

The points noted were raised by one or more participants, and the extent to which a particular view is shared by participants is only indicated where this is considered relevant. Some of the points noted might be inconsistent with others because not all participants hold the same views.

IASB ED Question 2

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

- There is a clear objective set out for the amortised cost category, and it is acknowledged that recognising expected losses completes the objective, but some participants have reservations about the proposed methodology, i.e. using an expected cash flow model.
- The proposed methodology seems to be trying to introduce fair value notions into the expected cash flow model that is supposed to be based on historical cost—as a result, there is inconsistency between the objective and mechanism of the model.
- The logic of effectively recognising some losses on initial recognition is compelling, and a form of expected loss model is supported, but not a completely new model based on expected cash flows.
- Is the underlying result of the expected loss model to determine the fair value of credit losses?
- The objective should be broken down into objectives of the measurement category and objective of impairment of amortised cost separately as they are inconsistent in principle. For example, paragraph 4 of the ED states, "... amortised cost is a measurement that combines cash flow information at each measurement date with a valuation of those cash flows that reflects conditions on initial recognition...". The definition of this measurement category does not match the objective of impairment and it would be helpful to have clarification from the IASB.
- The model is not suitable for non-financial institutions, and the objective seems to be focused on the needs of financial institutions. If the objective were more principle-based there should not be a need for different requirements for non-financial institutions.
- The objective of the IASB in proposing the methodology is not clear—if the IASB is reacting to G20 and FCAG recommendations, i.e. to curb delays in recognising loss provisioning for amortised cost assets, then the IASB should modify the existing methodology by explicitly removing the restriction in the incurred loss model to allow for incurred but not yet directly evident losses to be recognised upfront.
- There should be more focus on the principles of the measurement, rather than the methodology.
- The proposals seem to be more about how to measure amortised cost and only incidentally about impairment, and yet the Effective Interest Rate methodology was originally designed as a basis for revenue recognition.
- The IASB's thinking on liability accounting remains focused on present obligations, yet in respect of asset impairment the expected loss model seems to be a departure from this focus.
- Once it has been decided to look at expected losses, it could be argued that the model should allow updated expectations to be factored into the effective interest rate. However, it is acknowledged that this would move the model further from a cost-basis.
- Banks think about impairment in terms of portfolios of assets (not individual loans), yet there is scant acknowledgement of this in the ED.
- Is it the role of the user of financial statements to assess expectations or the preparer?

AASB Roundtables on Amortised Cost and Impairment

Summary findings from the Roundtables

- Others suggest, in principle, that the amortised cost category should represent what you expect to recover from the financial asset.
- Although not specifically sought by the G20 or Financial Crisis Advisory Group, in the context of the expected loss model, the proposals might help to address the issue of ‘procyclicality’ that arose during the credit crisis.
- Preference is for a model that the FASB is proposing, i.e. similar to the mechanisms of an incurred loss model, without the reliance on trigger events and objective evidence, so as to allow for ‘expected losses’ to be recognised every measurement date.

Question 4

Do you agree with the measurement principles set out in the ED? If not, which of the measurement principles do you disagree with and why?

Are there any other measurement principles that should be added? If so, what are they and why should they be added?

- Credit losses should be incorporated into the expected cash flows and EIR, as that is a reflection of how loans are priced, however history has shown that credit loss is not priced well in the market.
- Banks will routinely and deliberately ‘misprice’ (in terms of creditworthiness) loans to meet conditions in the market – that is, underprice if the bank is trying to attract market share, or overprice if the market is tight.
- There was disagreement with the proposed effective interest method, which includes credit losses, in recognising interest revenue as this does not reflect how management assess operating revenue. This is particularly the case for smaller banks that generally look for other forms of security to gain assurance over expected credit losses, and are pressured to keep interest rates competitive regardless of a customer’s credit risk. Should a ‘through the eyes of management’ approach be applied here?
- The proposed model can be viewed as a loss provisioning tool at a micro level, however, in practice, loss provisioning decisions are mostly done at a macro level, thus creating conflicting ideas on how ‘expected loss’ should be dealt with.
- Re paragraph B8 of the ED, participants are seeking guidance on what is meant by:
 - future expectations – it is unclear whether an entity estimates future cash flows based on information prevailing at reporting date or on expectations of future changes beyond the reporting date (i.e. extrapolated data using current information). That is, under the proposed model it is not clear whether the entity can or must look at trends based on the information available today – beyond an assessment of existing information to make projections about future conditions over the life of loans. Most argue that the extent of impairment should be extrapolated and included as expected loss, from information that currently exists at reporting date. Accordingly, current information about house prices can be a ‘trigger’ for recognising further losses; and
 - historical data – how far back should an entity analyse historical amounts?
- The model might suit fixed-interest rate instruments, but not variable-rate instruments, as any change in yield curve in relation to a variable-rate instrument is going to cause impairment (or impairment reversed) in the asset—IASB should explain the inter-relationship between the yield curve changes, credit loss expectations and impairment.
- Calculating EIR is subjective and difficult—requires estimation on timing of losses which most banks have no ability to predict. Banks have more interest in calculating dollar amount losses.

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- Interest rates might include elements other than time value of money and credit risk, so to assume that movements in interest rates is confined to the two elements (time value and credit risk) means the model may be flawed and adds difficulty to the process of allocating credit losses. In particular, the credit spread on a variable rate loan could be difficult to isolate because it is influenced by many factors, including competition in the market. Accordingly, the effective interest rate calculation will always be ‘impure’ because considerable estimation will be needed to identify the credit component.
- The reliability of the proposed model is questionable—most banks and non-banks have no systems in place to accurately forecast cash flows, hence the subjectivity involved will be huge.
- Some major banks have been leveraging off the Basel II systems to build on their estimates—noting that risk losses (based on Basel II methodology) are different from accounting losses.
- Perhaps the IASB should think about the information entities should be presenting on the face of financial statements and/or disclosing in notes, and then build the model around that information. The proposed model will not easily provide information for the presentation and disclosure requirements as proposed in the ED. Measuring the assets and related provision in the one methodology makes it difficult to ‘unbundle’ the information for disclosure purposes.
- Analysts are interested in the interest margin – so any adjustments made to interest margins will impact the performance of the entity. Alternatively, banks might present an ‘extra’ underlying interest margin if they think the one determined under the expected loss model is unhelpful.
- Taking the expected losses and spreading them over the affected periods is an improvement on the current model.
- Every time there is an interest rate change, the calculation is such that there will be a ‘catch up’ adjustment because expected losses are present valued (discounted) – so changes to the discount rate have an impact on the provision itself, none of which will be transparent to users.

Question 6

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

- Most participants favour a one-line revenue presentation format.
- There is a proposal to present both the gross interest revenue and net interest revenue on face of income statement, but it is not clear why both are needed.
- The requirements are unsuitable for non-financial institutions and small banks as the proposed information on expected loss is difficult to obtain (similar issue with getting the measurement model to approximate expected loss).
- As commented in Question 4, the IASB should conduct a review of the information users need and use as a driver to determine what the measurement/impairment model should be, and how expected loss might be built into the model.
- If a form of ‘interest revenue’ is presented, then gross interest (i.e. contractual interest before including the effect of expected losses) should be retained. Participants are concerned that ‘net interest revenue’ is not useful to readers and may lead to misinterpretation of an entity’s operating revenue. Users might want to see operating revenue without the ‘noise’ of credit risk movements.

AASB Roundtables on Amortised Cost and Impairment Summary findings from the Roundtables

Question 7

Do you agree with the proposed disclosure requirements? If not, what disclosure requirement do you disagree with and why?

What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?

- There are concerns about requiring disclosures on:
 - write-off policy (paragraph 15(b)), based on an entity's accounting policy, when the ED provides a definition of write-off. Suggest that IASB remove the definition from the standard;
 - the effects on changes to inputs/assumptions that might lead to a change to the initial expected credit loss or subsequent changes in credit loss (paragraph 17(b))—participants question the objective of this requirement and whether the information would be comparable;
 - credit loss development and supplementary qualitative analysis (paragraph 19). Some acknowledged that providing information on credit loss development demonstrates how well an entity knows the business and, to an extent, how conservative they have been. However, the method proposed by the IASB may not be the best way to demonstrate it. There is also concern that the extent of information required to develop the table and analysis will be onerous and is not easily stored and provided by existing or prospective information systems. This requirement might add to the lead-time in developing the model;
 - vintage information (paragraph 22) as the existing information systems may not store such information and may lead to onerous reporting. Some suggest that instead of vintage information, perhaps information about the 'expected' life of the loans is more appropriate and useful to readers—when a loan originates and contractually matures does not tell much about the credit quality of loans. It would be more difficult to make the disclosures on an expected maturity basis, but far more relevant; and
 - stress testing (paragraph 20) and the relevance of disclosing such information in the financial statements if most banks that prepare them for internal risk management purposes do so based on regulatory stress testing requirements. Banks generally prepare voluminous stress testing information, and it is not clear whether all or some would need to be disclosed under the proposals. If it went beyond selected information, it would be onerous to include in the financial statements and overly complex to most readers and analysts. There may also be duplication of disclosure requirements for regulatory purposes and accounting purposes. It might help if the stress testing information required to be made available were limited to that reported to the chief decision makers for decision making purposes, and to that related to credit risks.
- Suggestions included:
 - using a principles-based approach to determine what information should be disclosed (i.e. 'through the eyes of management'); and
 - disclosing information that supplements the line items presented on the face of the financial statements.
- From an analyst's point of view, the most important piece of a financial report is the presentation of financial statements. Stress testing information will be the most contentious area and users will need as much information as possible to understand what it all means. Analysts are also interested to know about correlations between assumptions and how conservatively banks have provisioned.

AASB Roundtables on Amortised Cost and Impairment

Summary findings from the Roundtables

Questions 12

Is there a need for more consideration to be given to financial assets that are not loan receivables?

- For non-financial institutions and small banks, the effective interest methodology is not the best way to reflect how the entity has priced their products. Most small businesses use a provision matrix as a guide on whether receivables can be recovered. Smaller ADIs use a provisioning model developed and approved by APRA to conduct their loan loss provisioning—the model does not price for credit losses.
- Outside of the major financial institutions, pricing and credit analysis are separate functions – so it could be difficult for entities to make the separate disclosures proposed in paragraphs 13(a) and 13(b).
- Movements in interest rates are also dependent on elements other than time value of money and credit risk, e.g. competition.
- Non-financial institutions mostly use ageing of debtors, sales representative information, and information from credit rating agencies to estimate their losses. For bad credit risk, a cash-on-delivery approach is usually adopted to minimise losses.
- Having two lines of disclosure – one based on historical information and another on expectations would be of no help to users in the context of non-financial institutions.

Other matters raised

- The proposed model should not be the only possible method to arrive at an ‘expected loss’ approach, and the IASB focus should be on the principles of the model and allow entities to develop the methodology.
- Most participants are not against an ‘expected loss’ model but they are not comfortable with the ‘expected cash flow’ approach. Their view is that an expected loss model can be simplified by using the incurred loss model and adapting it to allow expected losses to be recognised (using ‘management overlays’ based on historical information and knowledge of the business).
- Some suggest more guidance on AG7 and AG8 in IAS 39, and use these as application guidance.
- There seem to be few, if any, issues unique to the public sector – public policy loans would be the main concern, but these are already known about and the treatment is generally agreed (that is, when interest is below market, there may be a need to initially recognise an element of a public policy loan as a grant).