

## **Impairment of Financial Assets: Expected Cash Flow Approach**

## **Candidates for Expert Advisory Panel membership**

Applications to be received by 5 November 2009

October 2009

# Implementation of the Expected Cash Flow Approach

## Expert Advisory Panel

### Introduction

The International Accounting Standards Board (IASB) is seeking candidates to participate in an expert advisory panel (EAP) that will advise the Board on the operational issues surrounding the application of the Expected Cash Flow approach (ECF).

### Background

At its September 2009 meeting, the IASB tentatively decided to set up an expert advisory panel to provide input to the Board on *operational aspects* of applying the expected cash flow approach.

The IASB reached this decision in the light of the responses received to the [Request for Information](#) on the feasibility of the ECF approach, as well as on responses to the IASB Staff's accompanying outreach activities. The Board started discussing the ECF approach in April 2009 as part of its project to replace IAS 39 *Financial Instruments: Recognition and Measurement*.

The Financial Accounting Standards Board (FASB) decided to also participate in the EAP to provide input on *operational aspects* of applying its decided upon credit impairment model. That model is described as follows:

At the end of each period, an impairment loss would be measured as the present value of management's current estimate of cash flows that are not expected to be collected. (That is, the impairment loss recognised in a period is the decrease in the net present value amount of cash flows expected to be collected.) In estimating the amount of future cash flows, an entity would consider all available information relating to past events and existing conditions that are relevant to the collectibility of the financial asset(s), such as the remaining payment terms, the financial condition of the issuer, expected defaults, and collateral values, as well as existing environmental factors such as industry, geographical, economic, and political data that indicate that some contractual cash flows are not expected to be collected. The entity would not consider possible future scenarios.

### Objective of the Expert Advisory Panel

The EAP has the following objectives:

1. to advise the Boards on how operational challenges of the IASB's ECF approach and the FASB's approach might be resolved; in particular:

- (a) how to best address process-driven implementation issues; the EAP is expected to provide analyses and develop practical solutions for this purpose.
  - (b) what guidance would be useful to be provided by the Boards and in what format (educational guidance or as part of authoritative literature).
2. to assist in organising and running field testing of any proposals made by the Board.

## Candidates for panel membership

The Board is looking for EAP member candidates. To meet the EAP's objectives, suitable candidates would have a background in risk management, systems development or operations, or in product development or in controlling (including auditing) these areas. The two key aspects that the EAP is expected to look at are:<sup>1</sup>

1. how to derive estimates of the cash flows expected over the life of financial assets not measured at fair value with changes in fair value recognised in profit or loss; and
2. application of the effective interest rate (or other allocation mechanisms for credit costs over the life of a financial instrument).

Candidates are expected to have *relevant practical experience* in relation to at least one of the two areas (eg regarding cash flow estimates in connection with implementation of Basel II regulatory requirements). The Board is *not* looking for candidates who would represent other people that have the relevant experience and relay those people's views, rather than give their own personal opinion. Candidates will also be expected to be reasonably familiar, or be able to become reasonably familiar, with the development of the Boards' project regarding impairment of financial instruments (including the IASB's Request for Information). Candidates need not be accountants with IFRS or US GAAP experience.

The Board expects that candidates will engage in open and constructive discussion at EAP meetings and will not be restricted by their respective employers to giving the official views of that particular employer. Candidates are expected to commit sufficient time to the EAP so that they can actively participate. This requires significantly more time than just the meeting time and travel.

The Board is looking for candidates from all geographical areas. Candidates are expected to speak English fluently (the language used for EAP meetings).

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<sup>1</sup> Appendix A provides a list of specific issues that the EAP is expected to address.

Because of the EAP’s focus on operational issues, the candidate profile set out above is tailored towards preparers and related groups rather than towards users of financial statements. The Boards intend to engage separately in outreach activities with users of financial statements to seek their views on the usefulness of information. (If there are conflicts between the usefulness of information, and the operational challenges of providing it, the Boards may consider holding discussions with EAP members and user representatives at a later stage.)

## **Administrative matters**

It is expected that the EAP will have a limited life of seven to eight months, which is the comment period of the IASB’s ED on impairment of financial instruments. Table 1 sets out the tentative impairment project timetable.

**Table 1:** Financial Instruments: Impairment project timetable

<i>Around October 2009</i>	IASB Publishes ED
<i>November 2009 – June 2010</i>	Public consultation
<i>July – October 2010</i>	IASB redeliberations
<i>December 2010</i>	Deadline for final standard

The Boards’ intentions are that it will consider feedback from the EAP in its deliberations on this issue.

The EAP meetings will be held in public. Meetings will be physical meetings to the largest degree possible, but the Board will also consider participation by some panel members via video link or phone. The frequency of meetings is expected to be every four to six weeks (but might be more frequently as necessary). The duration of each meeting is expected to be about two days including travel time.

In addition to the formal panel meetings, we would expect to task subcommittees of EAP members to hold additional discussions between the public EAP meetings to address particular issues and to develop possible solutions to them.

All EAP members will bear their own costs (such as for travel) and time spent on EAP duties. The Board is aware that travel costs vary significantly depending on panel members’ locations. In order to achieve a fairer sharing of this burden, the Board will contemplate rotating the meeting venue among different countries.

Candidates who would like to participate in the EAP should contact the IASB via email ([iasb@iasb.org](mailto:iasb@iasb.org)) by 5 November. The submission should include:

1. a brief summary of how the candidate meets the profile set out in this document.; and
2. suggestions for major issues that the candidate believes should be addressed in the EAP.

## **Appendix A**

The Board expects the EAP to address the following specific issues that have been identified in the course of the Board's project regarding impairment of financial instruments, including the comments received on the Request for Information. In addition, EAP members may identify other issues that need to be addressed as well.

### **Estimating cash flows:**

- lack of historical data;
- estimates for individual financial instruments;
- estimates on a portfolio and individual level;
- implications of 'actual' losses;
- correlation in portfolios;
- migration of instruments over time;
- penalty payments;
- recovery costs;
- interaction with Basel II requirements
- implications of probability of pre-payment; and
- estimates using data from secondary sources.

### **Effective interest method/allocation mechanism for initial expected loss**

- variable rate instruments;
- possible alternatives for the allocation of the initially expected losses;
- determination of the initial expected spread; and
- applying the ECF approach to specific types of instruments (eg instalment loans or revolving facilities).