

### **Impairment of bonds**

On 31 December 20X3, Hummings Co purchased \$10 million 5% bonds in Stave Co at par value. The bonds are repayable on 31 December 20X6 and the effective rate of interest is 8%. Hummings Co's business model is to collect the contractual cash flows over the life of the asset. At 31 December 20X3, the bonds were considered to be low risk and as a result the 12-month expected credit losses are expected to be \$10,000.

On 31 December 20X4, Stave Co paid the coupon interest, however, at that date the risks associated with the bonds were deemed to have increased significantly. The present value of the repayments for the year ended 31 December 20X5 were estimated to be \$462,963 and the probability of default is 3%. At 31 December 20X4, it is also anticipated that no further coupon payments would be received during the year ended 31 December 20X6 and only a portion of the nominal value of the bonds would be repaid. The present value of these cash shortfalls was assessed to be \$6,858,710 with a 5% likelihood of default in the year ended 31 December 20X6.