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DSR-Sitzung:	**144. / 10.05.2010 / 15:15 – 17:15 Uhr**
TOP:	**05 – Financial Instruments – Impairment**
Thema:	**Diskussion der Stellungnahme an den IASB (Stellungnahmeentwurf)**
Papier:	**144_05a_Entwurf DSR-CL ED Impairment**

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

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Dear David,

Exposure Draft ED/2009/12 Financial Instruments: Amortised Cost and Impairment

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB Exposure Draft ED/2009/12 'Financial Instruments: Amortised Cost and Impairment' (herein referred to as 'ED'). We appreciate the opportunity to comment on the ED.

The GASB believes that the expected loss model introduced in the ED is conceptually sound. However, we see major operational challenges in implementing it. This is because the focus lies on expected cash flows which are the estimates of the amounts and timing of cash flows over the remaining life of a financial instrument; information that the entities' current systems do not provide.

In our opinion the expected loss model still has a pro-cyclical effect as actual market developments can differ significantly from expectations based on past experience. We have concerns regarding the high degree of judgement involved in determining expected future credit losses, which gives rise to earnings management opportunities and impedes auditing.

In evaluating cost-benefit aspects, the GASB therefore questions the application of the proposed expected loss model. We think that applying the proposed model will in practice result in an outcome that does not deviate significantly from the current incurred loss model, in particular when considering the incurred but not reported approach currently applied to portfolios of financial assets.

While the GASB welcomes the inclusion of practical expedients, we disagree with the approach taken and believe that the guidance for trade receivables – a major class of financial instruments for non-financial institutions – is not sufficient.

Please find our detailed comments on the questions raised in the ED 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

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Appendix

> **Question 1**
>
> Is the description of the objective of amortised cost measurement in the exposure draft clear? If not, how would you describe the objective and why?
>
> **Question 2**
>
> Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

In GASB's opinion the description of the objective of amortised cost measurement in the ED is clear. The GASB also believes that this objective is generally appropriate for the amortised cost measurement category, although the focus is placed too much on financial assets.

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> **Question 3**
>
> Do you agree with the way that the exposure draft is drafted, which emphasizes measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?
>
> **Question 4**
>
> (a) Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?
>
> (b) Are there any other measurement principles that should be added? If so, what are they and why should they be added?

The GASB believes that the expected cash flow model introduced in the ED is conceptually superior to the incurred loss model of IAS 39. Considering that we favour principle-based accounting standards, we appreciate the way the ED is set up. However, since the model is focussing on expected cash flows being the estimates of the amounts and timing of cash flows over the remaining life of a financial instrument, the implementation of such a model will cause immense operational challenges, i.e. will

be very costly and time consuming to change current systems or install new ones to provide the necessary information. This focus appears to be based on an assessment of the individual financial instrument. But although the proposals include no requirements whether the expected cash flows have to be estimated on a collective or individual basis, we believe that this model encourages a portfolio approach. Following intensive discussions, the GASB holds the view that, despite the principle-based approach of this ED, the outcome of applying this expected loss model will be in practice not so far away from applying the current incurred loss model, especially when considering the incurred but not reported approach currently used for portfolios of financial assets. We therefore question if implementing a new impairment model justifies the efforts regarding costs and time, while the effect is rather small.

In addition, we have the following concerns that also question the cost-benefit ratio of this new model: The GASB believes that this expected loss model is still pro-cyclical. Even with past experience, any future developments cannot be fully anticipated. Accordingly, major market downturns or uplifts will also have the so-called cliff effect in profit or loss under the expected loss model when estimates are adjusted; in comparison to the incurred loss model the only difference would be that the recognition takes place a little earlier. This effect would only decrease if the estimates of the expected losses focus more on worst case scenarios based on historical experience, which in our opinion is not appropriate. Finally the high degree of judgement required in determining future expected losses gives rise to earnings management opportunities and impedes auditing.

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Question 5

(a) Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the exposure draft clear? If not, how would you describe the objective and why?

(b) Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the exposure is appropriate? If not, why? What objective would you propose and why?

The GASB believes that the objective of presentation and disclosure in relation to financial instruments at amortised cost set out in the ED is clear and basically appropriate.

Question 6

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

The GASB agrees that the proposed presentation requirements are appropriate for financial institutions with significant revenue streams resulting from interest-bearing financial assets. We have doubts that these requirements are still appropriate for non-financial entities whose financial assets mainly consist of trade receivables. Therefore, we do not agree with the proposed requirement to include the five line items on the face of the income statement in all cases. We prefer to retain the current requirements in IAS 1.82 and 1.85, that is, additional line items shall be presented in the statement of comprehensive income, when such presentation is relevant to an understanding of the entity's financial performance. Accordingly, an entity with significant interest revenue resulting from financial assets measured at amortised cost will present the proposed line items.

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Question 7

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

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

The GASB acknowledges that the IASB is proposing more comprehensive disclosures in relation to financial instruments measured at amortised cost and thereby reflecting received critical feedback. In this respect, some of the proposals are independent of the impairment model for financial instruments. Others are necessary because of the judgement and resulting subjectivity inherent in the proposed expected loss model. Having said this, we have the following comments regarding the proposed disclosures.

Paragraph 15(b) of the ED requires entities to disclose its write-off policy for each class of financial assets. As appendix A of the ED contains a definition of write-off, we see no room for a write-off policy and the required disclosure, which would be copying the definition. Hence, this disclosure would only make sense when an entity can individually determine its write-off policy. On the other hand, we understand that giving a definition enhances comparability.

We have concerns with defining the status of a financial asset that is 90 days past due as non-performing. Whether or not a financial asset is considered as non-performing depends on several factors such as the specific branch or industry sector, the business model, geographical region or local payment habits, and cannot be determined by bright lines. In this regard, an entity specific determination of non-performing financial assets would be more appropriate. But again, a given definition would support comparability of relating disclosures. We would, therefore, suggest replacing the negative non-performing with a more neutral term. It is then up to the users of financial statements whether they assess financial assets that are 90 days past due as non-performing in each specific case.

We support the proposed comparison of loss allowance with cumulative write-offs (‘loss triangle’) and agree with the reasoning in BC55 und 56 of the ED. However, we are not

sure if these objectives will be met, because based on the definition of write-off in the ED, the time-lag between the 'actual' loss incurring and the write-off may be significant. Additionally, it is not clear for how many period(s) the write-offs have to be accumulated and when – if at all – they can be netted out. Resulting high cumulative write-off figures would impact the transparency of the disclosures.

We anticipate difficulties in practice in circumscribing what is a stress test that leads to the proposed disclosure requirements.

Paragraphs 18(b) and 19(b) of the ED both require disclosures only when the effect is significant (also in paragraph 21(b)). The GASB still holds the view that a general materiality principle applies to all IFRSs, which not necessarily has to be repeated in each standard. Thus, we recommend eliminating the above-mentioned references to significance.

The GASB understands that – in particular in the context of the financial crisis – origination and maturity (vintage) information has been important for certain financial assets (CDOs and similar structures). However, requiring that information to be disclosed for all financial assets measured at amortised cost and by all IFRS-preparers of financial statements will result in an onerous and burdensome task, for which the decision-usefulness of the information will be questionable in the majority of cases. Furthermore, if that information is seen as so important, why is it then not required for financial assets measured at fair value?

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Question 8

Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?

Question 9

(a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?

(b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?

(c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.

Question 10

Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

We agree that a sufficient lead time given the expected implementation challenges is necessary. Considering the feedback from last year's request for information the proposed three years until mandatory effective date are understandable. Despite this fact, it would be preferable to determine a mandatory effective date for all three phases of the IAS 39 replacement project. This would help entities planning to implement all three phases at once, as well as those jurisdictions switching to IFRS in the next years. This will also give a clear sign as to when full comparability of IFRS financial statements in regard of accounting for financial instruments will be given again.

The GASB understands and agrees with the reasoning why the IASB proposed neither fully retrospective nor fully prospective application of the new requirements of the ED. We also understand the reasons why the IASB rejected the alternative transition approach. It is our impression that in the eyes of the IASB a transition approach should meet two objectives: to recognise an adequate bad debt allowance (contractual cash flows not expected in the future) at transition date and to ensure correct revenue recognition (interest revenue) in future periods. The GASB believes that – as this is an ED on amortised cost and impairment – the focus should be placed on the bad debt allowance. Therefore we see merits in the alternative transition approach, which will reduce implementation issues. The fact that the proposed transition approach in the ED is also an approximation affirms our view.

Regarding the restatement of comparative figures, we question whether applying the proposed requirements to trade receivables might result in retrospective adjustment of revenue figures. In this context, we would like to point out that the forthcoming exposure draft on revenue recognition envisages retrospective application.

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As mentioned above, the GASB prefers the alternative transition approach for which the proposed disclosures in relation to transition are not necessary. In case of the proposed transition approach, these disclosures would be appropriate.

Question 11

Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

Question 12

Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements, and what is the basis for your assessment?

The GASB appreciates the inclusion of practical expedients into this ED, which was developed with a focus on financial institutions but will nevertheless be applicable to all IFRS preparers, including those for which trade receivables are the majority of financial assets. But we are troubled by the course of action the IASB has taken in this respect. As already mentioned above, it is our view that the general materiality principle applies to all IFRSs; that is, a certain requirement is not applicable if the issue is immaterial. In contrast to this, the ED prescribes what to do if something is immaterial. The GASB does not agree with this approach, unless it is the IASB's intention to introduce a new materiality level.

Secondly, we do not see the relief for the preparer in this approach. To assess whether the effect is immaterial, the entity has to perform both the proposed amortised cost calculation and the practical expedient, resulting in more and not less effort.

Irrespective of this criticism the GASB welcomes the explanations in B16 of the ED regarding trade receivables. But we believe that there are some important issues not yet addressed. We agree that the initial expected losses on trade receivables shall be treated as a reduction from revenue as this is in line with the proposed model. Accordingly, if cash flows are received in excess of the initially expected losses, we

believe that these should also be recognised as revenue. We also believe that it is appropriate that subsequent changes in the estimated expected losses on trade receivables shall be presented in a separate line item in the statement of comprehensive income. However, we do not think that this line item should be presented as a component of interest revenue. Additional questions arise if the cash flows received exceed both the initially and subsequently expected losses on trade receivables, e.g. nominal amount of CU 100, initially expected cash flows CU 95, subsequently expected additional losses of 5 (resulting in amortised cost of CU 90) and cash flows finally received in the amount of CU 98. In those cases the excess amount has to be split up between reversal of subsequently expected losses and the initial estimate. In combination with the required use of an allowance account such cases might lead to recording difficulties or the need to use two allowance accounts.

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