

STAFF PAPER

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REG IASB Meeting

Project	Financial Instruments: Impairment		
Paper topic	Transition		
CONTACT(S)	Katherine Cancro	kcancro@ifrs.org	+44 (0)20 7246 6928
	Jana Streckenbach	jstreckenbach@ifrs.org	+44 (0)20 7246 6473

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*.

Purpose and structure of the paper

1. This paper addresses the transition to the proposed expected loss impairment model for IFRSs. This paper contains five questions for the Board.
2. It is structured into the following sections:
 - (a) Previous proposals (paragraphs 4–7);
 - (b) Background: Full retrospective application (paragraphs 8–9);
 - (c) Summary of staff recommendations and questions to the Board (paragraphs 10–11);
 - (d) Grandfathering (paragraphs 12–18);
 - (e) Applying the new model without initial credit quality data (paragraphs 19–39);
 - (f) Determining the relevant assets (for applying the new model without initial credit quality data) (paragraphs 40–46);
 - (g) Hindsight and comparative periods (paragraphs 47–53);
 - (h) Other issues (related to IAS 8 disclosures and first-time adopters) (paragraphs 54–64).
3. Because the transition implications resulting from both the limited modifications project for classification and measurement and the impairment project are being considered at this

meeting (see Agenda Paper 6B for the transition provisions for the limited modifications project), the interaction of the transition provisions of all three phases of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement* and the effective dates of those phases can now be evaluated together. Transition interaction is addressed in Agenda Paper 6C, and includes discussion and a recommendation for early application of the new impairment model.

Previous proposals

4. The original IASB exposure draft (ED)¹ with respect to amortised cost and impairment proposed calculating amortised cost using an integrated effective interest rate that included the initial estimate of expected credit losses on the financial asset. In other words, the proposal was to ‘couple’ the measurement and presentation of interest revenue with the initial expected impairment losses.
5. As described in more detail in Appendix A of this paper, the original IASB ED proposed a transition approach that would have determined an adjustment to the effective interest rate previously determined in accordance with IAS 39 with the objective that the adjusted rate would approximate the effective interest rate that would have been determined under the proposed approach.
6. The Supplementary Document (SD)² did not address transition.
7. While both models are based on recognising expected losses, the credit deterioration impairment model currently being developed is different to the original IASB ED, and therefore the transition considerations are different.

Background: Full retrospective application

8. IAS 8 *Accounting Policies, Changes in Accounting Estimates, and Errors*, provides the principles and framework for changes in accounting policies in the absence of specific transition provisions in an IFRS. IAS 8 states that as a general rule, retrospective application

¹ Exposure Draft ED/2009/12 *Financial Instruments: Amortised Cost and Impairment*.

² Supplement to ED/2009/12 *Financial Instruments: Impairment*.

results in the most useful information to users, and that it is the preferred approach unless it is impracticable to determine the period-specific effect and/or the cumulative effect of the change. The definition of ‘impracticability’ includes situations in which it is not possible to distinguish objectively historical information relevant for estimating expected losses from information that would not have been available at that date. (This is commonly called ‘hindsight’.) There are two main issues with retrospective application for the new impairment model:

- (a) The new impairment model relies on entities assessing whether there has been a deterioration or improvement in credit quality since the initial recognition of a financial asset to determine whether an allowance balance is required to be established to reflect lifetime expected credit losses. Entities have told us that currently information about initial credit quality is not typically retained indicating that making this assessment on transition is likely to be difficult.
 - (b) Entities have not previously been required to recognise or disclose expected losses for accounting purposes. Accordingly, there is a risk that hindsight would be used to determine the amount of expected losses in prior periods.
9. Given that retrospective application is the preferred approach to transition, this paper considers whether these issues can be addressed and then based upon these decisions consideration is then given to the general approach to transition for the new impairment model.

Summary of staff recommendations and questions to the Board

10. In this paper the staff make three recommendations:

- (a) For assets whose initial credit quality is not used on transition to the new impairment model (‘the relevant assets’), the transfer notion should be modified so that it is based only on the second criterion in the transfer notion. That is, the relevant assets would be classified in Buckets 2 or 3 on transition when the likelihood of default is such that it is at least reasonably possible that the contractual cash flows may not be

recoverable. Other assets would be classified into Bucket 1 on transition (paragraph 38/Question 1).

(b) The staff recommend that the issue of hindsight be addressed by prohibiting the restatement of prior period(s) (paragraph 53/Question 3).

(c) The disclosures required by IAS 8 paragraph 28(f) should be prohibited for prior periods (paragraph 56/Question 4).

11. The staff also have two questions to the Board for which they do not have recommendations. These questions are:

(a) In order to define the relevant assets for which initial credit quality information is not used on transition, how much effort should entities be required to undertake to use the actual initial credit quality (paragraphs 40–46/Question 2)?

(b) Does the Board want the disclosures in paragraph 28(f) of IAS 8 to be required for the current period when initially applying the new impairment model (paragraphs 57–60/Question 5)?

Grandfathering

12. One approach to transition that would address both the issues set out in paragraph 8 above would be for the Board to ‘grandfather’ the impairment for existing financial assets at the date of initial application; that is, entities would only apply the new model to financial assets that are initially recognised from the date when the new model is initially applied. Entities would continue to apply IAS 39 impairment to all existing financial assets on transition to the new model. This would be a form of prospective application of the new impairment model.

13. This grandfathering approach would remove the need to determine expected losses for periods prior to application of the new model, and would also eliminate the problem of applying the new model to financial instruments for which information about the credit quality at initial recognition is not available or would be very burdensome to obtain on transition.

14. It would also allow the Board to specify an earlier mandatory effective date than would be required for full retrospective application (ie retrospective application with restatement of comparatives).
15. This approach would ‘phase in’ the effect of the new impairment model. This would delay the improvements to impairment accounting. However, those who are concerned about the potentially significant effect on equity of moving to the new model (which may have regulatory consequences for some) may view this positively.
16. However, the staff do not think that a grandfathering approach is satisfactory, because it could result in a long period during which the impairment accounting for some assets is in accordance with IAS 39, while the new model applies to others. This would reduce comparability between those two groups of assets, and would extend the time during which the incurred loss model, with all of its shortcomings, would be applied. Depending on the life of an entity’s assets, these issues could be relevant for an extended period of time.
17. In addition, in order to do this, entities would need to prepare information in accordance with both the IAS 39 impairment model and the new impairment model until all grandfathered assets were derecognised, which would be burdensome, at least for some entities.³
18. Put simply, grandfathering would impair the usefulness of the information provided to users of financial statements, and it would be burdensome for preparers. Consequently, the staff dismiss this alternative. The following section explores other alternatives to address the transition issues highlighted above.

Applying the new model without initial credit quality data

19. The impairment model contains a transfer notion that determines when financial assets are transferred to or from Bucket 1. That is, financial assets would move out of Bucket 1 when there is both:
- (a) a more than insignificant deterioration in credit quality since initial recognition, and

³ The transition provisions could permit but not require ‘grandfathering’, but this would even further degrade comparability because incomparability would be not just between ‘old’ and ‘new’ assets, but between entities as well.

(b) the likelihood of default is such that it is at least reasonably possible that the contractual cash flows may not be recoverable.

20. To determine whether the allowance balance for financial assets on transition should reflect lifetime expected losses in accordance with this criteria, an entity needs information about the initial credit quality of an asset. Therefore, ideally on transition entities would use information about the credit quality of financial assets as at initial recognition, either through historical data that is available despite not having been required for accounting or risk reporting, or by another means with comparable integrity (eg a data provider for traded debt securities).

21. IAS 8 would not require information about initial credit quality to be used for existing assets if it is impracticable to do so. That would, however, leave open the question of how the expected loss model should be applied on transition without information about the initial credit quality. Also, ‘impracticability’ may be considered by some to be an inappropriately high hurdle for applying the simplified transition provisions. So later in the paper we consider which assets such treatment should be applied to (the ‘relevant assets’)—see further discussion in paragraphs 40–46.

22. The staff have identified the following possible ways in which the transition provisions could apply to the relevant financial assets (ie those for which the credit quality at initial recognition is not used). They are summarised as follows⁴:

- (a) resetting or deeming the ‘initial credit quality’ to be the credit quality at the date the new model is initially applied;
- (b) categorising these financial assets in Buckets 2 or 3 until derecognition; or
- (c) modifying the transfer notion so that the transition provisions require these assets to be evaluated only on the basis of the second criterion in the transfer notion⁵. That is,

⁴ The staff note that the provisions in subparagraphs (a) and (c) of this paragraph would only apply to financial assets that are subject to the transfer notion—that is, not purchased financial assets with an explicit expectation of loss, nor trade or lease receivables that use lifetime expected credit losses as the impairment measure upon initial recognition and throughout their lives.

the assets would be classified in Buckets 2 or 3 on transition to the new impairment model when the likelihood of default at that time is such that it is at least reasonably possible that the contractual cash flows may not be recoverable.⁶ To be clear, this would mean that some financial assets subject to this transition relief would be initially categorised in Bucket 1 even though they have deteriorated in credit quality.

23. Analysis of these alternatives is presented below. It is noted that in all cases these approaches would mean that the relevant assets would be treated differently to assets recognised post transition so the issue of comparability is not discussed explicitly for any of the alternatives.

Resetting the initial credit quality

24. For the relevant assets the transition provisions could treat the credit quality at the date of initial application as though it were the initial credit quality. In effect, the credit quality at application of the new impairment model would be deemed to be the initial credit quality and the impairment accounting would be as if the assets were initially recognised on the date the new impairment model is first applied. As a result, at the date of initial application all relevant financial assets would be allocated to Bucket 1. This would reduce the effect on equity of the initial transition to the new impairment model (as lifetime loss allowances would not be required to be established on transition) which some would likely view as beneficial.
25. This would be the least burdensome of the three alternatives to apply, as history is ignored. Deteriorations or improvements in credit quality would be considered subsequent to the date of initial application of the new model to assess future transfers, so the deterioration concept implicit in the model would be retained albeit not assessed relative to the real initial credit quality.

⁵ The first criterion in the transfer notion is that transfer from Bucket 1 to Buckets 2 or 3 occurs 'when there is a more than insignificant deterioration in credit quality since initial recognition'. This clearly cannot be applied when the credit quality at initial recognition is not known.

⁶ Paragraphs 29-34 of Agenda Paper 6B from the December 2011 meeting discuss this criterion in more detail.

26. However, this transition approach would ignore deteriorations or improvements in credit quality since initial recognition. For assets that have deteriorated more than insignificantly since initial recognition, this approach would result in a worse credit quality acting as the reference point for the transfer notion. Even if these assets initially and/or subsequently meet the second criterion in the transfer notion, they could nonetheless be categorised in Bucket 1 even if they would have been in Bucket 2 or 3 if the new model had been applied since the initial recognition of that asset. This would make it possible for very low credit quality assets to be categorised into Bucket 1 (including in the extreme those with incurred losses) unless and until there is another (probably very slight) deterioration in credit quality.
27. The opposite would be true for assets whose credit quality has improved more than insignificantly since initial recognition—the transfer notion would be evaluated by reference to a better credit quality than at initial recognition. If these assets meet the second criterion in the transfer notion, they could be categorised in Buckets 2 or 3 even though they could have been in Bucket 1 if the new model had always been applied (if their credit quality has not suffered more than insignificant deterioration since initial recognition).
28. Given the above, all else being equal, resetting the credit quality on transition would reduce the incentive to obtain information for deteriorated assets, and would increase the incentive for assets whose credit quality has improved.

Classification in Bucket 2 or 3 until derecognition

29. Under this alternative the relevant assets would be categorised in Buckets 2 or 3 at the date of initial application and stay in that category until derecognition. Thus a lifetime expected loss based allowance would always be recognised.
30. This alternative would be relatively simple to apply because there would be no requirement to analyse changes in credit quality at transition nor over the life of these assets.
31. However, not only does this alternative ignore deteriorations or improvements in credit quality since initial recognition, it continues to ignore changes in credit quality until the assets are derecognised. This is inconsistent with the overall model which is designed to reflect changes in credit quality by applying the transfer notion. This approach would also

mean that assets that are of high credit quality would have lifetime expected losses recognised, even if that credit quality is actually better than that on initial recognition of the financial asset.

Modifying the transfer notion

32. Alternatively, for financial assets for which the credit quality at initial recognition is not used, the transition provisions could require them to be evaluated only on the basis of the second criterion in the transfer notion. That is, the assets would be classified in Buckets 2 or 3 when the likelihood that the contractual cash flows may not be recoverable is at least reasonably possible. In this case, assets could be initially classified into Buckets 2 or 3 when they had not experienced a more than insignificant deterioration in credit quality since initial recognition.
33. A consequence of this approach is departure from the credit deterioration aspect of the model—a lifetime loss would be recognised for assets of weaker credit quality even though they may not have deteriorated.
34. This alternative should be relatively simple to apply because it would not require any assessments of deteriorations or improvements in credit quality for these assets relative to initial credit quality. It also relies on a notion that is already present in the model. In addition, it corresponds with credit risk models in that credit quality is assessed as at a reporting date, so transition to the model should be easier.
35. This approach also considers the likelihood of collecting the contractual cash flows both at and after the date of initial application.
36. Moreover, this approach sets the correct incentives to encourage the use of actual data. This is because a lifetime allowance would be required for *all* financial assets for which the absolute criterion is met, even though some of them would otherwise have only a 12-month allowance because they have not experienced more than insignificant credit deterioration since initial recognition. This should encourage entities to obtain initial credit information.
37. However, this alternative would not consider credit deterioration since initial recognition in determining the allowance measure. The boards included the first criterion in the transfer

notion because they felt it was appropriate to continue to recognise only 12-month expected losses on assets that have a credit quality that is not more than insignificantly worse than on initial recognition. Under this approach of modifying the transfer notion, lifetime expected losses would always be recognised for an asset that was always of low credit quality, even if it had been priced to reflect that risk. The impairment allowance would thus not properly reflect application of a credit deterioration impairment model. It would also have a more negative impact for those whose business model results in them originating or purchasing a high portion of financial assets with high credit risk.

Staff recommendation

38. The staff recommend that for the relevant assets for which initial credit quality information is not used, the transfer notion should be modified so that it is based only on the second criterion in the transfer notion. That is, the relevant assets would be classified for impairment purposes from transition based on whether or not it is at least reasonably possible that the contractual cash flows may not be recoverable.
39. If entities use the initial credit quality at transition but apply the transition relief for relevant assets as discussed in the following section, the approach would be ‘modified retrospective’.

Question 1—Transition provisions if credit quality at initial recognition is not used

Does the Board agree with the staff recommendation in paragraph 38 that if the credit quality at initial recognition is not used at the date of initial application, the transition provisions should require these financial assets to be evaluated only on the basis of the second criterion in the transfer notion?

Determining the relevant assets

40. In some situations the initial credit quality of existing assets may be available, although it would be very burdensome to obtain. If the general provisions in IAS 8 were followed, the initial credit quality would be required to be used unless **impracticable**. This is a high hurdle and it might be the case that entities could be required to exert considerable effort to obtain this information. This raises the question of whether a broader group of assets should

be considered relevant assets for which initial credit quality information is not required to be used on transition.

41. In determining that the relevant notion in IAS 8 should be impracticability, an alternative such as ‘undue cost or effort’ was also considered. This approach was proposed but not used, because as BC23-24 states, the Board was concerned that an exemption based on undue cost or effort was too subjective to be applied consistently by different entities, and balancing benefits and costs is the task of the Board rather than of preparers. Consequently, the staff believe that the alternative to the impracticability threshold would be to allow entities a choice of whether to use information about initial credit quality on transition.
42. Modifying the transfer notion as recommended by the staff (paragraphs 32–37) would result in credit deterioration or improvement relative to initial credit quality being ignored for those assets. This is inconsistent with the transfer notion in the proposed impairment model. The inconsistency would cause (perhaps significant) incomparability between assets for which the initial credit quality is used and those for which it is not, which would persist until the derecognition of all assets for which the initial credit quality was not used. This could be a long period depending on the life of the assets in question, and it would increase the lead time until the new impairment model is (fully) applied to all assets, which is incompatible with the urgency of this project (paragraph 48 below). However, the proposed approach still provides information on changes in the assessment of whether it is at least reasonably possible that the cash flows will not be collected.
43. The staff note the tension between:
 - (a) the burden on preparers in being required to use initial credit quality data that is available, but that would be very burdensome to use at transition because it has not previously been required to be collected for accounting purposes, and
 - (b) the increased non-comparability that would result from allowing entities to ignore the initial credit quality, which would delay the (full) application of the new impairment model, potentially for a significant period of time.

44. The staff note that the Board cannot give an ‘undue cost or effort’ threshold for applying the modified transfer notion, because according to IAS 8 an evaluation of cost or effort is a task for the Board and not for preparers. Consequently, it would seem that the only choices are requiring the use of initial credit quality unless impracticable, or allowing entities the option on transition of whether to use information about initial credit quality or not.
45. Some staff place more weight on the burden to preparers and therefore think that entities should be allowed the option of whether or not to use initial credit quality for assets subject to impairment accounting at the date the new impairment model is initially applied. Other staff place more weight on the potentially significant non-comparability and the increase in lead time until the new model would be (fully) applied, and therefore think that information about initial credit quality should be used unless impracticable.
46. Consequently, the staff do not have a recommendation as to whether the initial credit quality should be required to be used at transition.

Question 2—When should entities apply the transition relief and thus not use initial credit quality information?

When does the Board think entities should obtain relief from using the initial credit quality at the date of initial application to the new model, on the basis of the considerations in paragraphs 40–46?

Hindsight and comparative periods

47. As reflected in IAS 8, retrospective application (including the restatement of comparative periods) is the preferred approach to transition. One issue with retrospective application for the new impairment model would be the risk of hindsight being used to determine the amount of expected losses in prior periods and applying the transfer criteria in prior periods to determine whether assets should be in Bucket 1 or Buckets 2/3. One way to address this issue would be to consider allowing a long lead time between the issue of the new impairment requirements and the mandatory effective date so that expected losses could be calculated for comparative periods so that restated comparative information could be provided.
48. However, in considering a longer lead time, the staff note the urgency of this project. It was placed on the Board's agenda in order to improve financial instruments accounting quickly as recommended by the G20, the Financial Stability Board (FSB), and the Financial Crisis Advisory Group (FCAG). However, establishing a lead time that would enable the impairment model to be applied on a retrospective basis, including providing restated comparative information, in a way that addresses the risk of hindsight, would result in a significant delay between the issue of the final requirements and their mandatory application. This is because:
- (a) Outreach so far has indicated that entities may need as long as two to three years to prepare for implementation of the credit deterioration impairment model.
 - (b) Although IFRSs require only one comparative period to be presented, many jurisdictions require more prior periods to be presented.
49. Also, to date the Board has decided that it should pursue an approach of requiring the same mandatory effective date for all phases of the project to replace IAS 39. Introducing a long lead time for the impairment phase would therefore also affect the mandatory effective date of the classification and measurement and hedge accounting requirements, or it would necessitate reconsidering requiring the same mandatory effective date for all phases of the project. Given that each phase has been designed with previous IFRS 9 requirements in

mind, having different mandatory effective dates for different project phases would add complexity and have potential knock-on effects (see further Agenda Paper 6C from this meeting).

50. In addition, requiring restatement of comparative periods for impairment would require running two models in parallel which would be very burdensome, at least for some entities.
51. Another approach to address the problem of hindsight would be to prohibit the restatement of prior period(s). Then entities would not be ‘looking back’ to determine expected losses in prior periods.
52. At the beginning of the period in which the new model is initially applied, the allowance amount would be adjusted to be in accordance with the new impairment model at that date, with an offsetting entry to opening retained earnings. If the Board agrees with the earlier staff recommendations in this paper the model would still be applied on a (modified) retrospective basis as the initial allowance balances would be determined (subject to the agreed relief) based on information about initial credit quality. Thus (subject to the agreed relief) the initial credit quality would be used to determine whether on transition allowance balances reflect lifetime or 12-month loss expectations. A prohibition from restating comparatives would just mean that the allowance balances resulting from applying the new model would only be reflected in the financial statements from the date of initial application.

Staff recommendation

53. The staff recommend that the issue of hindsight be addressed by prohibiting the restatement of prior period(s).

Question 3—Prohibition on providing comparatives

Does the Board agree with the staff recommendation in paragraph 53 that the restatement of comparative periods should be prohibited?

Other transition issues

IAS 8

54. When the initial application of an IFRS has an effect on the current period or on any prior period, paragraph 28(f) of IAS 8 requires an entity to disclose, for the current and each prior period presented, the amount of any adjustment on the initial application of an IFRS for each financial statement line item.
55. This requirement is the subject of an ongoing workstream. Notwithstanding that workstream, in the following paragraphs the staff have analysed the considerations of applying this requirement specifically to this project.

Prior periods

56. Requiring these disclosures for prior periods would, in effect, undo the effect of prohibiting comparative restatement and reintroduce the issues regarding hindsight. Consequently, the staff recommend that the disclosures in paragraph 28(f) of IAS 8 should be prohibited for prior periods when initially applying the new impairment model.

Question 4—IAS 8 paragraph 28(f) disclosures for prior periods

Does the Board agree with the staff recommendation in paragraph 56 that the disclosures in paragraph 28(f) of IAS 8 should be *prohibited* for prior periods when initially applying the new impairment model?

Current period

57. The ‘current period’ would refer to the reporting period containing the date of initial application of the new impairment model.
58. The staff note on the one hand that this disclosure would provide a basis for comparison between the IAS 39 impairment model and the new impairment model in the current period, which would not be available for prior periods if the staff recommendation in paragraph 53 is accepted and prior periods are not restated for impairment.
59. On the other hand, the staff note that this would require entities to continue applying the IAS 39 impairment model, even after they have made the transition to the new model. Some

might question why this would be appropriate if the new model results in more useful information. Applying two models in parallel would also be burdensome.

60. The staff do not have a recommendation in this section. Instead, we are asking the Board whether the requirements in IAS 8 paragraph 28(f) should apply in the reporting period containing the date of initial application of the new impairment model.

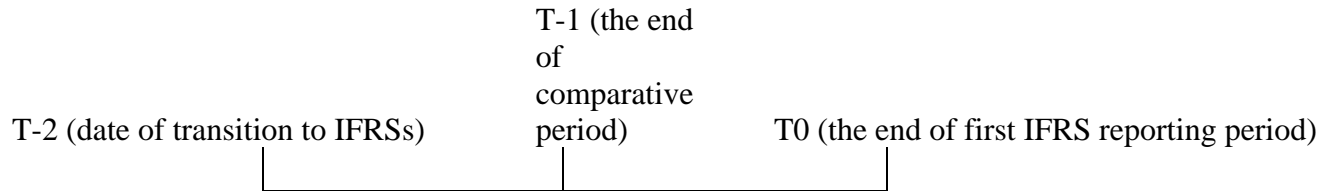
Question 5—IAS 8 paragraph 28(f) disclosures for the current reporting period

Does the Board want the disclosures in paragraph 28(f) of IAS 8 to be required for the current period when initially applying the new impairment model?

First-time adopters

61. Generally, that staff believe that IFRS 9 transition provisions for entities that apply IFRSs for the first time should be the same as for entities already applying IFRSs. However, the staff acknowledge that there are unique considerations for first-time adopters that arise due to the interaction of IFRS 1 *First-time Adoption of International Financial Reporting Standards* with the proposed approach to presentation of comparative information under IFRS 9⁷.
62. Specifically, IFRS 1 requires the first IFRS financial statements, *including the comparative information* (ie from T-2 to T0 on the figure below), to be prepared under consistent accounting policies that must comply with each IFRS effective *at the end* of the first IFRS reporting period (T0 on the figure below).

⁷ Refer to paragraphs 36-40 of this paper and paragraphs 47-53 of Agenda Paper 5G. The soon-to-be-issued hedge accounting requirements is generally prospective so they generally would not result in the restatement of comparatives, subject to specific exceptions.



63. IFRS 9 applies to annual periods beginning on or after 1 January 2015. Therefore, a first-time adopter that prepares its first IFRS financial statements for the calendar year 2015 would be *required* to reflect IFRS 9 in their financial statements from 1 January 2014 (ie for both reporting and comparative years). In contrast, an entity that already applies IFRSs would only be required to apply IFRS 9 from 1 January 2015 if the Board follows the staff recommendation and the restatement of comparative information under IFRS 9 is not allowed for existing preparers.
64. The staff believe that the Board will need to consider transition to IFRS 9 for first-time adopters once the re-deliberations of this project and of the limited modifications to IFRS 9 and the impairment project progress sufficiently to make sure that first-time adopters of IFRSs are given sufficient lead time for the adoption of IFRS 9 and are not disadvantaged compared to existing preparers. Until that time, if a first-time adopter of IFRSs chooses to early apply an available version of IFRS 9, it would follow the current requirements in IFRS 1 that relate to IFRS 9⁸.

⁸ These provisions will require IFRS 9 to be applied as at T-2 in the diagram above.

Appendix A: Transition provisions of the original IASB impairment ED

What was proposed and why

- A1. In developing the transition approach for those proposals, the IASB noted that the transition involved a trade-off between the most useful information (which implies retrospective application) on the one hand and operational challenges and potential use of hindsight (which implies prospective application) on the other hand.⁹
- A2. The IASB rejected fully retrospective application, because it was unlikely that many entities had performed the estimates necessary to apply the proposed approach in the past, and it was therefore concerned about hindsight.
- A3. The IASB also rejected fully prospective application. In order to apply the proposed approach prospectively, entities would have had to adjust the amortised cost of financial assets already on their statement of financial position at the transition date. This adjustment would be necessary because the proposed approach ‘coupled’ the measurement and presentation of interest revenue with the initial expected impairment losses. This adjustment could not be made to financial assets on the statement of financial position at the transition date, because this would necessitate retrospective application (see previous paragraph). Consequently, the IASB noted that using prospective application would mean ‘phasing in’ the proposed approach only for newly-recognised financial assets over a period that depends on the nature of the financial instruments of each entity.
- A4. Because of the reasons in the preceding paragraphs, the IASB proposed a transition approach that would determine an adjustment to the effective interest rate previously determined in accordance with IAS 39, with the objective that the adjusted rate would approximate the effective interest rate that would have been determined under the proposed approach. In determining that adjustment, entities would have had to use all available historical data and supplement them as needed with information for similar financial instruments for which the expected effective interest rate under the proposed approach has been determined (ie

⁹ Paragraphs BC65–BC77 of the original IASB impairment ED.

instruments originated or acquired near transition). This principle could be applied in different ways, for example by using ratio analysis.

Feedback received on the original IASB ED

A5. The feedback on the original IASB ED resulted in ‘decoupling’ interest recognition from impairment, and therefore a detailed discussion of the proposed transition provisions was not pursued.