IASB
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

7 June 2010

Dear Sir/Madam,

RE: ED ON FINANCIAL INSTRUMENTS: AMORTISED COSTS AND IMPAIRMENT

BUSINESSEUROPE is pleased to comment on the Exposure Draft on financial instruments: amortised costs and impairment.

We note that the Board have very much had financial institutions in the forefront of their minds in developing the Exposure Draft (ED.) We are not in a position to evaluate the proposals from their angle but have considered them from the viewpoint of industrial/commercial preparers in general (subsequently referred to as non-financial groups.) We note that, while the financial statements of many groups in this latter category would be little affected in quantitative terms by the proposed changes – e.g. where they have primarily short-term trade receivables with low credit losses – , several suggestions could bring considerable difficulties where preparers are in special situations e.g. for consumer durables retailers, groups holding surplus funds in high quality bonds and other debt securities or groups which include financial divisions or subsidiaries for sales financing purposes.

We should nonetheless say at the outset that BUSINESSEUROPE supports in principle the basic notion of financial assets taking into account current estimates of future cash flows, which may be insufficiently considered in the incurred-loss approach. Real, active users with whom we have regular, day-to-day contact are primarily interested in such expectations of future cash flows. One might even argue that taking into account expectations of future credit losses not yet incurred is actually necessary to avoid an overvaluation of assets. For many non-financial groups the difference from the measurements produced on an incurred-loss basis would admittedly be minimal, so the benefits would probably not justify the implementation costs. We can share the misgivings of the two dissenting Board members on this point (AV2.) And even with the expectations of future cash flows in mind as the overall target which we support, we do nevertheless have substantial concerns on the modalities as they affect non-financial groups and try to explain these below and in the appendices. It is also worth mentioning that many believe that the ED in several places lacks clarity and understandability and that any resulting standard must be considerably better articulated to make it operable in a consistent fashion.

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Three of our key concerns stem from the almost exclusive concentration of the ED on the situation of financial institutions. While one can understand this focus in recent circumstances, one cannot accept it. The majority of issuers of IFRS financial statements are not financial institutions, and IFRS must be able to properly reflect the business realities of non-financial groups as well as financial institutions'. The three main specific areas where we must consequently take issue with the ED in this respect are as follows:

- *Trade receivables and other operating financial assets*

With the exception of one throw-away paragraph, the ED focuses on financial assets purely as interest-earning assets and totally ignores such financial assets (e.g. trade receivables, travel advances to employees, advances to suppliers, etc.) which are not first and foremost interest earners but arise as a by-product of "real-economy" transactions. It completely fails to recognise the very real and substantial differences in nature and role between such operating financial assets and purely financial assets like loans, bonds, etc. As it would lead to significantly worse (irrelevant, potentially misleading) information, this would be quite unacceptable. The final standard should therefore prescribe a distinct and different approach for those financial assets which arise as the by-product of non-financial transactions (e.g. sales) from that to be applied to purely financial assets which exist solely as lending transactions. We expand on this key issue in Appendix 1, focusing on trade receivables.

- *Financial operations within non-financial groups – system impacts*

Taking as an example the separate financial operations of certain car manufacturers related to sales financing, we believe that the imposition of the proposals would involve very costly and substantial system changes and complexities which would not result in significantly better information for users. At present such operations generally base their accounting for sales financing contracts on their contract management systems, where naturally no allowance for any potential individual credit loss is reflected. The proposed approach would mean substantial, costly modification and higher running costs for these systems to give parallel data adjusted for expected credit losses, with yet another set of interest factors. As such operations often already have to make additional calculations for (e.g.) Basel II purposes, the extra imposition of a further diverging basis would have appreciable negative effects.

- *Disclosures*

While we are not in a position to judge whether the disclosure requirements proposed in paragraphs 14-22 and 28-29 might be desirable and necessary for financial institutions, we believe that they would generally be quite excessive for the specific circumstances of non-financial groups. The latter already suffer appreciably under IFRS 7 which similarly fails to make adequate provision for flexibility in the level and detail of disclosures depending on circumstances (materiality, relevance, etc.) This is also unacceptable.

Finally, we have very serious doubts about the relationship between the work of the Expert Advisory Panel and the due process. Nothing in the ED suggests that the Panel's recommendations would be open for consultation and comment by constituents before becoming adopted in the final standard. If this were the case, we would strongly object to such a violation of the Board's laid-down due process.

Should you wish to comment on the above further, please do not hesitate to contact us.

Yours sincerely,

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Director
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BUSINESSEUROPE

Appendix I to BUSINESSEUROPE letter on ED Financial Instruments: Amortised Costs and Impairment

Trade receivables

The solutions proposed for trade receivables in the ED appear to us to be quite inappropriate and unsatisfactory. Only paragraph B16 shows any perception of the need for more adequate treatment, and even this is limited to a short-cut method for calculating the expected credit losses and their initial recognition, with a disconcerting absence of any appreciation of the substantial differences in nature and role between trade receivables and purely financial assets such as loans, bonds, etc.

With loans, bonds, etc. the asset ***is*** the transaction, being solely the provision of funds to a third party in exchange for interest and return of principal. While it is certainly true that a trade receivable does involve the provision of some form of credit to a third party, it is first and foremost the reflection of a sale transaction in which any credit aspect is generally completely ***subsidiary and incidental***. It is not of itself a revenue-earning asset. There may occasionally attach rather greater significance to this credit aspect, e.g. when extended credit terms are agreed, possibly with an implicit or explicit increase in consideration as a result, when a financial lease is involved or when in inflationary conditions the seller seeks some form of compensation for the loss in value resulting from delayed payment. (Even here the compensation may well not reflect any expectation of credit loss but only time-value.) But we venture to suggest that such situations are exceptions to the plain-vanilla trade receivable which accounts for the overwhelming majority of non-financial groups' sale transactions. These exceptions should be treated as such, with specific approaches to take account of their specific nature, rather than having standard trade receivables subjected to a meaningless, indeed often misleading, treatment as quasi-loans, with nonsensical negative interest revenues.

In contrast to financial institutions pricing their loan transactions, non-financial groups will generally not determine their product pricing with any reference to an amount to cover credit losses or even the time-value of money but will charge what the market will bear for the product under offer. Credit losses are regarded as a cost in the same way as selling expenses or production costs, not an element of revenue. They are not a (negative) "effective return on a financial asset" (cf. ED, paragraph 3.) Indeed, active users whom we have consulted confirm that they also consider trade credit in the same fashion and are absolutely unanimous that the revenue they wish to see reported as such is the gross amount of the sale before any allowance for credit losses. In short, the application to trade receivables of the approach proposed in the ED for purely financial assets such as loans, bonds, etc. would in fact misrepresent the business reality and thus perform a disservice to users. Its imposition would simply lead to even more non-GAAP information being presented by non-financial groups, in the form understood and used by both preparers and active users, and thus to further side-lining of the IFRS financial statements.

The Board may also like to re-consider the potential conflict with IAS 18 and the implications for the unit of account. For an individual sale it will rarely be the case that any credit loss is expected at the outset so that a gross revenue measurement and presentation is totally appropriate. On a portfolio basis, however, based on historical experience etc., a certain, not individually identified portion may be expected to result in a loss, so that an allowance to align balance-sheet values with overall expected cash inflows is justified. We share the dissenting Board members' misgivings on this unit-of-account aspect (AV5.) It has been suggested that the standard should simply exclude short-term trade receivables in order to avoid the distortions to which the ED approach would lead. However, some (more appropriate) approach for measuring trade receivables would still have to be laid down – even if it were just to repeat the current incurred-loss principles. We believe that a more constructive approach would be, for the measurement of trade receivables (and other operating financial assets whose creation does not result solely from the transfer of money in return for interest), to continue as now to recognize the individual sales transactions at full value and to assess credit losses (but expected rather than, as now, incurred) at each reporting date on a portfolio basis, making valuation adjustments as necessary in the form of a global allowance and presented as expense.

This appendix has focused on trade receivables. Nonetheless, the same arguments apply to other operating financial assets which are not primarily created for themselves and as a source of interest income, such as those mentioned in our covering letter.

Appendix II to BUSINESSEUROPE letter on ED Financial Instruments: Amortised Costs and Impairment

Specific responses to the questions asked in the ED

OBJECTIVE OF AMORTISED COST MEASUREMENT

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?

In respect of loans, bonds, etc., we are happy with this description, though we do think that referring to "**current estimates of future cash flows**" rather than "current cash flow information" would be a little more precise. As mentioned in our covering letter, however, we have considerable difficulty in relating what is written in the ED to trade receivables and other operating financial assets (see covering letter and Appendix 1.)

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?

Again, while the objective in para. 3 of the ED is suitable for loans, bonds, etc., we do not find it appropriate for trade receivables etc. in that form.

MEASUREMENT PRINCIPLES

Question 3

Do you agree with the way that the exposure draft is drafted, which emphasises 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?

We are happy with the proposed general approach as we consistently favour principle-based standards. However, we would like to make two points:

(a) Again, we find the almost exclusive focus of the ED on loans, bonds, etc. completely unhelpful and inappropriate for non-financial groups with trade receivables and other operating financial assets. Even the throw-away referring paragraph B16 raises more questions than it answers. It is rather disturbing that the Board has apparently not grasped the fundamentally different nature of trade receivables etc. but has deemed that this paragraph offers a sufficient and appropriate solution for non-

financial groups, despite being made aware of the circumstances in such groups' responses to the Request for Information (see also covering letter and Appendix 1.)
(b) Perhaps we should have started our response to this question with "We think we are happy with the proposed approach insofar as we understand it." The ED is not readily understandable. A "principle-based" standard should not require jumping back and forth between different parts of the standard but should be so clear that it enables the reader to fully understand what is required. A standard should set out the principles in bold and explain what it means and wants directly. The reader currently cannot even start to grasp what the ED wants without having had a look at the detailed calculation and explanations which the IASB staff have put online. There is a difference between explaining what one is trying to achieve and giving cook-book guidance, but the ED seems to be nowhere. Also, the proposed standard needs in several instances to be clarified by information currently contained in the Basis for Conclusions: the substance of BC 25 and BC 34-36 on impairment, for instance, could usefully find its way into the standard itself.

Question 4

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?

Are there any other measurement principles that should be added? If so, what are they and why should they be added?

Here we would have a general remark on the legitimation of the principles set out within the broader conceptual framework. The Board appears to be still somewhat at sea as to the extent to which uncertain future events should be taken into account in measuring assets and liabilities. This major cross-cutting issue has also manifested itself recently in (e.g.) contingent rental payments and renewal options on leases and rights of return in revenue recognition, and we sincerely hope that a resolution of this conceptual matter in Phase C of the Framework project will not lead to a subsequent "volte face" on this particular issue. As mentioned in our covering letter, we support the proposal to consider the uncertain future events (credit losses) as we believe that this would better reflect expected future cash flows and so would be more relevant for users.

It is perhaps unfortunate that the term "expected" in this sense is sometimes taken as being identical with the "expected-value" approach. We do not believe that this is true: the key objective must be to arrive at the best estimate of expected future cash flows, by whatever method is deemed most appropriate under the circumstances. This certainly is not necessarily a probability-weighted approach. Hence our support for the ED's approach, which is appropriate under the circumstances of portfolios of trade receivables or loans, should not be taken as implicit support for universal application of the expected-value method, which in many circumstances would simply confer a misleading aura of scientific accuracy to what is a "best shot" (e.g. litigation provisions.)

The approach would, however, not be without certain practical application problems. It would be more subjective than the incurred-loss method as it would be even more subject to elements of judgment. One important aspect to bear in mind here is the uncertain timing of expected cash flow shortfalls. However, users might well find comfort on this subjectivity issue in the proposed provision of comparative data on estimated vs. actual losses. Furthermore, in many cases historical data might not be readily available.

In view of the fact that many entities will now have far more investments in marketable debt securities falling into the amortised cost category than nefore and therefore subject to such complex and potentially costly impairment testing, we would also like to suggest that the Board should consider permitting a fair value option with value changes going through OCI (cf. equity securities), which would obviate the need for such testing.

OBJECTIVE OF PRESENTATION AND DISCLOSURE

Question 5

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?

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

No, the description of the objective is not clear. It should be better articulated with the objective formulated in para. 3 by focusing firstly on effective return, e.g.

> *An entity shall present and disclose information that enables users of the financial statements to evaluate* ***the effective return on financial instruments carried at amortised cost. This includes information on*** *the financial effect of interest revenue and expense, and the quality of financial assets including credit risk.*

However, at the risk of being repetitive, we must say that it is not possible for us to relate the proposed objective to trade receivables and other operating financial assets (see covering letter and Appendix 1.)

PRESENTATION

Question 6

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

No, we cannot relate to the proposed presentation requirements as they would affect trade receivables and other operating financial assets (see also covering letter and Appendix 1.)

Question 7

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

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

No, we do not agree. The disclosure requirements proposed in the ED are very comprehensive and address amortised cost from various perspectives. Before commenting on the individual proposals, we wish to express considerable concerns relating to the disclosure package as a whole. While it focusses on financial institutions, on which we cannot judge, the volume of disclosures that non-financial groups would have to produce would in most cases be totally excessive – and generally scarcely relevant - and might distract the attention of active users from the core business of the reporting entity. In the proposed form we are certain to end up with the same situation as on IFRS 7 where disclosure requirements designed with a focus on banks have led to a massive and largely unhelpful explosion of data being disclosed by non-financial groups in a generally dysfunctional fashion. For many non-financial groups, surplus funds may be invested in high quality bonds and similar debt securities, currently often accounted for as available-for-sale but in future likely to fall into the amortised-cost category and therefore subject to these onerous disclosure requirements. Given that such groups – in contrast to many financial institutions - will not normally be investing for maximum gain with these assets but focusing on minimum-risk investments, we very much doubt whether, in practice, the mass of additional data which would have to be published is going to add sufficiently to users' understanding to justify the cost. We strongly urge the Board to seek ways of making the requirements far more flexible depending on the circumstances of the entity concerned.

The link between the proposed disclosures and those included in IFRS 7 is also unclear. We think that the information is inherently linked and can only be fully understood if considered as a whole.

Allowance account

We support the proposed approach on the allowance account, even for entities whose principal financial assets are trade receivables as it gives an easily prepared picture of the development of credit exposures over the period in a form which should be readily understandable for active users. A historical perspective of the key components of change (cf. paragraph 19) would also be a helpful addition for active users to give them some basis for assessing the reliability of estimates. In conjunction with the Financial Statement Presentation project, the Board might also consider a roll-forward of gross

trade receivables (movements) which could provide for non-financial entities a useful link between income and cash flow statements.

Estimates and changes in estimates

Here our main plea is again to make the requirements more flexible depending on the entity's circumstances.

Stress testing

We understand that many active users would prefer some form of sensitivity analysis to the proposed stress-testing information and suggest that the Board might give more consideration to this alternative. Again, this should be flexible enough to reflect the entity's circumstances.

Other disclosures

Our general comment – on the need for more flexibility to reflect the entity's circumstances, especially for non-financial groups – similarly applies to the proposals on credit quality and origination and maturity information.

EFFECTIVE DATE AND TRANSITION

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?

We have some sympathy with along implementation period for financial institutions, bearing in mind the potentially extensive system changes which would be necessary in many cases. We further think that the need to restate comparative periods with retrospective application would also requires considerable time and resources. We therefore propose prospective application (see Question 9.) With such prospective application the lead-time would be appropriate.

Question 9

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

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

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.

In the particular circumstances of these proposals, we believe that retrospective application should not be applied. They would in effect require a period of parallel-running of (often large) systems on two divergent bases without, in our opinion, any significant gain in decision-useful information for users.

Question 10

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

With the caveat of our general comment – on the need for flexibility to reflect the entity's circumstances, especially for non-financial groups - we support the proposed disclosure.

PRACTICAL EXPEDIENTS

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?

We do not agree with the proposed guidance, which is complex and unclear. In any case we do not believe that "practical expedients" are the right way to set high quality principle-based standards. As we have argued above, the proposed approach for trade receivables and other operating financial assets is simply wrong and inappropriate. Rather than create "practical expedients", the Board must identify more relevant and workable principles for such instruments in the body of the standard.