bucket model and explore an alternative that (a) did not use a dual-measurement approach and (b) reflected all credit risk in a portfolio at each measurement date. The IASB chose to continue proceeding with the three bucket model.
10. The IASB and staff conducted additional outreach during the development of the three bucket model, focusing on the tentative decisions. Matters raised during those meetings were reported to the IASB on a timely basis and reflected in the staff analysis during the deliberations. The outreach has been composed of written correspondence, conference calls, and face-to-face meetings with representatives of:
 - (a) major accounting firms;
 - (b) international and regional banks, insurers, and financial institutions;
 - (c) users including industrial entities, investment firms, and consultancies;
 - (d) regulators and government agencies;
 - (e) user forums, non-profit organisations, and discussion groups.
11. In August and September 2012, the IASB staff had more detailed discussions with the aforementioned groups, including undertaking discussions based on an initial draft of the proposed model:

- (a) to receive feedback on whether the three-bucket model would be operational; and
 - (b) to receive feedback on whether the three-bucket model or a lifetime day one loss model provides more useful information.
12. A summary of feedback received was presented in the October 2012 IASB meeting. Overall, the majority of respondents, including users of financial statements, supported an impairment model that distinguishes assets that have deteriorated from those that have not. However, additional clarification was requested on determining when lifetime losses would be recognised. A few participants in the outreach questioned the conceptual merits of the model in the absence of convergence and noted they would prefer the IASB to reconsider the SD based only on the IASB objective or the expected cash flow model in the original IASB ED.
13. During the November 2012 IASB meeting the IASB agreed to clarify the lifetime loss criteria and its assessment in order to address issues raised during the recent outreach. In that meeting, the IASB also decided to proceed with the three bucket model instead of reconsidering the SD. The basis for this decision was primarily the information content and responsiveness to credit deterioration in the three bucket model.

Major technical proposals

14. The main technical issues and respective proposals for the re-exposure draft are as follows:
15. **Scope:** An entity would apply the proposals in the new exposure draft to:
- (a) financial assets measured at amortised cost under IFRS 9 *Financial Instruments*;
 - (b) financial assets measured at [fair value through other comprehensive income] under [draft Amendments to IFRS 9 *Financial Instruments* (2010)];
 - (c) loan commitments, except for loan commitments that are accounted for at fair value through profit or loss under IFRS 9;

- (d) financial guarantee contracts to which IFRS 9 is applied and that are not accounted for at fair value through profit or loss; and
 - (e) the measurement of the impairment allowance for lease receivables within the scope of IAS 17 Leases [or for the right to receive lease payments under [draft] IFRS X Leases].
16. **The expected loss model:** The current impairment model in IAS 39 is an incurred loss model. The incurred loss model has been criticised for many reasons, and these criticisms were brought to the forefront as a result of the global financial crisis. The IASB considered alternative approaches (i.e. modifying the incurred loss model)¹, but decided to propose an expected loss model in the original ED. The specific proposals in respect to the timing of recognition of expected credit losses have changed through the various redeliberations of the impairment project; however, all proposals have been fundamentally based on an expected loss model.
17. **The use of a dual measurement approach:** Many respondents raised concerns about the cost of implementing proposals in the original ED—specifically the requirement to determine and track the credit adjusted effective interest rate and changes in estimates of expected cash flows. To address this the IASB decided to separate (decouple) the measurement of the impairment allowance from the determination of the credit adjusted interest rate so that the asset and the allowance for expected credit losses would be measured separately using the contractual effective interest rate (ie not the credit adjusted rate). In addition, a distinction between initial loss expectations and changes in the estimates was no longer used. As a consequence of these simplifications, the IASB decided to split the recognition of the full expected credit losses into two measurement approaches which are the following in the three bucket model:
- (a) 12 month expected losses; and
 - (b) lifetime expected losses.
18. **The criterion for recognition of lifetime expected losses:** The IASB has decided that an entity must measure lifetime expected loss if there has been significant

¹ Financial Crisis Advisory Group (which held meetings from January 2009 to July 2009), March 2008 discussion paper, and June 2009 Request for Information.

deterioration in credit quality since initial recognition (taking in consideration the term of the asset and the original credit quality).

19. In addition, the current proposals provide an exception to the assessment of lifetime expected losses for high quality assets by requiring the recognition of lifetime losses when assets deteriorate below “investment grade”.²
20. Advantages of this approach include that the deterioration in credit risk for both high quality and low quality assets will be relevant (thereby providing important information content for users of financial statement), and that tracking for changes in credit quality will not be required for assets above “investment grade”.
21. **Purchased credit impaired (PCI) assets:** The scope and the treatment of PCI assets remains unchanged from IAS 39. For these assets lifetime expected losses are included in the estimated cash flows when computing the effective interest rate on initial recognition, and subsequent changes in lifetime losses are recognised in profit and loss.
22. **The simplified approach for trade and lease receivables:** The IASB has decided to provide a simplified approach for measuring trade and lease receivables at lifetime expected losses. This provides operational relief by removing the requirements to track credit migration and the difficulty of calculating 12-month expected losses on assets with longer maturities.
23. **Disclosure requirements:** To aid understanding of application, and to assist in comparability, disclosures will accompany the model. Those disclosures will be less extensive for entities applying the simplified approach for trade and lease receivables.

Analysis of compliance with due process

24. The formal due process procedures for the IASB specify mandatory, non-mandatory and other optional steps in the standard-setting process. This section analyses how the IASB has complied with the due process requirements set out in these categories.

² Any references to rating grades in this paper are for the purpose of facilitating discussion. The proposals will not rely on this terminology in isolation.

Mandatory steps

IASB meetings held in public, with papers available for observers. All decisions are made in public sessions

25. Following the original Exposure Draft, the IASB has held public meetings on the impairment project from July 2010 to this meeting. Staff papers for these meetings have been posted on the website prior to meeting dates. All of the tentative decisions have been made in those public meetings, and summaries of the tentative decisions reached were posted on the website after each meeting.

Exposing for public comment a draft of any proposed new IFRS or proposed amendment to an IFRS – with minimum comment periods

26. The IASB published the Exposure Draft ED/2009/12 *Financial Instruments: Amortised Cost and Impairment* ('the ED') on 5 November 2009. The ED had a comment period ending on 30 June 2010. Due to the proposed changes to impairment accounting being quite substantial and having far reaching operational considerations, the comment period was extended to eight months in order to give respondents adequate time to understand the proposal and provide feedback. The ED included a Basis for Conclusions and was approved for publication by thirteen of the fifteen board members.
27. The IASB published a joint supplement to the ED on 31 January 2011, *Financial Instruments: Impairment* ('the SD'). The SD had a comment period ending on 1 April 2011. Because the scope of the SD was limited to open portfolios and built on the original ED, the boards believed 60 days to be a sufficient comment period. The SD included a Basis for Conclusions, but did not incorporate a page on formal IASB approval or dissenting opinions.
28. In Agenda Paper 5C from this meeting, the staff will ask the IASB for permission to publish a re-exposure draft for the impairment model for public comment with a 120 day comment period.

Considering in a timely manner those comment letters received on proposals

29. The IASB received a total of 193 comment letters on the original exposure draft. A comment letter summary was presented to the board in July 2010, covering the 149

letters received by the 30 June 2010 comment letter deadline. Any additional key points in comment letters received after that meeting were to be communicated to the board in a later meeting.

30. The boards received 214 comment letters on the supplementary document.³ A comment letter summary was presented to the board in April 2011, covering the 180 comment letters received by the 1 April 2011 comment letter deadline. Any additional issues in comment letters received after that date were to be communicated in later board papers.

Reporting to the Advisory Council on major projects

31. The impairment project has been addressed in ongoing discussions with the Advisory Council as a regular part of the work plan update. In addition, it has been discussed specifically during the November 2010 and February 2012 meetings.⁴ During discussions, the Advisory Council has had the opportunity to ask questions or provide commentary about the project.

Considering whether the proposals should be exposed again

32. The staff considered feedback and comment letters on the supplementary document to the original ED during the April 2011 and May 2011 board meetings. As a result of this analysis, and to enhance the possibility of achieving convergence, the boards decided to pursue an alternative impairment model. The IASB has decided to proceed with the current proposals, in absence of convergence, as a result of feedback received from constituents that showed favour for an impairment model that distinguishes assets that have deteriorated from those that have not. The staff analyse the re-exposure process and request permission to re-expose in Agenda Paper 5C.

Analysis of likely effects of the forthcoming IFRS

33. An effect analysis will be included in the Re-exposure Draft as part of the Basis for Conclusions. Appendix B of this paper discusses the due process requirements of an effect analysis and considerations for the impairment project.

³ The FASB website currently lists 216 total letters, however one letter from the American Bankers Association is for the three bucket model and two letters from BDO are effectively identical.

⁴ The three bucket model was discussed in February 2012.

Drafting quality assurance steps are adequate

34. The Translations and XBRL teams will be included in the review process before the re-exposure draft is issued.

Non-mandatory steps*Publishing a discussion document (eg a discussion paper) before an exposure draft is developed*

35. In March 2008 the IASB published for comment the discussion paper *Reducing Complexity in Reporting Financial Instruments*, which asked for responses on measuring financial instruments not measured at fair value and the accounting for impairment losses. A comment letter summary was presented to the board in October 2008, covering the 157 comment letters received by the 19 September 2008 comment letter deadline. In March 2009 the staff presented another analysis of the total 162 comment letters received.
36. The IASB published a *Request for Information* in June 2009 that solicited feedback on the feasibility of an expected cash flow (ECF) approach. A total of 89 comment letters were received, and an analysis of 79 of these received to date was presented to the board in September 2009.

Establishing consultative groups or other types of specialist advisory groups

37. A panel of credit risk experts, the Expert Advisory Panel (EAP), was established to advise the IASB on the operational implications of applying the proposals in the IASB's original Exposure Draft. The panel's summary findings and proposed solutions were presented in June 2010. As of this meeting, some of the members of the EAP have continued to provide input on the operational implications of the current proposals.
38. The IASB created a Financial Instruments Working Group (FIWG) in 2004 to address issues related to financial instruments projects. The working group is composed of preparers, users and auditors who have contributed to the impairment project during its deliberations. The FIWG met to discuss the three bucket model in August 2011.

39. The IASB also, jointly with the US FASB, formed a Financial Crisis Advisory Group that met six times from January to July 2009 to deliberate on accounting issues recognised as a result of the global financial crisis. Among the major issues discussed were delayed recognition of impairment and the incurred loss model.

Holding public hearings

40. The impairment project has been discussed with the Capital Markets Advisory Committee (formerly Analyst Representative Group) during various meetings in London. It has also been considered in meetings with the Global Preparers Forum, an independent body of members with extensive experience in financial reporting. Meeting papers and audio webcasts are available for these meetings on the IASB's website.

Undertaking fieldwork

41. The IASB has not considered it necessary to undertake formal field tests before the publication of the current proposals. The IASB thinks that this is not necessary because sufficient input has been received through the following channels:
- (a) formal feedback through comment letters to the ED and SD; and
 - (b) extensive outreach activities during the exposure and redeliberation periods (discussed further in the next section), including impact assessments by various organisations which indicated the impact the proposals would have.
42. However, the IASB intends to undertake some fieldwork in conjunction with the exposure process. We believe that this will be best achieved by working closely with a small number of institutions in different jurisdictions. The primary objective of the fieldwork would be to assess and illustrate the benefits of the dual measurement approach, i.e. how faithfully the three bucket model represents expected credit losses in different scenarios (e.g. under different economic circumstances and/or portfolio stages). In addition, the IASB will solicit views on the cost and operability of the proposals. While it will not be possible to understand fully the impact on allowance balances—nor should this be the primary role of an accounting standard setter—we will also seek to understand the directional impact on allowance balances compared with IAS 39 today.

Other optional steps

43. Throughout the impairment project, the IASB has performed a significant amount of outreach and consultation with constituents in order to understand concerns and inform constituents of the project's progression. IASB members and staff have:
- (a) held a large number of meetings with individuals and groups of auditors, industry representatives, preparers, regulators, standard-setters, and users of financial statements;
 - (b) maintained lines of communication with industry groups, regulators, and national standard-setters;
 - (c) appeared at public events to exchange views with constituents.
44. Other consultative steps, such as webcasts and podcasts, are documented in Appendix A.

Considerations for the redeliberation period of the re-exposure draft

45. The IASB has considered many views in the development and selection of the proposed three bucket impairment model for re-exposure. Constituents will have the opportunity during the comment period (discussed in AP 5C of this meeting) to respond to the proposed model. In addition to analysing received comments, the IASB will continue to perform further outreach and fieldwork to ensure that full and fair consultation is achieved. The IASB will consider if other consultative steps should be performed before finalising the impairment model.

Summary

46. In the staff's view the IASB has complied with the requirements of the *IFRS Foundation Due Process Handbook* in the development of the current impairment model, and the project is ready to start the balloting process. In Agenda Paper 5C the staff request permission to begin the balloting process for the Re-exposure Draft.

Questions for the IASB

Does the IASB agree with the staff's view that due process requirements have been met?

Are there any further due process steps that the IASB thinks are necessary before beginning the balloting process?

Appendix A: Development and publication of an exposure draft for an IFRS, practice guidance or *Conceptual Framework* chapter

| Step | Required/Optional | Metrics or evidence | Protocol for and evidence provided to DPOC | Action |
|---|-------------------|---|--|--|
| IASB meetings held in public, with papers available for observers. All decisions are made in public session | Required | Meetings held to discuss topic Project website contains a full description with up-to-date information on the project Meeting papers posted in a timely fashion | Members of the IASB discuss with DPOC progress on major projects, in relation to the due process being conducted DPOC reviews comments from interested parties on IASB due process as appropriate | IASB meetings Following the ED, the IASB has held public meetings on the impairment project from July 2010 to now. Project website A project page has been in place over the course of the project. The website is currently being updated as part of a comprehensive website reconstruction. It is on track to be up-to-date in due course. Meeting papers Staff papers for meetings have been posted on the website prior to meeting dates |
| Formal consultation with the Trustees and the Advisory Council | Required | Discussions with the Advisory Council on topic | DPOC meets with the Advisory Council to understand perspectives of stakeholders on due process of IASB Advisory Council chair invited to Trustees' meetings and meetings of DPOC | Advisory council The impairment project has been part of specific and ongoing discussions with the Advisory council on a regular basis. Trustees The impairment project has been addressed in meetings with, and reports to, the Trustees. |
| Analysis of likely effects of the forthcoming IFRS or major amendment, for example, costs or ongoing associated costs | Required | Publication of effect analysis | IASB reviews with DPOC results of effect analysis and how it has considered such findings in proposed IFRS IASB provides a copy of the effect analysis to the DPOC at the point of standard's publication | An effect analysis will be included in the re-exposure draft as part of the Basis for Conclusions. Appendix B of this paper discusses the requirements of an effect analysis and considerations for the impairment project. |
| Consultative groups utilised, if formed | Optional | Number of consultative group meetings, and evidence of substantive involvement in issues Consultative group review of draft exposure draft | DPOC receives report of consultative group activity from IASB | The Financial Instruments Working Group discussed impairment in August 2011. The IASB has formally consulted on the ECF model with the Expert Advisory Panel. |

| Step | Required/ Optional | Metrics or evidence | Protocol for and evidence provided to DPOC | Action |
|---|-----------------------|--|--|--|
| Fieldwork undertaken in analysing proposals | Optional | IASB describes approach taken on fieldwork IASB explains why it does not believe fieldwork is warranted, if that is the preferred path Number of field tests | If fieldwork is deemed by the IASB as not required, DPOC to review and discuss the explanation with IASB DPOC receives a report on fieldwork activities and how findings have been taken into consideration by IASB | The IASB has not considered it necessary to undertake formal field tests to this point. |
| Outreach meetings with a broad range of stakeholders, with special effort for investors | Optional | Number of meetings held and venues documented Evidence of specific targeted efforts for investors | DPOC receives a report on outreach activities and reviews, with the IASB, the outreach plan for the ED and its approach to the optional steps to ensure extensive outreach and public consultation | Throughout the impairment project, the IASB has performed a significant amount of outreach and consultation with constituents in order to understand concerns and inform constituents of the project's progression. IASB members and staff have: (a) held a large number of meetings with individuals and groups of auditors, industry representatives, preparers, regulators, standard-setters, and users; (b) maintained lines of communication with industry groups, regulators, and national standard-setters; (c) appeared at public events to exchange views with constituents. |
| Webcasts and podcasts to provide interested parties with high level updates or other useful information about specific projects | Optional | Number of and participation in webcasts | DPOC receives a report on outreach activities | The IASB has had eight webcasts and one podcast on the various stages of the impairment project. |
| Public discussions with representative groups | Optional | Number of discussions held | DPOC receives a report on outreach activities | The impairment project has been discussed with the Capital Markets Advisory Committee and Global Preparers Forum during various meetings in London. |
| Online survey to generate evidence in support of or against a particular approach | Optional | Number and results of surveys | DPOC receives a report on outreach activities | The staff did not consider it necessary to undertake online surveys. |

| Step | Required/ Optional | Metrics or evidence | Protocol for and evidence provided to DPOC | Action |
|--|-----------------------|---|--|---|
| IASB hosts regional discussion forums, where possible, with national standard-setters | Optional | Schedule of meetings held in these forums | DPOC receives a report on outreach activities | The IASB has not considered it necessary to hold regional discussion forums during the development of the three bucket model. |
| Round-table meetings between external participants and members of the IASB | Optional | Number of meetings held | DPOC receives a report on outreach activities | The IASB has not considered it necessary to hold round-table meetings during the development of the three bucket model. |
| Drafting quality assurance steps are adequate | Required | Translations team included in review process | DPOC receives summary report on due process steps followed before an exposure draft is issued | To be completed in due course. |
| Drafting quality assurance steps are adequate | Required | XBRL team included in review process | DPOC receives summary report on due process steps followed before an exposure draft is issued | To be completed in due course. |
| Drafting quality assurance steps are adequate | Optional | External reviewers used to review drafts and comments collected and considered by the IASB | DPOC receives summary report on due process steps followed before an exposure draft is issued, including the extent to which external reviewers have been used in the drafting process | To be completed in due course. |
| Drafting quality assurance steps are adequate | Optional | Review draft made available to members of IFASS and comments collected and considered by the IASB | DPOC receives summary report on due process steps followed before an exposure draft is issued | The staff do not consider this step necessary. |
| Drafting quality assurance steps are adequate | Optional | Review draft posted on project website | DPOC receives summary report on due process steps followed before an exposure draft is issued | To be completed in due course. |
| Due process steps reviewed by IASB | Required | Summary of all due process steps discussed by the IASB before an IFRS is issued | DPOC receives summary report on due process steps followed before an exposure draft is issued | This paper provides a summary for IASB discussion on the due process steps taken in this project. |
| Exposure draft has appropriate comment period | Required | IASB sets comment period for response Any period outside the normal comment period requires explanation from IASB to DPOC, and subsequent approval | DPOC receives notice of any change in comment period length and approval if required | In Agenda Paper 5C from this meeting, the staff recommend a comment period of 120 days. |
| Press release to announce publication of exposure draft | Optional | Press release published Media coverage | DPOC informed of the release of the exposure draft | To be completed in due course. |
| Snapshot document to explain the rationale and basic concepts included in the exposure draft | Optional | Snapshot posted on IFRS Foundation website | DPOC receives a report on outreach activities Snapshot sent to DPOC members | To be completed in due course. |

| Step | Required/ Optional | Metrics or evidence | Protocol for and evidence provided to DPOC | Action |
|--------------------------|-----------------------|--|--|--------------------------------|
| Exposure draft published | Required | Exposure draft posted on IFRS Foundation website | DPOC informed of the release of the exposure draft | To be completed in due course. |

Appendix B: Analysis of the effects of this Re-exposure Draft

47. The IASB is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and the likely ongoing associated costs and benefits of each new IFRS—the costs and benefits are collectively referred to as ‘effects’. The IASB gains insight on the likely effects of the proposals for new or revised IFRSs through its formal exposure of proposals and through its fieldwork, analysis and consultations with relevant parties through outreach activities.
48. The IASB has considered the costs and benefits of the proposals comprehensively in reaching its conclusions. However, because the impairment project is still at the stage where the staff are seeking permission to re-expose proposals and begin the balloting process, the effect analysis contained in this document is a summary and is less comprehensive than what will be published as part of the IASB’s Basis for Conclusions on the Exposure Draft.
49. In evaluating the likely effects of the proposed impairment approach, the IASB should consider the following factors:
- (a) how the proposed impairment approach is likely to affect how activities are reported in the financial statements of those applying IFRSs;
 - (b) how the proposals improve the comparability of financial information between different reporting periods for an individual entity and between different entities in a particular reporting period;
 - (c) how the proposals will improve the quality of the financial information and its usefulness in assessing the future cash flows of an entity;
 - (d) the benefit of better economic decision-making as a result of improved financial reporting;
 - (e) the likely effect on compliance costs for preparers, both on initial application and on an ongoing basis; and
 - (f) how the likely costs of analysis for users (including the costs of extracting data, identifying how the data has been measured and adjusting data for the purposes of including them in, for example, a valuation model) are affected.

50. An analysis of the likely effects for each of the aforementioned factors will be included in the Re-exposure Draft as a part of the Basis for Conclusions. The analysis will consider:
- (a) timing of recognising credit losses;
 - (b) the operational impacts of the proposed approach (including the impact on systems, processes and internal controls); and
 - (c) usefulness and relevance of information to be provided through the proposed disclosure requirements.
51. The staff note that although the effect analysis may consider the directional impact of the proposed approach on the net carrying amount of financial assets at amortised cost, it is not intended to provide an indication of the magnitude of the impact. This is because the calculation of overall magnitude will require entities to implement necessary system changes that will require a significant amount of time and effort.

Benefits of the three bucket model

52. In the staff's view, the IASB's original ED *Amortised Cost and Impairment* published in November 2009 best reflected the economic phenomenon of expected credit losses. The benefits of the three bucket model can therefore be expressed in terms of how closely it faithfully represents the economic phenomenon of expected credit losses consistent with the original ED.
53. As mentioned in the major technical proposals, the three bucket model is based on a dual measurement approach. This in effect converts the original ED to a tiered approach in which an entity recognises lifetime expected credit losses if they meet credit quality and deterioration criteria, and 12-month expected losses otherwise. The initial recognition of the 12 months expected losses and the timely recognition of lifetime expected losses will better reflect expected credit losses by minimising the overstatements and understatements of expected losses compared to the original ED.
54. The advantage of this approach is that the timing of recognition of expected losses is more responsive to deterioration in credit quality. Thus the three bucket model results in a more timely recognition of lifetime expected losses than the current requirements of IAS 39.

Costs of a dual measurement approach as applied in the three bucket model

55. It is complex and costly to calculate lifetime expected losses. In addition, the costs resulting from the three bucket model are caused by the complexities involved with:
- (a) tracking assets for assessing the deterioration criterion and the difficulty of making that assessment; and
 - (b) calculating 12-month expected losses.
56. The IASB addressed interested parties' concerns regarding the clarity of the lifetime loss criterion in the November 2012 meeting. Notwithstanding those clarifications, the three bucket model will require an assessment to be made of when lifetime losses are required to be recognised. That assessment will increase the complexity and cost of implementing the proposals.
57. Participants in recent outreach have noted that the costs of applying the deterioration criterion vary depending on how entities segment their portfolios. An entity may, for example, segment its portfolios based on credit quality at origination and assess deterioration by means of comparing subsequent changes back to original credit quality. Costs would therefore fluctuate depending on the diversity of initial credit quality and the sophistication of risk management systems.
58. In addition, the IASB has sought to address some concerns about the difficulties of applying the model by acknowledging the role of delinquency information in applying the model and in proposing that lifetime losses need not be recognised on investment grade assets.
59. The IASB has addressed the above difficulties for non-financial institutions and other entities through the proposed simplified approach for trade and trade receivables. This approach reduces cost and complexity by removing the need to:
- (a) calculate 12-month expected losses for assets with a longer maturity; and
 - (b) track credit migration on these instruments.
60. The assessment of credit risk inherently involves a significant amount of subjectivity, and therefore reduces the verifiability and comparability of reported amounts. This inevitably passes on costs of analysis to users. This has been mitigated to some extent by expanding disclosure requirements to provide users with information regarding the

inputs, assumptions and techniques used to assess the criterion for recognition of lifetime expected losses and the measurement of 12-months and lifetime expected losses.