Hong Kong Institute of
Certified Public Accountants
香港會計師公會

6 July 2009

To: Members of the Hong Kong Institute of CPAs
All other interested parties

INVITATION TO COMMENT ON IASB REQUEST FOR INFORMATION ("EXPECTED LOSS MODEL") IMPAIRMENT OF FINANCIAL ASSETS: EXPECTED CASH FLOW APPROACH

Comments to be received by 10 August 2009

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Request for Information which has been posted on the Institute's website at:
www.hkicpa.org.hk/professionaltechnical/accounting/exposuredraft/content.php.

Impairment is one of the issues that the IASB is addressing in the second phase of its comprehensive review of IAS 39 *Financial Instruments: Recognition and Measurement*. The Request seeks inputs on the feasibility of an expected loss model for the impairment of financial assets. The input will assist the IASB in developing formal proposals that it plans to publish in an exposure draft in October 2009.

The current model in IAS 39 requires an entity to account for credit losses in financial assets only if an event (or a combination of events) has occurred that has a negative effect on future cash flows and that effect can be reliably estimated (this is known as the incurred loss model). A feature of that model is that an entity is not permitted to consider the effects of future expected losses. The financial crisis has highlighted this as an area of concern. Responding to the request of the G20 leaders and others the IASB is reviewing that approach and examining the expected loss model as an alternative.

The expected loss model requires an entity to make an ongoing assessment of expected credit losses, which may require earlier recognition of credit losses. This would better reflect the way that financial assets are priced and the way some companies manage their business.

--- A summary of the main features of the expected cash flow approach is set out in the Appendix.

In accordance with the Institute's Convergence Due Process, comments are invited from any interested party.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Request for Information to be considered, they are requested to be received by the Institute on or before **10 August 2009**.

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Comments may be made available for public review unless otherwise requested by the contributor.

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Appendix

Summary of the main features of the expected cash flow approach

In summary, the main features of the expected cash flow approach include:

(a) interest revenue is recognised on the basis of expected cash flows (including expected credit losses) upon the initial recognition of an instrument.

[**Note**: This differs from the approach in IAS 39 whereby an entity considers some expected cash flows (eg expected prepayments) but not others (eg expected credit losses). Because the treatment of expected credit losses constitutes an important difference between the current approach and the expected cash flow approach, emphasis is given below to the effect of expected credit losses.]

(b) impairment results from an adverse change in credit loss expectations (ie expectations of credit losses are higher than those previously expected).

(c) an impairment loss is recognised in profit or loss and is measured as the difference between the carrying amount of the financial asset and the present value of the revised expected cash flows of that asset.

(d) when determining the present value of expected cash flows, fixed rate instruments are discounted using the effective interest rate calculated upon the initial recognition of the instrument and variable rate instruments are discounted using the current effective interest rate.

(e) subsequent or additional impairment loss is recognised through continuous re-estimation of credit loss expectations.

(f) reversal of impairment loss is recognised in profit or loss when there is a favourable change in credit loss expectations (ie expectations of credit losses are less than those previously expected).

An expected cash flow impairment approach is likely to present the following application challenges, some of which are shared by an incurred loss impairment approach:

(a) the need to formulate expected cash flow data for individual assets and/or portfolios of assets.

(b) the need to estimate initially and subsequently re-estimate credit loss expectations for individual assets and portfolios of assets (which is not a requirement of the incurred loss impairment approach).

(c) the interaction between individual and collective impairment assessments in the event of a loss incurred on specific assets in the portfolio (which also affects the incurred loss impairment approach to some degree).