

STAFF PAPER

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Introduction

1. In July 2012 the IASB asked the staff to consider the application of the disclosures in the proposed impairment model to entities applying the simplified approach for trade receivables and lease receivables (the ‘simplified approach’).
2. The purpose of this paper is to identify disclosures in the three-bucket model that are applicable to entities applying the simplified approach. In doing so, it will set out:
 - (a) the background and reasoning for the simplified approach;
 - (b) an analysis of disclosure requirements currently proposed in the three-bucket impairment model that would be applicable for the simplified approach; and
 - (c) the interaction of those disclosure requirements with the disclosure requirements for lease receivables in the Leases project.
3. The staff recommend that the disclosures previously tentatively decided for general impairment accounting are applicable to entities applying the simplified approach to the extent they apply to the measurement of lifetime expected losses.
4. In addition to the above, the staff recommend the following amendments to the disclosures:

- (a) to meet the requirements for the disclosure of their risk profile entities applying the simplified approach may use provision matrices as a basis for the disclosure (Appendix A disclosure 11);
- (b) assets accounted for under the simplified approach are exempt from the disclosure of modifications until they are 30 days past due; and
- (c) lease receivables are additionally excluded from the qualitative description of the disclosure of collateral.

Simplified approach for trade and lease receivables

5. During the February, April and May 2012 meetings the IASB tentatively decided that a simplified form of the three-bucket model would apply to trade receivables and lease receivables.
6. The Boards tentatively decided that trade receivables without a significant financing component in accordance with the revised ED 2011/6 *Revenue from Contracts with Customers* (the Revenue ED):
 - (a) would be initially measured at the transaction price as defined in the Revenue ED; and
 - (b) would have an impairment allowance measurement objective of lifetime expected losses on initial recognition and throughout the life of the asset.
7. For trade receivables with a significant financing component and lease receivables within the scope of the proposed leases model and IAS 17 *Leases*, the IASB tentatively decided that entities can make a policy election to use an impairment allowance measurement objective of lifetime expected losses at initial recognition and throughout the life of the asset.

Basis

8. Despite the disadvantage of reduced comparability due to different accounting for trade and lease receivables as compared to other financial assets, the IASB concluded that the advantages for the proposed simplified approach were

significant enough to allow different requirements for these assets. Advantages identified included that:

- (a) operational relief would be provided to non-financial institutions, due to the difficulty in calculating 12-month expected losses for assets with a longer maturity; and
- (b) entities would not be required to track credit migration on these instruments.

9. It was additionally noted that applying the simplified approach to trade receivables without a significant financing component was consistent with the Revenue ED's practical expedient of allowing entities to recognise revenue based on the undiscounted invoice amount.

Analysis of disclosures

10. Based on recommendations in Agenda Paper 5A *Impairment – Disclosures* at the July 2012 joint Board meeting, the IASB considered two objectives for proposed disclosures:
- (a) **Expected Loss Objective:** To disclose information about the expected credit losses for an entity's financial assets within the scope of the impairment model
 - (b) **Credit Migration Objective:** To enable users to understand the credit quality migration of financial assets within the scope of the impairment model
11. These original objectives are reflected in the current disclosure objectives of the three-bucket model, which state that an entity shall disclose information about:
- (a) All amounts arising from financial assets at amortised cost; and
 - (b) The effect of deterioration and improvements in credit quality of financial assets.
12. The staff has analysed and provided commentary on all disclosure requirements in the current impairment model as they relate to assets under the simplified

approach in Appendix A. In doing so, we have identified two disclosures that require more detailed analysis:

- (a) Disclosure of the credit risk profile of an entity's assets (paragraphs 14 – 18); and
 - (b) Disclosure of modifications to financial assets (paragraphs 19 – 23).
13. The staff have also compared the proposed disclosure requirements with the proposed disclosure requirements for lease receivables in the Leases project to limit duplication and overlap (paragraphs 24 – 32).

Disclosure of entity's risk profile

14. In July 2012 the IASB tentatively decided that entities should disaggregate the carrying amount of financial assets into relevant risk categories (along with a description of how the entity determines those categories). The purpose of requiring an entity to disclose the gross carrying amount of financial assets by risk categories is to provide users with information about the entity's credit risk profile for its assets at a given point in time and to help show trends of credit migration, from which more forward-looking assumptions can be inferred.
15. In April 2012 the Boards tentatively decided to allow the use of a provision matrix as a practical expedient to calculate expected losses on trade receivables. The decision to incorporate this was based on the April 2012 meeting which noted that many entities use a provision matrix to estimate their incurred credit losses on portfolios of trade receivables. When extended to the expected credit loss model, the provision matrix remains a useful expedient for non-financial institutions.
16. In the staff's view, the provision matrix can be a useful expedient for the disclosure of the disaggregation of an entity's financial assets by credit risk. The disclosure of the provision matrix will help a user understand the quality of an entity's financial asset portfolio and assess credit migration. However, requiring the disclosure of provision matrices may be unnecessary.
17. One argument against their disclosure is that users already have the resources and analytical tools, e.g. the receivables turnover ratio, that can provide similar information. However, the precision of those tools can decrease as transactions

become more diverse, and there will be an increase in the benefit of disclosure that helps users understand the quality of an asset portfolio.

18. Another concern in requiring disclosure of provision matrices is that some entities may consider internal risk rating information to be proprietary, and would be reluctant to disclose such specificity. To address this and preserve an entity's proprietary information, it could only be required that the representative risk categories are based on, but not identical to, the internal provision matrix and other risk management information.

Disclosure of modifications

19. The disclosure of modifications for the general approach only requires disclosing modifications for financial assets with an allowance measured at lifetime expected losses. This in effect limits the scope of the disclosure to assets with deteriorated credit quality, and therefore assets that an entity would more likely have modified due to credit risk.¹ Also required to be disclosed is the gross carrying amount of assets which have been modified and have improved in credit quality to the point they migrate to the 12-month measurement objective. This disclosure is not applicable to assets using the simplified approach because it relates to credit migration within the general three-bucket model.
20. The staff note that the proposed disclosure requirements for modification may be burdensome for non-financial institutions and those implementing the simplified approach for trade and lease receivables. Of concern is that without an equivalent distinction for scope in the simplified approach, the disclosure captures all modifications for trade and lease receivables. Trade and lease receivables may however be subject to modifications in terms due to numerous commercial reasons aside from those related to credit deterioration.
21. In particular for leases, the staff note that under proposed requirements in the Leases project an entity recognises a new lease when a modification to contract terms substantially changes the existing lease. The staff have noted that there is generally a low occurrence in practice of lease modifications that would not be

¹ The staff recommend not scoping the disclosures based on the reason for the modification as we have been told previously that this is operationally challenging.

considered a substantial change, particularly for credit reasons and for leases to which the receivable and residual approach will apply. In some cases however the disclosure of modifications may be applicable (i.e. the original lease may continue to be recognised), therefore the staff do not make a differentiation from trade receivables for the proposed treatment.

22. To address issues of scope and operational complexity, entities using the simplified approach could be exempted from the disclosure of modifications. This would remove any need for entities to differentiate between terms modified due to credit and those modified for other reasons.
23. An alternative is to limit the disclosure of modifications for trade and lease receivables to a scope that will tend to capture more modifications that have occurred due to changes in credit quality. In this case the staff suggest to limit the disclosures to assets that are 30 days past due, which is consistent with the rebuttable presumption recommended in Agenda Paper 5C for recognition of lifetime expected losses under the general approach. The benefits of this approach would be to capture modifications that would more likely be due to changes in credit quality and thus be most consistent with the disclosure requirements under the general approach.

Detailed analysis of lease receivables

24. According to the proposals in the Leases project, a lessor applies either:
 - (a) the receivable and residual approach if the lessee is expected to consume more than an insignificant portion of the economic benefits of the underlying asset; or
 - (b) an approach similar to operating lease accounting if the lessee is not expected to consume more than an insignificant portion of the economic benefits of the underlying asset. A lessor does not recognise a lease receivable under this approach.
25. According to the receivable and residual approach, at commencement of a lease the lessor recognises a lease receivable and a residual asset. The boards tentatively decided that the lease receivable is subject to impairment accounting for financial

instruments. The residual asset, representing rights to the underlying asset retained by the lessor, remains subject to the impairment accounting for non-financial assets in IAS 36 *Impairment of Assets*.

26. The staff have analysed disclosure proposals in the Leases project to limit duplication and overlaps. There are two disclosures identified that interact with both the Leases project and the three-bucket model:
- (a) Reconciliation of opening and closing balance
 - (b) Collateral

Reconciliation of opening and closing balance

27. The Leases project will require the following disclosure relating to lease receivables:

A lessor shall disclose a reconciliation of the opening and closing balances of the lease receivable. The reconciliation shall include items that are useful in understanding the change in the lease receivable, which may include but are not limited to:

...

- (g) impairment.

28. This is in comparison to the current reconciliation disclosure in the three-bucket model:

An entity shall provide a reconciliation from the opening balance to the closing balance for the net carrying amount of financial assets at amortised cost, showing separate reconciliations for the gross carrying amount and associated impairment allowance for:

...

- (b) financial assets with an expected loss allowance measured at lifetime expected losses. In addition to the reconciliation for these assets, an entity shall disclose the gross carrying amount, related allowance and interest revenue for financial assets for which interest revenue is calculated on a net basis.

...

29. The reconciliation in the Leases project limits the disclosure of the impairment to a single line item that only shows any impairment recognised during the period, and does not include the opening or closing balances of the impairment allowance. For this reason, the reconciliation requirement for the allowance balance in the three-bucket model is still relevant and applicable. However, the lease receivables should be exempt from the requirement to disclose the reconciliation of the gross carrying amount.

Collateral

30. The lease receivable is “collateralised” by the underlying asset, because the lessor owns the asset and in the event of default it could be reclaimed. The amount of the underlying asset representing collateral for the lease receivable is linked to the right-of-use asset.² The other portion of the underlying asset from the lessor’s perspective – the residual asset – is considered separately for purposes of impairment.

31. The three-bucket model requires for collateral the disclosure of:

If an entity holds collateral as security or other credit enhancements, it shall disclose:

- (a) a description of the collateral held as security and other credit enhancements, including a discussion of the quality of collateral held and an explanation of any changes in quality as a result of deterioration or changes in policies of the reporting entity;
- (b) for financial assets that meet the [incurred loss criteria], quantitative information regarding the extent to which collateral and other credit enhancements reduce the severity of loss; and
- (c) the gross carrying amount of fully collateralised financial assets.

32. The staff consider the collateral disclosure to be partially applicable to lease receivables. The disclosure of information in (b) regarding the severity of loss is applicable because the right-of use portion of the underlying asset functions as collateral, and it is relevant to understand the effect it will have in reducing the

² The right-of-use asset is the amount that represents the lessee’s right to use the underlying asset for the lease term.

severity of loss if the lessor were to default on the lease receivable. The disclosure of the carrying amount of collateralized assets in (c) is applicable, but only in some cases. Leased assets to which the receivable and residual approach applies (ie mainly, equipment and vehicles) typically depreciate rapidly in the early part of their economic lives. Accordingly, when lease payments are made evenly over the lease term, a lease receivable is likely to be only partially collateralised by the leased asset. The description of collateral in (a), however, overlaps with what is already disclosed about leased assets (ie the qualitative disclosures about the nature of a lessor's leasing activities). (a) is not a complete duplication, however there is substantial overlap to the point the staff believe there is a low marginal benefit of the additional disclosure. Accordingly, is the staff consider it to be unnecessary, and lease receivables should be exempt from (a).

Conclusion and staff recommendation

33. The application of simplified disclosures would be consistent within the context of the simplified impairment approach. The analysis of disclosures in Appendix A illustrates that:
- (a) the disclosures previously tentatively decided for general impairment accounting, reduced by excluding those related to the effect of deterioration and improvements in credit quality of financial assets, are applicable to entities applying the simplified approach; and
 - (b) these selected disclosures are applicable to the extent they apply to the measurement of lifetime expected losses.
34. This paper considers both trade receivables with and without a significant financing component. In the staff's view, depending on materiality, the disclosures would be relevant regardless of whether there is a significant financing component or not. The staff note that in the Revenue project the Board has not differentiated between disclosures on the basis of that distinction.
35. In addition to the above observations, the staff recommend the following amendments to the disclosures:

- (a) to meet the requirements for the disclosure of their risk profile entities may use provision matrices as a basis for the disclosure (Appendix A disclosure 11);
- (b) assets accounted for under the simplified approach disclose the effect of modifications for assets that are 30 days past due; and
- (c) lease receivables, due to their treatment under the Leases project, are additionally excluded from the qualitative description of the disclosure of collateral.

Question to the IASB

Does the IASB agree with the staff recommendations regarding disclosure requirements for entities applying the simplified approach? If not, what disclosures would the Board prefer, and why?

Appendix A: List of disclosures

Listed below are all disclosure requirements for the proposed impairment model alongside staff commentary regarding their relevance to the simplified approach applicable to trade and lease receivables.

Disclosure requirement	Application to simplified approach
<p>Objectives</p> <p>1 An entity shall disclose information that identifies and explains:</p> <p>(a) the amounts in its financial statements arising from financial assets at amortised cost; and</p> <p>(b) the effect of deterioration and improvements in credit quality of financial assets.</p> <p>2 To meet the objectives in paragraph 1, an entity shall consider all of the following:</p> <p>(a) the level of detail necessary to satisfy the disclosure requirements;</p> <p>(b) how much emphasis to place on each of the various requirements;</p> <p>(c) how much aggregation or disaggregation to undertake; and</p> <p>(d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.</p> <p>3 If the disclosures provided under the requirements in this Standard and other IFRSs are insufficient to meet the objectives in paragraph 1, an entity shall disclose additional information to meet those objectives.</p>	<p>The objectives have been set-up such that (a) applies the amounts resulting from the model, while (b) applies to the switch from 12 month expected loss and lifetime expected loss recognition</p> <p>Under the simplified approach disclosures supporting objective (b) would not be applicable</p>
<p>Classes of financial instruments and level of disclosure</p> <p>4 An entity shall group financial assets into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those <i>financial instruments</i> (including their grouping into portfolios). An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.</p>	<p>Classification and level of disclosure is applicable</p>
<p>Amounts arising from financial assets at amortised cost</p>	
<p>5 An entity shall provide a reconciliation from the opening balance to the closing balance for the net carrying amount of financial assets at amortised cost, showing separate reconciliations for the gross carrying amount and associated impairment allowance for:</p> <p>(a) purchased credit impaired assets. In addition to the reconciliation for these assets, an entity shall disclose the total amount of undiscounted expected losses at initial recognition.</p> <p>(b) financial assets measured at lifetime expected losses. In addition to</p>	<p>Disclosure (b) is applicable as it applies to lifetime expected losses.</p> <p>(c) is not applicable, and (a)</p>

<p>the reconciliation for these assets, an entity shall disclose the gross carrying amount, related allowance and interest revenue for financial assets for which interest revenue is calculated on a net basis.</p> <p>(c) financial assets measured at 12-month expected losses. In addition to the reconciliation for these assets, an entity shall disclose the gross carrying amount and related allowance of financial assets that are more than 90 days past due.</p>	<p>is applicable only in rare cases</p>
<p>6 An entity shall disclose its write-off policy, including whether assets that have been written off are subject to enforcement activity. In addition to including any write-offs and recoveries in the reconciliation under paragraph 5, an entity shall disclose the balance of financial assets written off for which the entity is still pursuing collection.</p>	<p>Disclosure is applicable</p>
<p>7 An entity shall disclose the following for financial assets that have been modified:</p> <p>(a) the gross carrying amount and the gain or loss resulting from a modification during the period for assets with an impairment allowance measurement of lifetime expected losses <u>(or for assets 30 days past due if applying the simplified approach)</u>; and</p> <p>(b) the gross carrying amount of these assets for which the impairment allowance measurement has changed from lifetime expected losses to 12-month expected losses.</p>	<p>Discussed in staff analysis – Staff recommend that (a) is scoped by the 30 days past due criterion</p> <p>(b) is not applicable</p>
<p>8 An entity shall explain the inputs and assumptions used in determining the amounts of 12-month and lifetime expected credit losses. For this purpose an entity shall disclose:</p> <p>(a) the basis of inputs (eg internal historical information or rating reports) and the estimation technique;</p> <p>(b) an explanation of the changes in estimates and the cause of the change (eg loss severity, change in portfolio composition, changes in volume of assets purchased or originated);</p> <p>(c) if there has been a change in estimation technique, disclosure of that change and the reason for the change; and</p> <p>(d) qualitative information regarding the discount rate selected.</p>	<p>Disclosure is applicable as it applies to lifetime expected losses</p>
<p>9 If an entity holds collateral as security or other credit enhancements, it shall disclose:</p> <p>(a) a description of the collateral held as security and other credit enhancements, including a discussion of the quality of collateral held and an explanation of any changes in quality as a result of deterioration or changes in policies of the reporting entity, <u>except for lease receivables</u>;</p> <p>(b) for financial assets that meet the [incurred loss criteria], quantitative information regarding the extent to which collateral and other credit enhancements reduce the severity of loss; and</p> <p>(c) the gross carrying amount of fully collateralised financial assets.</p>	<p>Discussed in staff analysis – for lease receivables this should be scoped to take into account the value of the right-to-use asset</p> <p>Lease receivables should be exempt from (a)</p>

10	An entity shall disclose quantitative and qualitative analyses of significant positive or negative effects on the impairment allowance that are caused by a particular portfolio or geographical area.	Disclosure is applicable
11	An entity shall disclose by credit risk rating grades the gross carrying amount of financial assets in a grade. An entity shall disclose this analysis separately for financial assets [with 12 month and lifetime expected losses]. The number of credit risk rating grades used for this disclosure shall be sufficient to enable users of the entity's financial statements to evaluate the extent of credit risk. The number of grades shall not exceed the number that the entity uses for internal credit risk management purposes and shall not be less than three. <u>For entities applying the simplified approach, this disclosure may be based on a provision matrix.</u>	Discussed in staff analysis – the staff propose the option of disclosing a provision matrix for entities applying the simplified approach
The effect of deterioration and improvements in credit quality of financial assets		
12	<p>An entity shall explain the inputs and assumptions used in determining whether financial assets meet the criteria [for recognition of lifetime expected losses and incurred losses]. For this purpose an entity shall disclose:</p> <ul style="list-style-type: none"> (a) the basis of inputs (eg internal historical information or rating reports) and the estimation technique; (b) an explanation of the changes in estimates and the cause of the change (eg loss severity, change in portfolio composition, changes in volume of assets purchased or originated); and (c) if there has been a change in estimation technique, disclosure of that change and the reason for the change. 	Disclosure is not applicable because entity would not need to apply criteria under the simplified approach
13	An entity shall disclose the gross carrying amount of financial assets for which the criteria for a lifetime expected loss are assessed on an individual basis and that [recognise lifetime expected losses].	Disclosure is not applicable because entity would not need to apply criteria under the simplified approach