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Exposure Draft ED/2009/12

Financial Instruments: Amortised Cost and Impairment

Comments to be received by 30 June 2010



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Board®

Exposure Draft
**FINANCIAL INSTRUMENTS:
AMORTISED COST AND
IMPAIRMENT**

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Introduction and invitation to comment

Reasons for publishing the exposure draft

- IN1 IAS 39 *Financial Instruments: Recognition and Measurement* sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. The International Accounting Standards Board inherited IAS 39 from its predecessor body, the International Accounting Standards Committee.
- IN2 Many users of financial statements and other interested parties have told the Board that the requirements in IAS 39 are difficult to understand, apply and interpret. They have urged the Board to develop a new standard of financial reporting for financial instruments that is principle-based and less complex. Although the Board has amended IAS 39 several times to clarify requirements, add guidance and eliminate internal inconsistencies, it has not previously undertaken a fundamental reconsideration of reporting for financial instruments.
- IN3 In October 2008, as part of a joint approach to dealing with the reporting issues arising from the global financial crisis, the Board joined with the US Financial Accounting Standards Board (FASB) in setting up the Financial Crisis Advisory Group (FCAG). The FCAG was asked to consider how improvements in financial reporting could help enhance investor confidence in financial markets. The FCAG published a report in July 2009. In that report the FCAG identified delayed recognition of losses associated with loans (and other financial instruments) and the complexity of multiple impairment approaches as primary weaknesses in accounting standards and their application. One of the FCAG's recommendations was to explore alternatives to the incurred loss model that use more forward-looking information.
- IN4 Earlier, in April 2009, in response to the input received as a result of their work responding to the global financial crisis, and following the conclusions of the G20 leaders and the recommendations of international bodies such as the Financial Stability Board, the Board with the FASB announced an accelerated timetable for replacing their respective financial instruments standards.

The IASB's approach to replacing IAS 39

- IN5 The Board noted requests from interested parties that the accounting for financial instruments should be improved quickly. The G20 leaders recommended that the Board take action by the end of 2009 to improve

and simplify the accounting requirements for financial instruments. To achieve this, the Board divided its project to replace IAS 39 into three main phases. As the Board completes each phase, it will delete the relevant portions of IAS 39 and, along with its current project on the derecognition of financial instruments, create an IFRS that will eventually replace IAS 39. The Board published an exposure draft on derecognition in March 2009. As part of the first phase of replacing IAS 39 the Board published an exposure draft on classification and measurement in July 2009.

- IN6 This exposure draft proposes requirements for how to include credit loss expectations in the amortised cost measurement of financial assets. The Board decided to address this aspect as the second phase because the classification and measurement decisions from the first phase form the foundation for the measurement basis (including impairment). Moreover, as a result of its deliberations on impairment the Board decided to seek input on the feasibility and operational aspects of the expected cash flow approach before publishing an exposure draft. In June 2009 a Request for Information was posted on the IASB's website inviting views from interested parties by 1 September 2009. The IASB staff also obtained additional input on operational aspects through an extensive outreach programme.
- IN7 Responses to the Request for Information and the outreach programme particularly highlighted the difficulty of deriving estimates of expected cash flows over the life of the financial asset, which requires using historical data that might be difficult to obtain or not exist. However, the Board observed that estimation uncertainty and the necessity for management to use significant assumptions and judgement are not unique to the estimates of expected cash flows for the purpose of amortised cost measurement of financial instruments. IAS 1 *Presentation of Financial Statements* sets out several examples in the section about sources of estimation uncertainty. For example, other areas of financial reporting that often necessitate estimates involving management's difficult, subjective or complex judgement include estimating the recoverable amount of non-financial assets, provisions dependent on the outcome of litigation, restoration or decommissioning obligations that relate to actions that will be taken decades after the measurement date reflecting technology that will be available in the future, insurance obligations and pension obligations. The Board also noted that deriving fair values when observable market prices are not available also requires significant assumptions and judgement. The Board plans to seek the

advice of an expert advisory panel (see paragraph IN12) on the nature and extent of guidance necessary to derive the estimates of expected cash flows over the life of a financial asset.

- IN8 This exposure draft also addresses some of the concerns that the FCAG identified in its report. The proposed requirements would use more forward-looking information than the incurred loss model. They would also result in earlier recognition of credit losses because they avoid the delay resulting from the 'loss event' threshold of the incurred loss model.

Presentation of the contents of this exposure draft

- IN9 The proposals in this exposure draft would replace the amortised cost (including impairment) requirements in IAS 39 for financial instruments. The proposals would also result in consequential amendments to other IFRSs and to the guidance on those IFRSs. For the convenience of readers, all proposed amendments are set out in this booklet. The Basis for Conclusions is set out in a separate booklet.
- IN10 In order to promote discussion of the proposals, the publication of the exposure draft is accompanied by numerical examples of the calculation mechanics on the IASB website (in the section for the project to replace IAS 39, second phase regarding impairment of financial assets). The examples were prepared by the IASB staff and do not form part of this exposure draft.

Next steps

- IN11 The Board plans to develop an IFRS from the proposals in this exposure draft. The Board expects that the IFRS will be published in 2010 and would be available for early application. However, the Board expects that the IFRS will not become mandatory until about three years after it is issued. This reflects the Board's acknowledgement that implementing the proposed approach would require a substantial lead-time.
- IN12 The Board also plans to form an expert advisory panel that will advise the Board on the operational aspects of implementing the proposals and help the Board to undertake some field testing. That panel would also help the Board identify further practical expedients.
- IN13 The Board and the FASB are committed to working together to develop a comprehensive standard to improve the measurement and reporting of financial instruments. The Board has chosen to complete the project in three phases. However, the FASB believes that it will be important to its constituents to be able to comment on a proposed standard including

classification, measurement, impairment and hedge accounting at the same time. It is not uncommon for the boards to deliberate separately on joint projects and then subsequently to reconcile any differences in their technical decisions.

Summary of the proposals and invitation to comment

The Board invites comments on all matters in this exposure draft, and in particular on the questions set out in the following paragraphs. Respondents need not comment on all of the questions. Comments are most helpful if they:

- (a) respond to the questions as stated
- (b) indicate the specific paragraph or paragraphs to which the comments relate
- (c) contain a clear rationale
- (d) describe any alternatives the Board should consider.

The Board is not seeking comments on aspects of IAS 39 not addressed in this exposure draft.

Comments should be submitted in writing so as to be received no later than **30 June 2010**.

Objective of amortised cost measurement (paragraphs 3–5)

The exposure draft proposes stating the objective of amortised cost measurement. The proposed description of the objective is ‘to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument.’ The exposure draft further expands on that objective by clarifying:

- that amortised cost is a measurement that combines current cash flow information at each measurement date with a valuation of those cash flows that reflects conditions on initial recognition of the financial instrument; and
- the types of amounts that are allocated over the expected life of the financial instrument (including for a financial asset the initial estimate of expected credit losses).

Question 1

Is the description of the objective of amortised cost measurement in the exposure draft clear? If not, how would you describe the objective and why?

Question 2

Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

Measurement principles (paragraphs 6–10)

The exposure draft proposes to underpin the objective of amortised cost measurement with measurement principles. These are:

- (a) Amortised cost shall be calculated using the effective interest method. Hence, amortised cost is the present value of the expected cash flows over the remaining life of the financial instrument discounted using the effective interest rate.
- (b) The estimates of the cash flows are expected values at each measurement date. Hence, estimates of amounts and timing of cash flows are the probability-weighted possible outcomes.
- (c) The effective interest method is the allocation mechanism for interest revenue and interest expense. The effective interest rate used for this purpose reflects the nature of the financial instrument's interest (type of interest formula), ie what part of the contractual interest rate (if any) is reset.

The requirements in IAS 39 for calculating amortised cost and the effective interest rate are mainly included in the definition of terms and some paragraphs in the application guidance. The definitions in IAS 39 are, in essence, measurement guidance rather than a definition. Most of the guidance reflects application of the effective interest method to fixed rate instruments. The exposure draft would establish principles for the amortised cost calculation and elevate some guidance to the main body of the standard. The lengthy definitions in IAS 39 would be shortened. The measurement principles would apply to both fixed rate and variable rate instruments. Overall, the exposure draft would provide a more principle-based approach to establishing measurement requirements for amortised cost.

Question 3

Do you agree with the way that the exposure draft is drafted, which emphasises measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

Question 4

- (a) Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?
- (b) Are there any other measurement principles that should be added? If so, what are they and why should they be added?

Objective of presentation and disclosure (paragraphs 11 and 12)

The exposure draft proposes stating the objective of presentation and disclosure in relation to financial instruments measured at amortised cost. The proposed description of the objective is providing ‘information that enables users of the financial statements to evaluate the financial effect of interest revenue and expense, and the quality of financial assets including credit risk.’ The exposure draft further emphasises the importance of explaining to users of the financial statements the overall effect on the entity’s performance and financial position and the interaction between different aspects of the information provided (including a discussion of the causes of both that overall effect and any interaction between different aspects).

Question 5

- (a) Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the exposure draft clear? If not, how would you describe the objective and why?
- (b) Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the exposure draft is appropriate? If not, why? What objective would you propose and why?

Presentation (paragraph 13)

The exposure draft proposes the following line items to be separately presented in the statement of comprehensive income:

- (a) gross interest revenue (calculated using the effective interest method before taking into account expected losses);
- (b) the effect of allocating the initial expected credit losses, which shall be presented as a reduction of gross interest revenue (item (a) above);
- (c) net interest revenue (the subtotal of items (a) and (b) above);
- (d) gains and losses resulting from changes in estimates in relation to financial assets and liabilities that are measured at amortised cost; and
- (e) interest expense (calculated using the effective interest method).

The measurement approach proposed in the exposure draft would require an entity to take into account the initial estimate of expected credit losses when calculating amortised cost and to allocate that amount over the expected life of a financial asset. The proposed presentation requirements reflect that proposed measurement approach and are designed to provide transparency about the different factors that affect interest revenue, interest expense and experience adjustments from revising cash flow estimates.

Question 6

Do you agree with the proposed presentation requirements? If not, why? What presentation would you prefer instead and why?

Disclosure (paragraphs 14–22)

In order to meet the objective for disclosures (see Questions 5 and 6) the exposure draft proposes to require:

- (a) mandatory use of an allowance account to account for credit losses with disclosure of a reconciliation and the entity's write-off policy.
- (b) disclosures about estimates and changes in estimates, including:
 - (i) information about inputs and assumptions used in determining credit losses;
 - (ii) disaggregation of gains and losses resulting from changes in estimates and an explanation of those changes; and

- (iii) information that compares the development of the credit loss allowance over time with cumulative write-offs together with a qualitative analysis if the effect of changes in estimates is significant.
- (c) disclosure of stress testing information if an entity prepares such information for internal risk management purposes.
- (d) disclosures about the quality of financial assets that reconcile changes in an entity's non-performing assets with supplementary qualitative information.
- (e) information about the origination and maturity of financial assets (vintage information).

The exposure draft would require disclosures about amounts presented in the statement of comprehensive income, inputs and assumptions used for determining credit loss estimates, and the quality of financial assets measured at amortised cost. The proposed disclosure requirements reflect that the amounts in the statement of financial position and the statement of comprehensive income, in isolation, are not sufficient to allow users of financial statements to evaluate the effects of financial instruments on an entity's financial position and performance as well as its related risk exposures.

Question 7

- (a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirement do you disagree with and why?
- (b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?

Effective date and transition (paragraphs 23–29)

The Board will review the effective date in due course, but expects that the IFRS will not become mandatory until about three years after it is issued. The Board expects to permit early application of the IFRS.

The exposure draft proposes specific requirements in paragraphs 24–27 for transition to the proposed IFRS. In its deliberations leading to the exposure draft, the Board also considered an alternative simplified transition approach that would use the original effective interest rate determined in accordance with IAS 39 rather than an adjusted effective interest rate as set out in paragraph 25 (alternative transition approach). The Board preferred the proposed approach because it provides more relevant information. The discount rate used in the proposed approach is closer to the effective interest rate that would have been determined in accordance with the proposed measurement approach had it been

applied retrospectively. The Board believed the benefit of more relevant information would outweigh the additional complexity and cost of preparing that information. The Board also considered providing an exemption from the requirement to provide comparative information in accordance with the proposed requirements in the year of initial application. However, the Board believed that the benefit of comparative information that uses the proposed requirements would outweigh the additional complexity and cost of preparing that information.

The exposure draft also proposes specific disclosure requirements in paragraphs 28 and 29 in relation to transition.

Question 8

Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?

Question 9

- (a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?
- (b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?
- (c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.

Question 10

Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

Practical expedients (paragraphs B15–B17)

The exposure draft proposes guidance on practical expedients for calculating amortised cost. It sets out principles that practical expedients would have to be consistent with and provides two examples of practical expedients:

- (a) using a provision matrix for trade receivables.
- (b) using two separate present value calculations to determine amortised cost.

The exposure draft includes practical expedients in order to facilitate cost-effective ways of determining amortised cost for situations in which a simplified calculation is an appropriate approximation of the outcome that would result from applying the effective interest method as proposed in the exposure draft.

Question 11

Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

Question 12

Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements, and what is the basis for your assessment?

[Draft] International Financial Reporting Standard X *Financial Instruments: Amortised Cost and Impairment* ([draft] IFRS X) is set out in paragraphs 1–29 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

[Draft] International Financial Reporting Standard X Financial Instruments: Amortised Cost and Impairment

Objective

- 1 The objective of this [draft] IFRS is to establish principles for the measurement at *amortised cost* of *financial assets* and *financial liabilities* that will present useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of future cash flows. The principles in this [draft] IFRS complement the principles for recognising, classifying, measuring, presenting and providing disclosures about financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures*.

Scope

- 2 **This [draft] IFRS shall be applied to all items within the scope of IAS 39 that are measured at amortised cost.**

Subsequent measurement at amortised cost

Objective of amortised cost measurement

- 3 The objective of amortised cost measurement is to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the *financial instrument*.
- 4 For the purpose of this cost-based measurement the effective return is determined on the basis of the initial expectations about cash flows over the expected life of the financial asset or financial liability and its initial carrying amount. Hence, amortised cost is a measurement that combines current cash flow information at each measurement date with a valuation of those cash flows that reflects conditions on initial recognition of the financial instrument.
- 5 The effective return reflects an allocation over the expected life of the instrument of fees, points paid or received, *transaction costs* and other premiums or discounts as well as the initial estimate of expected credit losses on a financial asset.

Measurement principles

- 6 **Amortised cost shall be calculated using the *effective interest method*. Hence, amortised cost is the present value calculated using the following inputs:**
- (a) **the expected cash flows over the remaining life of the financial instrument; and**
 - (b) **the *effective interest rate* as the discount rate.**
- 7 Amortised cost reflects at each measurement date current inputs regarding the cash flow estimates. As a cost-based measurement, amortised cost also reflects an input relating to initial measurement, which is the effective interest rate to the extent that it is not contractually reset to current conditions (eg the effective interest rate of a fixed rate financial instrument or a constant spread of a variable rate financial instrument).
- 8 **The estimates for the cash flow inputs are expected values. Hence, estimates of the amounts and timing of cash flows are the probability-weighted possible outcomes.**
- 9 The cash flow inputs used for amortised cost are based on expected cash flows because the objective is to provide information about the effective return.
- 10 **The effective interest method determines the allocation of interest revenue and interest expense. The effective interest rate used for this purpose reflects how the contract sets the interest payments for the financial instrument (ie what part of the contractual interest rate, if any, is reset).**

The proposed presentation and disclosure requirements are included in the exposure draft together with the related measurement requirements in order to facilitate understanding of the proposals. In finalising [draft] IFRS X the Board may treat the presentation and disclosure requirements as amendments of IAS 1 *Presentation of Financial Statements* and IFRS 7 *Financial Instruments: Disclosures*, respectively.

Presentation and disclosure

Objective of presentation and disclosure

- 11 An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effect of interest revenue and expense, and the quality of financial assets including credit risk.
- 12 In order to meet this objective an entity shall:
- (a) provide as a minimum the information required by paragraphs 13–22; and
 - (b) provide the information in a way that explains to users of the financial statements the overall effect on the entity's performance and financial position and the interaction between different aspects of the information provided. Such an explanation shall include a discussion of the causes of both the overall effect and the causes of any interaction between different aspects of the information provided.

Presentation

- 13 The statement of comprehensive income shall include line items that present the following amounts for the period:
- (a) gross interest revenue (calculated using the effective interest method before taking into account the allocation of the initial estimate of expected credit losses).
 - (b) the portion of initial expected credit losses allocated to the period, which shall be presented as a reduction of gross interest revenue (item (a) above).
 - (c) net interest revenue (the subtotal of items (a) and (b) above).
 - (d) gains and losses resulting from changes in estimates in relation to financial assets and liabilities that are measured at amortised cost.
 - (e) interest expense (calculated using the effective interest method).

Disclosure

Classes of financial instruments and level of disclosure

- 14 When this [draft] IFRS requires disclosures by class of financial asset or financial liability, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments.

An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

Allowance account

15 For financial assets measured at amortised cost an entity shall use an allowance account to account for credit losses. An entity shall disclose for each class of financial assets:

- (a) a reconciliation of changes in that account during the period; and**
- (b) its write-off policy.**

Estimates and changes in estimates

16 An entity shall disclose information that explains estimates and changes in estimates that are required to determine amortised cost.

17 An entity shall explain the inputs and assumptions used in determining expected credit losses. For this purpose an entity shall disclose:

- (a) the basis of inputs (eg internal historical information or rating reports) and the estimation technique used to determine initial expected credit losses;**
- (b) if changing one or more of the inputs to reasonably possible alternative assumptions would significantly change the initial expected credit loss or subsequent changes in credit loss:**
 - (i) that fact; and**
 - (ii) the effect of those changes and how it was derived;**
- (c) for changes in estimates, an explanation of what estimates have changed, the cause of the change and the new inputs and assumptions used; and**
- (d) if there has been a change in estimation technique, disclosure of that change and the reason for the change.**

18 Paragraph 13(d) requires separate presentation in the statement of comprehensive income of the gains and losses resulting from changes in estimates in relation to financial assets and liabilities that are measured at amortised cost. An entity shall explain those gains and losses. For this purpose an entity shall disclose:

- (a) a disaggregation of these gains and losses into:**
 - (i) the amount attributable to changes in estimates of credit losses; and**

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- (ii) the amount attributable to other factors (eg changes in estimates of prepayment rates).
 - (b) further quantitative and qualitative analyses for these gains and losses if:
 - (i) these gains and losses have a significant effect on profit or loss; or
 - (ii) a particular portfolio, period of origination or geographical area has significant effects on these gains and losses.
- 19 An entity shall disclose for each class of financial assets:
- (a) a comparison between the development of the credit loss allowance over time and cumulative write-offs; and
 - (b) a qualitative analysis of the effect of changes in credit loss estimates on this comparison if that effect is significant.

Stress testing

- 20 **If an entity prepares stress testing information for internal risk management purposes it shall disclose that fact and information that enables users of financial statements to understand:**
- (a) the implications for the financial position and performance of the entity; and
 - (b) the entity's ability to withstand the stress scenario or scenarios.

Credit quality of financial assets

- 21 **For financial assets measured at amortised cost an entity shall disclose for each class of financial assets:**
- (a) a reconciliation of changes in *non-performing* financial assets during the period; and
 - (b) a qualitative analysis of the interaction between changes in non-performing financial assets and changes in the allowance account if that interaction is significant.

Origination and maturity (vintage) information

- 22 **For financial assets measured at amortised cost an entity shall disclose for each class of financial assets information showing the year of origination and the year of maturity (vintage information).**

Effective date and transition

Effective date

- 23 An entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies this [draft] IFRS in its financial statements for a period before [date to be inserted after exposure], it shall disclose that fact and at the same time apply the amendments set out in Appendix C.

Transition

- 24 For the purposes of the transitional provisions in paragraphs 25–29, the date of initial application is the beginning of the annual period for which an entity first applies the requirements in this [draft] IFRS.
- 25 For financial instruments measured at amortised cost that were initially recognised before the date of initial application of this [draft] IFRS the objective is to approximate the effective interest rate that would have been determined in accordance with this [draft] IFRS if it had applied on initial recognition of the financial instrument. This is accomplished by applying an effective interest rate transition adjustment to the effective interest rate previously determined in accordance with IAS 39.
- 26 **In determining the effective interest rate transition adjustment an entity shall use all available historical data and supplement them as needed with information for similar financial instruments for which the effective interest rate is determined in accordance with this [draft] IFRS (ie financial instruments initially recognised around the date of initial application).**
- 27 **An entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if this [draft] IFRS had always been applied but use as the effective interest rate the rate previously determined in accordance with IAS 39 adjusted for the effective interest rate transition adjustment.**

Disclosure

- 28 In explaining the effect of the initial application of this [draft] IFRS in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* an entity shall provide a qualitative analysis of:

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- (a) the effect on profit or loss that results from the difference between the effective interest rate determined in accordance with this [draft] IFRS (including the transition requirements in paragraphs 24-27) and the rate used in accordance with the entity's previous accounting policy; and
 - (b) how that effect (item (a) above) relates to the amount of the transition adjustment to the amortised cost of financial assets.
- 29 In applying paragraph 19, an entity need not disclose information about periods before the earliest prior period presented.

Appendix A Defined terms

This appendix is an integral part of the [draft] IFRS.

The following terms are defined in paragraph 11 of IAS 32 or paragraph 9 of IAS 39 and are used in this [draft] IFRS with the meanings specified in IAS 32 or IAS 39:

- (a) fair value
- (b) financial asset
- (c) financial instrument
- (d) financial liability

amortised cost A cost-based measurement of a financial instrument that uses amortisation to allocate interest revenue or interest expense.

effective interest method A method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) that uses the effective interest rate.

effective interest rate The rate that (or spread that, in combination with the interest rate components that are reset in accordance with the contract,) exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability.

non-performing The status of a financial asset that is more than 90 days past due or is considered uncollectible.

transaction costs Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

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

Appendix B

Application guidance

This appendix is an integral part of the [draft] IFRS.

Measurement principles (paragraphs 6–10)

Amortised cost

- B1 Amortised cost is the amount at which a financial asset or financial liability is measured at initial recognition adjusted over time as follows:
- (a) minus principal repayments;
 - (b) plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount; and
 - (c) plus or minus any addition or reduction resulting from the effect of revising estimates of expected cash flows (eg regarding prepayments or uncollectibility) at each measurement date.

The initial measurement adjusted as set out above results in the carrying amount that is the present value of the expected cash flows over the remaining life of the financial instrument discounted using the effective interest rate (see paragraph 6) at the respective measurement date.

- B2 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual cash flows and the revised estimate of expected cash flows. In accordance with paragraph 6, the entity recalculates the carrying amount by computing the present value of expected cash flows (on the basis of the revised estimate) using the financial instrument's effective interest rate. Any adjustment is recognised in profit or loss and presented in the statement of comprehensive income in accordance with paragraph 13(d).

Expected cash flows

- B3 The cash flow inputs used for amortised cost are expected cash flows. In accordance with paragraph 8 the estimates are derived as expected values. An entity shall estimate the expected cash flows considering:
- (a) all contractual terms of the financial instrument (eg prepayment, call and similar options);

- (b) fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see IAS 18 *Revenue*) to the extent they are not included in the initial measurement of the financial instrument; and
- (c) for financial assets, credit losses over the entire life of the asset.

For financial liabilities estimates of expected cash flows do not reflect the entity's own non-performance risk.

- B4 For the purpose of calculating amortised cost the expected cash flows may be estimated on a collective basis (eg on a group or portfolio level) or an individual basis. The basis for estimates may be changed during the life of a financial asset. For example, after a default or addition to a watch list, a financial asset may be removed from a portfolio and added to a different portfolio or the expected cash flows may be estimated individually for that financial asset. Irrespective of whether expected cash flows are estimated on a collective or an individual basis the estimate is always an expected value (see paragraph 8).
- B5 When an entity determines whether it estimates expected cash flows on a collective or an individual basis it shall:
- (a) use the approach that provides the best estimate; and
 - (b) ensure that the approach used does not result in double-counting of credit losses.
- B6 For the purpose of estimating on a collective basis the effect of credit losses on expected cash flows, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (eg on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The characteristics chosen are relevant to the estimation of expected cash flows for groups of such assets by indicating the debtors' ability to pay all amounts due according to the contractual terms of the financial assets being evaluated.
- B7 In estimating the effect of credit losses on expected cash flows entities may use various sources of data, which may be internal or external. For example, possible data sources are internal historical credit loss experience, internal ratings, credit loss experience of other entities, and external ratings, reports and statistics. Entities that have no entity-specific credit loss experience or insufficient experience may use peer group experience for comparable financial assets (or groups of financial assets).

- B8 Historical data such as credit loss experience are adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical data are based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in expected cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses on the financial asset or in the group of financial assets and their magnitude). The methodology and assumptions used for estimating the effect of credit losses on expected cash flows are reviewed regularly to reduce any differences between estimates and actual credit loss experience.
- B9 When using historical credit loss rates in estimating expected cash flows, it is important that information about historical credit loss rates is applied to groups that are defined in a manner consistent with the groups for which the historical credit loss rates were observed. Therefore, the method used shall enable each group to be associated with information about past credit loss experience in groups of assets with similar credit risk characteristics and relevant observable data that reflect current conditions.
- B10 The estimate of expected cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. Any collateral obtained as a result of foreclosure is not recognised as an asset separate from the collateralised financial asset unless it meets the recognition criteria for an asset in other IFRSs.

Allocation mechanism for interest revenue and interest expense

- B11 In accordance with paragraph 10 the effective interest rate reflects how the contract sets the interest payments for the financial instrument. The effective interest rate is first determined on initial recognition of a financial instrument. The effective interest rate is determined in relation to the component or components that are reset in accordance with the contract. For example:
- (a) for a fixed rate financial instrument the effective interest rate is the discount rate that results in a present value of the expected cash flows (determined in accordance with paragraph B3) that equals the carrying amount (ie the initial measurement) of the financial instrument (initial effective interest rate).

- (b) for a floating rate financial instrument that resets a benchmark interest component (eg LIBOR plus 100 basis points) the effective interest rate is not determined as a single constant rate. Instead, a combination of the spot curve* for the benchmark interest rate and a spread is used for discounting. This spread is derived by iteration so that the present value of the expected cash flows (determined in accordance with paragraph B3) equals the carrying amount (ie the initial measurement) of the financial instrument (initial effective spread).
- B12 Contractual resets of the interest cash flows of a financial instrument alter the effective interest rate to the extent that the interest rate is adjusted (and in relation to the component or components affected). For example:
 - (a) for a fixed rate financial instrument no component of the contractual interest is reset. Hence, the effective interest rate remains constant over the life of the financial instrument (ie the initial effective interest rate is used to calculate amortised cost at each measurement date).
 - (b) for a floating rate financial instrument that resets a benchmark interest component (eg LIBOR plus 100 basis points), periodic re-estimation of cash flows to reflect changes in the benchmark interest rate alters the effective interest rate in relation to that benchmark component. This means that the spot curve for the benchmark interest rate is updated while the initial effective spread remains constant. Hence, each cash flow of the floating rate financial instrument is discounted using a rate that is the combination of:
 - (i) the applicable spot rate for each cash flow date; plus
 - (ii) the initial effective spread.
- B13 The effective interest method generally allocates by way of amortisation any fees, points paid or received, transaction costs and other premiums or discounts included in the calculation of the effective interest rate over the expected life of the financial instrument. However, if the period to which the fees, points paid or received, transaction costs, premiums or discounts relate is a shorter period than the expected life of the instrument these amounts are allocated over that shorter period. The effect of that allocation is an adjustment to the interest revenue or interest expense for the financial instrument over that shorter period.

* The spot curve is alternatively referred to as the zero coupon curve.

For example, the relevant allocation period is shorter than the instrument's expected life when a premium or discount on a variable rate instrument reflects changes in the benchmark rate since the variable interest rate was reset. In that case, the appropriate allocation period is the period to the next such reset date. If, however, the premium or discount results from, for example, a change in credit risk compared with that reflected in the credit spread over the variable rate specified in the instrument it is allocated over the expected life of the instrument or the period to any earlier reset of the credit spread that reflects a repricing to then current conditions. For other variables or amounts that are not reset to market rates such as transaction costs the relevant allocation period is the expected life of the instrument.

- B14 If the terms of a financial instrument are renegotiated or otherwise modified because of financial difficulties of the debtor, any impairment is measured by calculating amortised cost using the effective interest rate before the modification of terms. Any resulting adjustment of the carrying amount is recognised in profit or loss and presented in the statement of comprehensive income in accordance with paragraph 13(d).

Practical expedients

- B15 An entity may use practical expedients in calculating amortised cost if their overall effect is immaterial. Practical expedients shall be consistent with the following principles:
- (a) the calculation incorporates the effect of the time value of money (except for cash flows relating to short-term receivables if the effect of discounting is immaterial);
 - (b) the calculation includes all expected cash flows for all of the remaining life of the financial instrument (not only for some part of the remaining maturity); and
 - (c) the calculation results in a present value that equals the initial measurement of the financial instrument (ie the calculation does not give rise to a loss because of a difference between the initial measurement of a financial instrument and its carrying amount determined using the practical expedient at that point in time).
- B16 An example of a practical expedient is determining the amortised cost of trade receivables using a provision matrix. The entity would use its historical loss experience on trade receivables to estimate the expected credit losses. A provision matrix might, for example, specify fixed provision rates depending on the number of days a receivable is past due

(eg 3 per cent if less than 90 days, 20 per cent if 90–180 days etc). Depending on the diversity of its customer base the entity would use appropriate grouping if its historical loss experience shows significantly different loss patterns for different customer segments. Examples of criteria that might be used to group assets include geography, product type, customer rating, collateral or trade credit insurance, or type of customer (such as wholesale or retail). Assuming that the trade receivables are without a stated interest rate and are so short-term that the effect of discounting is immaterial (see paragraph B15(a)), the entity would not impute interest. Hence, for those trade receivables the entity would neither determine an effective interest rate nor recognise any interest revenue. Instead, the entity would measure the trade receivables on initial recognition at their invoice amount less the initial estimate of undiscounted expected credit losses, which would also be their amortised cost at that point in time (see paragraph B15(c)). The initial estimate of undiscounted expected credit losses would be treated as a reduction of the invoice amount in determining the revenue to which the trade receivable relates (eg from the sale of goods).

- B17 Entities may also use practical expedients for the allocation over the expected life of a financial asset of the initial estimate of expected credit losses in lieu of the effective interest method if the difference in the outcomes of that method and the alternative allocation mechanism is immaterial. For example, an entity might determine amortised cost using two separate present value calculations:
- (a) the first calculation determines amortised cost excluding the effect of expected credit losses; and
 - (b) the second calculation determines the present value of expected credit losses (as a separate calculation) using a discount rate that is different from the effective interest rate (eg a risk-free rate). The entity determines an amortisation profile for the present value of the initial estimate of expected credit losses and accounts for the amortisation charge for the period as a reduction of the interest revenue that arises from the first calculation (see (a) above). Any change in the present value of expected credit losses as a result of revising the estimate of expected credit losses is recognised in profit or loss and presented as gains and losses resulting from changes in estimates (see paragraph 13(d)).

Presentation (paragraph 13)

- B18 Items that refer to amounts calculated using the effective interest method shall include only amounts that:
- (a) are interest in accordance with that method; or
 - (b) represent the effect on interest revenue or interest expense of hedging relationships that qualify for hedge accounting.
- B19 Any amounts other than those in paragraph B18 shall not be included in items that refer to amounts calculated using the effective interest method. Examples are:
- (a) foreign exchange gains or losses.
 - (b) gains or losses in relation to hedging transactions that do not qualify for hedge accounting.
 - (c) gains or losses from derecognition of financial assets or liabilities.
 - (d) fees or transaction costs that are not included in determining the effective interest rate.
 - (e) interest received or paid on financial instruments not classified as amortised cost (eg coupon interest received on a bond that is held for trading purposes).

Disclosure

Classes of financial instruments and level of disclosure (paragraph 14)

- B20 Paragraph 14 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. These classes are determined by the entity and are, thus, distinct from the measurement categories of financial instruments (which determine how financial instruments are measured and where changes in fair value are recognised).
- B21 An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this [draft] IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a

balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

Allowance account (paragraph 15)

- B22 The reconciliation of changes in the allowance account for credit losses shall reconcile the balances at the beginning and end of the period showing at a minimum:
- (a) increases resulting from the allocation of initial expected credit losses, ie amounts presented as a reduction of gross interest revenue in accordance with paragraph 13(b);
 - (b) increases resulting from changes in estimates of expected credit losses, ie amounts included in the gains and losses presented in accordance with paragraph 13(d);
 - (c) decreases resulting from changes in estimates of expected credit losses, ie amounts included in the gains and losses presented in accordance with paragraph 13(d); and
 - (d) write-offs.
- B23 An entity shall include all write-offs in the reconciliation of changes in the allowance account (ie on a gross basis as both an addition to and a use of the allowance account). This applies even if a financial asset becomes impaired and is written off in the same period. Hence, direct write-offs against the contractual amount of financial assets without using an allowance account are prohibited.

Comparison of loss allowance with cumulative write-offs (paragraph 19)

- B24 The comparison of the development of the credit loss allowance over time with cumulative write-offs shall be provided in tabular format (an example of a possible format is provided below).

Year of origination	20X1	20X2	20X3	20X4	Total
	CU	CU	CU	CU	CU*
Credit loss provision (cumulative):					
At the end of the origination year	xx	xx	xx	yy	
One year later	xx	xx	yy		
Two years later	xx	yy			
Three years later	yy				
Gross provision for credit losses (before write-offs)	<u>yy</u>	<u>yy</u>	<u>yy</u>	<u>yy</u>	<u>zz</u>
Cumulative write-offs as a result of delinquencies	xx	xx	xx	xx	zz
Cumulative write-offs as a result of foreclosures	<u>xx</u>	<u>xx</u>	<u>xx</u>	<u>xx</u>	<u>zz</u>
Total cumulative write-offs	<u>zz</u>	<u>zz</u>	<u>zz</u>	<u>zz</u>	<u>zz</u>
Net provision for credit losses (gross provision for credit losses less cumulative write-offs)	<u><u>zz</u></u>	<u><u>zz</u></u>	<u><u>zz</u></u>	<u><u>zz</u></u>	<u><u>zz</u></u>

- B25 The qualitative analysis of the effect of changes in credit loss estimates on this comparison is a narrative explanation of the causes of the development and how they relate to the write-offs.

* In this [draft] IFRS, monetary amounts are denominated in 'currency units (CU)'.

Stress testing information (paragraph 20)

- B26 The information that an entity provides about stress testing would typically include (but is not limited to):
- (a) how such stress tests are conducted;
 - (b) a description of the stress scenario used and the related assumptions; and
 - (c) the outcome of the stress testing, including any significant conclusions.

Credit quality of financial assets (paragraph 21)

- B27 The reconciliation of changes in non-performing financial assets shall reconcile the nominal amounts at the beginning and end of the period showing at a minimum:
- (a) increases resulting from reclassifications of performing loans as non-performing (ie deterioration of credit quality);
 - (b) increases resulting from acquisition of non-performing loans;
 - (c) decreases resulting from recoveries through enforcing securities;
 - (d) decreases resulting from recoveries due to payments of the debtor;
 - (e) renegotiations; and
 - (f) write-offs.
- B28 The qualitative analysis of the interaction between changes in non-performing financial assets and changes in the allowance account is a narrative explanation of how the two types of changes relate to each other and any common causes of the changes.

Origination and maturity (vintage) information (paragraph 22)

- B29 The information showing the year of origination and maturity shall be provided:
- (a) on the basis of nominal amounts; and

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- (b) in tabular format (an example of a possible format is provided below).

Maturity	Year of origination				Total
	20X1	20X2	20X3	20X4	
	CU	CU	CU	CU	
20X3	xx	xx	xx		ZZ
20X4	xx	xx	xx	xx	ZZ
20X5	xx	xx	xx	xx	ZZ
20X6		xx	xx	xx	ZZ
20X7		xx		xx	ZZ
20X8				xx	ZZ
Total	<u>ZZ</u>	<u>ZZ</u>	<u>ZZ</u>	<u>ZZ</u>	<u>ZZ</u>

Transition (paragraph 26)

B30 The principle set out in paragraph 26 can be applied in different ways, for example:

- (a) by using ratio analysis to infer the effective interest rate transition adjustment using information for similar financial instruments that are initially recognised near the date of initial application of this [draft] IFRS; or
- (b) by using the adjustment to the effective interest rate that reflects the effect of allocating the initial expected credit losses that is determined for similar financial instruments that are initially recognised near the date of initial application of this [draft] IFRS. When using this approach an entity shall ensure that the resulting adjusted effective interest rate is not lower than the risk-free interest rate that applied on the date of initial recognition of the financial instrument.

Defined terms

Transaction costs

- B31 Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Write-off

- B32 Write-offs can relate to a financial asset in its entirety as well as portions of a financial asset. For example, after an entity has enforced a security and recovered 30 per cent of a financial asset, the remaining 70 per cent might be written off if the entity does not expect to collect any further amounts from that financial asset.
- B33 At the time a financial asset is written off the expected loss would be 100 per cent of the write-off amount. In accordance with paragraph B23 an entity shall not write off any amount without including it as an addition to and a use of the allowance account.
- B34 The definition of a write-off means that the entity has no reasonable expectations of recovering the related amount. Therefore, a write-off constitutes a derecognition event.

Appendix C Amendments to other IFRSs

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies this [draft] IFRS for an earlier period, it shall apply these amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 7 *Financial Instruments: Disclosures*

C1 Paragraph 16 is deleted. Paragraph 20 is amended and paragraph 44H is added as follows:

Significance of financial instruments for financial position and performance

Statement of comprehensive income

Items of income, expense, gains or losses

- 20 An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:
- (a) net gains or net losses on:
- (i) financial assets or financial liabilities at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading in accordance with IAS 39;
 - (ii) available-for-sale financial assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified from equity to profit or loss for the period;
 - (iii) held-to-maturity investments (excluding those separately presented in the statement of comprehensive income in accordance with [draft] IFRS X);

- (iv) loans and receivables (excluding those separately presented in the statement of comprehensive income in accordance with [draft] IFRS X); and
- (v) financial liabilities measured at amortised cost (excluding those separately presented in the statement of comprehensive income in accordance with [draft] IFRS X);
- (b) ~~[deleted] total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss;~~
- (c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:
 - (i) financial assets or financial liabilities that are not at fair value through profit or loss; and
 - (ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;
- (d) interest income on impaired financial assets accrued in accordance with paragraph AG93 of IAS 39; ~~and~~.
- (e) ~~[deleted] the amount of any impairment loss for each class of financial asset.~~

Effective date and transition

44H [Draft] IFRS X *Financial Instruments: Amortised Cost and Impairment*, issued in [date to be inserted after exposure] deleted paragraph 16 and amended paragraph 20. It also amended paragraph B5 in Appendix B. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

- C2 In Appendix B (Application guidance), paragraph B5 is amended as follows:

Significance of financial instruments for financial position and performance

Other disclosure – accounting policies (paragraph 21)

- B5 Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:
- (a) for financial assets or financial liabilities designated as at fair value through profit or loss:
 - (i) the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;
 - (ii) the criteria for so designating such financial assets or financial liabilities on initial recognition; and
 - (iii) how the entity has satisfied the conditions in paragraph 9, 11A or 12 of IAS 39 for such designation. For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.
 - (b) the criteria for designating financial assets as available for sale.
 - (c) whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 38 of IAS 39).

- (d) ~~[deleted] when an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:~~
- (i) ~~the criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write down, increased directly) and when the allowance account is used; and~~
 - (ii) ~~the criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 16).~~
- (e) how net gains or net losses on each category of financial instrument are determined (see paragraph 20(a)), for example, whether the net gains or net losses on items at fair value through profit or loss include interest or dividend income.
- (f) ~~[deleted] the criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 20(e)).~~
- (g) when the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 36(d)).

Paragraph 122 of IAS 1 (as revised in 2007) also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

IAS 18 Revenue

C3 Paragraph 30 is amended and paragraph 39 is added as follows:

Interest, royalties and dividends

30 Revenue shall be recognised on the following bases:

- (a) **interest shall be recognised using the effective interest method as set out in IAS 39, paragraphs 9 and AG5-AG8 [draft] IFRS X;**

- (b) **royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and**
- (c) **dividends shall be recognised when the shareholder's right to receive payment is established.**

Effective date

- 39 [Draft] IFRS X *Financial Instruments: Amortised Cost and Impairment*, issued in [date to be inserted after exposure] amended paragraph 30. An entity shall apply that amendment for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendment for that earlier period.

IAS 28 Investments in Associates

- C4 Paragraph 31 is deleted, paragraphs 32 and 33 are amended and paragraph 41D is added as follows:

Application of the equity method

Impairment losses

- 31 ~~[Deleted] After application of the equity method, including recognising the associate's losses in accordance with paragraph 29, the investor applies the requirements of IAS 39 to determine whether it is necessary to recognise any additional impairment loss with respect to the investor's net investment in the associate.~~
- 32 The investor ~~also~~ applies the requirements of IAS 39 to determine whether any additional impairment loss is recognised with respect to the investor's interest in the associate that does not constitute part of the net investment and the amount of that impairment loss.
- 33 After application of the equity method, including recognising the associate's losses in accordance with paragraph 29, the investor applies the requirements of IAS 36 *Impairment of Assets* to determine whether it is necessary to recognise any additional impairment loss with respect to the investor's net investment in the associate. Because goodwill that forms part of the carrying amount of an investment in an associate is not separately recognised, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in IAS 36 ~~*Impairment of Assets*~~. Instead,

the entire carrying amount of the investment is tested for impairment in accordance with IAS 36 as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, ~~whenever application of the requirements in IAS 39 indicates that the investment may be impaired~~. An impairment loss recognised in those circumstances is not allocated to any asset, including goodwill, that forms part of the carrying amount of the investment in the associate. Accordingly, any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases. In determining the value in use of the investment, an entity estimates:

- (a) its share of the present value of the estimated future cash flows expected to be generated by the associate, including the cash flows from the operations of the associate and the proceeds on the ultimate disposal of the investment; or
- (b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Under appropriate assumptions, both methods give the same result.

Effective date and transition

41D [Draft] IFRS X *Financial Instruments: Amortised Cost and Impairment*, issued in [date to be inserted after exposure] deleted paragraph 31 and amended paragraphs 32 and 33. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

IAS 39 *Financial instruments: Recognition and Measurement*

C5 Paragraphs 58 and AG93 and one heading are amended. In paragraph 9 the definitions of amortised cost of a financial asset or financial liability, effective interest method, and transaction costs, the heading above paragraph 63 and paragraphs 63-65, the heading above paragraph AG5 and paragraphs AG5-AG8, and the heading above paragraph AG84 and paragraphs AG84-AG92 are deleted. Paragraph 108D is added.

Measurement

Impairment and uncollectibility of financial assets

- 58 **For financial assets that are carried at cost or classified as available for sale an** ~~An~~ entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply ~~paragraph 63 (for financial assets carried at amortised cost)~~, paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available-for-sale financial assets) to determine the amount of any impairment loss.

Effective date and transition

108D [Draft] IFRS X *Financial Instruments: Amortised Cost and Impairment*, issued in [date to be inserted after exposure] amended paragraph 58 and deleted paragraphs 63–65. It also amended paragraph AG93 and deleted paragraphs AG5–AG8 and AG84–AG92. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

- C6 In Appendix A (Application guidance), a heading and paragraph AG93 are amended as follows:

Measurement (paragraphs 43–70)

Impairment and uncollectibility of financial assets (paragraphs 58–70)

Interest ~~income~~ revenue after impairment recognition

AG93 Once an available-for-sale financial asset or a group of similar available-for-sale financial assets has been written down as a result of an impairment loss, interest ~~income~~ revenue is thereafter recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

[Draft] amendments to guidance on other IFRSs

The following [draft] amendments to guidance on IFRSs are necessary in order to ensure consistency with [draft] IFRS X Financial Instruments: Classification and Measurement and the related amendments to other IFRSs. In the amended paragraphs, new text is underlined and deleted text is struck through.

IFRS 7 Financial Instruments: Disclosures

IGA1 In the guidance on implementing IFRS 7, the heading above paragraph IG13 and paragraph IG13 are deleted.

IAS 18 Revenue

IGA2 In the appendix accompanying IAS 18, example 14 is amended as follows:

Rendering of services

14 *Financial service fees.*

The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

(a) *Fees that are an integral part of the effective interest rate of a financial instrument.*

Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognised in profit or loss, the fees are recognised as revenue when the instrument is initially recognised.

(i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IAS 39 is classified as a financial asset 'at fair value through profit or loss'.*

Such fees may include compensation for activities such as evaluating the borrower's financial condition,

evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs* (as defined in ~~IAS 39~~ [draft] IFRS X), are deferred and recognised as an adjustment to the effective interest rate.

- (ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IAS 39.*

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IAS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in ~~IAS 39~~ [draft] IFRS X), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

- (iii) *Origination fees received on issuing financial liabilities measured at amortised cost.*

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as 'at fair value through profit or loss', the origination fees received are included, with the related transaction costs (as defined in ~~IAS 39~~ [draft] IFRS X) incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from

* In *Improvements to IFRSs* issued in May 2008, the Board replaced the term 'direct costs' with 'transaction costs' as defined in paragraph 9 of IAS 39. This amendment removed an inconsistency for costs incurred in originating financial assets and liabilities that should be deferred and recognised as an adjustment to the underlying effective interest rate. 'Direct costs', as previously defined, did not require such costs to be incremental.

origination fees and transaction costs relating to the right to provide services, such as investment management services.

(b) *Fees earned as services are provided.*

(i) *Fees charged for servicing a loan.*

Fees charged by an entity for servicing a loan are recognised as revenue as the services are provided.

(ii) *Commitment fees to originate a loan when the loan commitment is outside the scope of IAS 39.*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IAS 39, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

(iii) *Investment management fees.*

Fees charged for managing investments are recognised as revenue as the services are provided.

Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in ~~IAS 39~~ draft IFRS X, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortised as the entity recognises the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the

financial instrument from the costs of securing the right to provide investment management services.

- (c) *Fees that are earned on the execution of a significant act.*

The fees are recognised as revenue when the significant act has been completed, as in the examples below.

- (i) *Commission on the allotment of shares to a client.*

The commission is recognised as revenue when the shares have been allotted.

- (ii) *Placement fees for arranging a loan between a borrower and an investor.*

The fee is recognised as revenue when the loan has been arranged.

- (iii) *Loan syndication fees.*

A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed.

IAS 39 *Financial Instruments: Recognition and Measurement*

IGA3 In the guidance on implementing IAS 39, the Questions and Answers B.24–B.27, E.4.1–E.4.3 and E.4.5–E.4.8 are deleted.

IFRIC 12 *Service Concession Arrangements*

IGA4 In the illustrative examples accompanying IFRIC 12, paragraphs IE3 and IE26 are amended as follows:

Example 1: The grantor gives the operator a financial asset

Arrangement terms

IE3 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year and that the operator expects to collect all cash flows.

Example 3: The grantor gives the operator a financial asset and an intangible asset

Arrangement terms

IE26 For the purpose of this illustration, it is assumed that all cash flows take place at the end of the year and that the operator expects to collect all cash flows.