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Accounting Standards Committee of Germany
Der Standardisierungsrat

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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Berlin, 28 August 2009

Dear David,

Request for Information ('Expected loss Model') Impairment of Financial Assets: Expected Cash Flow Approach

On behalf of the German Accounting Standards Board (GASB) I am writing to reply to the IASB Request for Information ('Expected Loss Model) Impairment of Financial Assets: Expected Cash Flow Approach. We appreciate the opportunity to communicate our views.

We support the IASB's plan to fundamentally review the impairment model for financial assets. We also support the approach to obtain information on the feasibility, the operational challenges and associated costs of an expected cash flow approach before deciding on the future impairment model. The GASB believes that cost-benefit considerations are very important in this case as the implementation of such an expected cash flow approach will be costly and time consuming.

We would like to point out that an expected loss model, once implemented in IFRS, would be applicable for all IFRS preparers even though the current discussions appear to be focussed on financial institutions as a result of the global financial crisis. Therefore, the application of this model to trade accounts receivable is an important issue which has not yet been fully reflected in the respective documents.

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Please find our detailed comments on the questions raised in the Request for Information in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix

Question 1

Is the approach defined clearly? If not, what additional guidance is needed, and why?

The GASB is aware of the fact that the IASB has not yet decided on a future impairment model for financial assets and thus has based its previous deliberations on agenda papers prepared by its staff. However, we believe that it is vital that an expected loss model representing an expected cash flow approach will be clearly described. This is important as constituents may have divergent conceptions of the term expected loss model, in particular as the understanding of the term is impacted by its use in regulatory requirements.

One important issue in our opinion is the unit of account. It is not clear whether an expected loss model should be applied on the level of a single financial asset, a portfolio of assets or a business unit. If applied to a portfolio, further questions arise when this portfolio is not composed as currently described in IAS 39 (eg on the basis of similar credit risk characteristics) but follows a diversification approach, so that the impairment of some positions are compensated by an increased value of other positions.

Another major issue is the treatment of trade accounts receivable. Even though the expected loss model is focussed on financial institutions, it is equally applicable to non-financial entities (the majority of IFRS preparers!), for which trade accounts receivable are a considerable portion of their financial assets. One question in this respect relates to the inclusion of expected losses on initial recognition and its impact on revenue recognition. Another question is whether the effective interest method represents an appropriate method for these assets.

Finally the GASB would like to point out the following aspect. The introduction of an expected loss model results in considering future events in the current accounting. However, this treatment may not be fully consistent. While expected credit losses of financial assets on hand are recognised future losses of financial assets not yet acquired are not recognized regardless of high likely such acquisition may be. Thus the future event ‘probable impairment’ is considered while the future event ‘probable acquisition’ is not. Hence, we have concerns whether the underlying rationale is fully thought through. We also believe that the generic question of whether future events should be reflected in the accounting requires consideration on a framework level rather than being dealt with on a standard by standard basis.

Question 2

Is the approach operational (ie capable of being applied without undue cost? Why or why not? If not, how would you make it operational?

Being a national standard setter, our answer represents views we heard from some of our constituents:

- An expected cash flow approach can be implemented. As this approach requires a continuous re-estimation of future cash flows it most likely can not be done using excel spreadsheets but rather requires considerable adjustments of an entity’s IT systems and processes. We therefore assume that those necessary structural changes will result in additional costs (both, one-time and continuous) and lead time.
- Non-financial institutions indicated that they already review trade accounts receivable for impairment on a portfolio basis based on past loss history and therefore welcome an expected loss model. For other financial assets, ie receivables from finance leases, they see operational challenges.
- Financial institutions pointed out that they have to adhere to regulatory requirements (ie Basel II regulations) and thus would prefer an expected loss model aligned to those requirements to avoid further changes and/or additions to their systems.

Question 3

What magnitude of costs would incur to apply this approach, both for initial implementation and on an ongoing basis? What is the likely extent of system and other procedural changes that would be required to implement the approach as specified? If proposals are made, what is the required lead time to implement such an approach?

We would like to refer to our answer to question 2.

Question 4

How would you apply the approach to variable rate instruments, and why? See the Appendix for a discussion of alternative ways in which an entity might apply the expected cash flow approach to variable rate instruments.

It is GASB's understanding that this issue results from applying the mathematical mechanics of the effective interest method to variable rate instruments rather than applying an incurred or expected loss model. It is our opinion that a future impairment model should be principle based. If in applying such a principle alternative ways are possible how to handle certain issues in detail, we believe that it should be an accounting policy decision made and consistently applied by the entity to determine which handling is appropriate. We see no reason for implementing detailed rules for those issues that would pretend an accuracy of the figures shown while the whole approach – estimation of expected cash flows – includes a significant amount of judgment. There are several other areas in IFRS where the choice of different approaches is up to an accounting policy election rather than being regulated by IFRS.

Question 5

How would you apply the approach if a portfolio of financial assets was previously assessed for impairment on a collective basis and subsequently a loss is identified on specific assets within that portfolio? In particular, do you believe:

(a) changing from a collective to an individual assessment should be required? If so, why and how would you effect that change?

(b) a collective approach should continue to be used for those assets (for which losses have been identified? Why or why not?

We believe that this question cannot be answered generally, as it heavily depends on the individual characteristics of a portfolio of financial assets. The GASB therefore believes that both approaches should be permitted and the entity should be allowed to exercise judgment in determining whether to remove impaired financial assets from the portfolio or not. The underlying principle of the expected loss model should assure that both double-counting and omittance of expected losses will be avoided.

Question 6

What simplifications to the approach should be considered to address implementation issues? What issues would your suggested simplifications address, and how would they be consistent with, or approximate to, the expected cash flow model as described?

As mentioned above the treatment of trade accounts receivable under an expected loss model is not described so far. Thus, this appears as one area where a simplification of the approach can have a significant effect in light of the importance of this item for non-financial institutions.