# *Straight away*
# An overview of financial reporting developments

## *IASB and FASB seek comments on impairment models for financial assets*

*No. 2011-02*

*February 4, 2011*

### What's new?

The IASB and FASB (the "boards") have issued a "supplementary document" to their original proposals on impairment of financial assets. This document, titled by the IASB as *Financial Instruments: Impairment* (the "supplement"), proposes a common approach to recognizing credit losses on financial assets managed in an open portfolio, one of the more challenging aspects of the boards' impairment model. The supplement puts forth a common proposal, but also affords constituents the opportunity to provide feedback on alternative approaches.

### What are the key provisions?

#### Common proposal

The supplement proposes a dual impairment model for financial assets managed in an open portfolio, with credit losses determined based on the credit characteristics of financial assets. This model is consistent with how many financial institutions manage credit risk and is referred to herein as a "good book" and "bad book" approach. The distinction between the categories depends on the degree of uncertainty about collectability.

When collectability becomes so uncertain that the entity’s credit risk management objective changes from receiving regular payments to recovery, the financial asset would be evaluated in the bad book. Thus, financial assets could move between the good book and the bad book according to the entity’s internal risk management policies.

For financial assets in the good book, impairment would be recognized on a portfolio basis over the life of the portfolio, with the allowance account recognized at the higher of
(1) the time-proportionate expected credit losses and
(2) the credit losses expected to occur within the foreseeable future (but not less than 12 months).

The latter effectively creates a "floor" for the good book allowance. The supplement does not describe how to measure expected credit losses. However, it does illustrate how to calculate the time-proportionate expected credit losses.

For financial assets in the bad book, the boards have concluded it is not appropriate to recognize impairment losses over time. Instead, the entire amount of the lifetime expected credit losses would be recognized immediately.

### *Alternative approaches*

The common proposal is the result of joint discussions on an impairment model that addresses the primary objectives of the individual boards. However, some members of the IASB and FASB prefer the models that each board had been developing separately. Accordingly, the supplement also affords constituents the opportunity to provide feedback on the IASB and FASB alternative approaches.

Under the IASB alternative approach, an entity recognizes the time-proportionate lifetime-expected credit losses on a good book with no "floor" and the full amount of lifetime-expected losses on a bad book. Under the FASB alternative approach, an entity immediately recognizes all credit losses expected to occur in the foreseeable future, with no minimum period specified.

### *Scope*

The scope of the proposals is limited to financial assets in open portfolios. However, the boards are also inviting comments as to whether the proposed approach is suitable for closed portfolios, individual instruments and any other types of instruments (including short-term trade receivables). At this time, the boards are not re-exposing other aspects of the impairment model, such as measurement of credit losses or interest revenue recognition. They will continue re-deliberating these issues based on the feedback received from their original exposure drafts while the supplement is open for comment.

## Am I affected?

Although it's a joint project by IASB and FASB, but it can further affect Indian Accounting Standards (Ind AS) in near future which are going to be converged with IFRS.

The proposal will mainly affect financial institutions. However, the boards are seeking feedback on whether the proposals should be applied to other investments in debt instruments, which could significantly impact non-financial institutions.

## What do I need to do?

The comment deadline is April 1, 2011. The IASB expects to finalize the impairment requirements by June 2011. The FASB expects that a final standard, which includes the credit impairment model, will be issued in 2011.

If you have questions about this issue, please contact the PwC IFRS team or your engagement partner.