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Chère Mme Flores

IASB ED *Financial Instruments: Amortised Cost and Impairment*

The ICAEW welcomes the opportunity to comment on EFRAG's draft comment letter to the IASB on its ED *Financial Instruments: Amortised Cost and Impairment*.

The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

We continue to develop our own views on the IASB proposals, but have reviewed the EFRAG draft submission as requested and our comments at this stage are as follows:

- Page 2 states that it should be possible to develop accounting standards that satisfy both the needs of prudential supervisors and capital market participants. We would reinforce the view that additional regulatory needs should be met through the use of prudential filters rather than disclosures in general purpose financial statements.

- Page 2 expresses support for more forward-looking information about credit losses and appears to extend this support to the use of the expected cash flow model as required by the IASB ED. We agree with reporting that incorporates more forward- looking information about credit losses, but we are not convinced that the model set out in the ED is the best way of improving existing practice in terms of the relevance, reliability and understandability of the information it provides. For example, the ED could result in negative allowances where actual losses in a period exceed that that were expected to date. We believe that actual losses in a period should be differentiated from expected future losses and changes in estimates of expected future losses and therefore that some notion of incurred loss should be retained. We would not focus on the elimination of a 'trigger event' as being necessary to incorporate more forward looking information as recognition and disclosure of losses that occur in a period (however this occurrence is defined) is important information which should be presented separately from the effect of expected losses.

- Pages 2 and 3 appear to support using effective interest as an allocation mechanism for initial expected losses. We believe that this theoretical approach is undermined by the fact that the timing

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of missing cash flows is impossible to predict (and would strengthen the comment on page 3 point b(i)accordingly) and by the significant operational issues which arise as a result of mixing impairment and effective interest calculations. It may be possible to determine expectations of future losses, but not expectations of the timing of missing future cash flows, which is a fundamental flaw in the approach set out in the ED.

- Page 2 supports the ‘loss triangle disclosures’. While we agree that it is important for losses arising in a period to be separately identified, we are concerned that a requirement to disclose cumulative write-offs may require the use of closed portfolios which could create significant operational issues.

- Page 3 expresses concerns regarding how the objective of amortised cost proposed in the ED relates to short-term receivables. We would express this concern more forcibly by stating that the standard should be suitable for implementation by all reporting entities, to ensure that trade creditors and other financial assets at amortised cost that are not loans and advances are accounted for in a way that is understandable to preparers and users. The business models used by non-financial sector entities are different from those used by those in the financial sector. Trade receivables are not key interest earning financial assets for most non financial reporting entities. It is not likely that there will be significant credit losses on initial recognition of sales revenue. If the issue here is revenue recognition, it should be dealt with in that project and included in a standard that is designed to deal with a different business model.

- Page 3 (b) (iii) states that the IASB should explain more fully why changes in estimates of expected credit losses should be recognised in profit or loss in the period of re-estimate. We believe that the IASB staff paper of 30 April has explained the board’s position clearly in this respect.

- Page 3 (b) (iv) states that the IASB ED does not address the issues that relate to financial assets that can be extended such as credit card receivables and overdrafts. We agree that this is an important issue relating to practical implementation.

- Page 3 (b) mentions the output of the Expert Advisory Panel. We understand that the EAP will not be publishing a report of its recommendations to the IASB for resolving operational challenges. We share the concerns of EFRAG that this could cause problems with interpretation of the IFRS for preparers and raise further issues of lack of comparability. It would be preferable to have the opportunity to comment on the findings and suggested solutions of the EAP. We note, however, that the IASB (rather than the EAP itself) has published a summary of its discussions to date which highlight some of the key operational issues which the IASB will need to address in developing the standard.

- With regard to practical expedients, on page 4, we do not agree that financial reporting standards should be drafted in such a way that they can only be implemented using practical expedients. We do not think it is helpful to suggest that practical expedients are acceptable if the difference in outcome of that method is immaterial to that required in the standard (B15). Entities will need to do both methods to prove immateriality either in theory or in practice to prove immateriality. If the method set out in the financial reporting standard is not possible to do, the entity will find it difficult if not impossible to prove immateriality. While practice will no doubt develop that supports the practical expedients, this does not represent good standard setting. We do, however, agree that entities are likely to continue recording effective interest as at present, determine an initial estimate of credit losses, spread this estimate to approximate effective interest and then determine the effect of changes in estimates as gains and losses because this seems the only practical, high level, method of approximating the requirements of the ED. Since this is the case, it may be preferable for the standard explicitly to set out this process thereby making it clear to the whole constituency how impairment is determined in practice.

- Pages 1-3, we note that the response mentions operational challenges for preparers but does not comment on the alternative views which state that the approach in the ED does not pass a reasonable cost/benefit test. We also share the concerns about whether the results of the model set out in the ED can be audited, and hence whether the results are verifiable and meet the qualitative characteristics of financial reporting, particularly that of understandability.

- Page 13 paragraph 44 refers to the new approach enabling the use of a broader range of credit related in formation to identify future credit losses. We agree with the use of judgement in determining appropriate allowances but are concerned that the ED lacks clear and practical guidelines around which management should exercise judgement, particularly how managements' views on possible future economic conditions should impact the assessment of expected losses. In the absence of clear guidelines, we are concerned that the results could be open to manipulation as managements' views on the future change. We are also concerned that undue optimism or pessimism in setting these expectations could result in volatility that is not related to actual economic conditions and give rise to concerns that the results are, therefore, more procyclical than the existing incurred loss approach. Rather, entities may be able to determine life time expected losses by considering past loss experience with appropriate adjustments that reflect current economic conditions.

- Page 15, paragraph 54, refers to the possible use of probability–weighted expected cash flows. We do not believe that this concept is used in practice for developing loss expectations for loan portfolios for risk management or financial reporting or could be successfully implemented given that the timing of missing cash flows cannot be predicted.

- Regarding page 20, paragraph 74, on the presentation of interest income and expected credit losses, we believe that impairment should be separate from effective interest. Mixing the two is not only confusing for presentation of the results, it leads to some of the unnecessary operational challenges.

- Regarding page 23, paragraph 89 (b), we agree that disclosures should be considered as a whole in IFRS7 . Disclosures, in our view, should enhance the accounting model rather than attempt to address its shortcomings. In our view, disclosures should focus on:

    - providing a movement over time of the impairment allowance so that users can see how allowances are created and utilised;
    - explaining the assumptions underlying the impairment calculations, including a sensitivity analysis;
    - facilitating comparisons between non-performing loans and impairment allowance; and
    - explaining the write-off policy.

- Regarding page 28, paragraph 111, we support a more simplified approach to implementation. Users seemed to be well served by the transition to IFRS in 2005 which provided reconciliations and explanations of the differences between closing and opening balance sheets without restated comparatives. Restating comparatives seems likely to add to the lead-time, costs and complexity of transition without corresponding benefit.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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