THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

KS/ASC-SUB/ks-mb

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Dear Mr Enevoldsen

IASB EXPOSURE DRAFT 2009/12: FINANCIAL INSTRUMENTS: AMORTISED COST AND IMPAIRMENT

The Institute's Accounting Standards Committee has considered the above exposure draft and I am pleased to forward its comments to the IASB.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires the Accounting Standards Committee to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

The ICAS Accounting Standards Committee supports the IASB's objective of developing an alternative to the current IAS 39 model for measuring financial instruments at amortised cost and impairment. We recognise that the incurred loss impairment model has been subject to a number of criticisms – chiefly that losses are recognised too late. We also agree that the current standard is too complex. However, we are firmly of the belief that financial reporting should not be used as a tool to achieve financial stability and that the aim of the IASB to create a single set of high quality globally acceptable principles-based accounting standards should not be compromised by allowing political aims to influence the standards.

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We appreciate that the IASB has been under considerable pressure from many stakeholders to improve the financial reporting of financial instruments following the financial crisis. However, we are concerned that due process would have been better served by allowing constituents to comment on the full proposals rather than on a piecemeal basis. The Financial Accounting Standards Board (FASB) in the USA has recently published an exposure draft of its full proposed replacement standard for financial instruments. This exposure draft proposes a different model for impairment and leads us to question how a globally accepted standard can be achieved. We believe that it is important that the IASB's constituents have the opportunity to comment on its proposals in the light of the FASB exposure draft and the current timescale does not adequately allow for this. We are also concerned that the Board will be placing a great deal of reliance on the Expert Advisory Panel (EAP) to advise on whether the proposals are operationally workable, yet constituents will not have the opportunity to comment on the findings of the EAP.

The concept of an expected loss model, incorporating more forward looking information, is considered by most commentators including our Committee to be a more appropriate approach in principle. However, we are concerned that the proposals in the exposure draft may not be the most suitable method of providing a clear, concise and unbiased account of business performance. We believe that the expected loss model is very complex, particularly the requirement for continual reassessment of expected losses, and therefore will be costly and time-consuming to implement. The level of subjectivity involved in the estimation of expected credit losses will mean that the model lacks reliability, and that the results will be difficult to interpret and compare across different entities.

We are also concerned that the proposals have been developed with only financial institutions in mind and the impact on those entities whose only financial assets are trade receivables have not been properly considered.

Our responses to the specific questions posed in the exposure draft can be found below.

Question One
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?

Yes we believe that the objective is clear.

Question Two
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?

Yes we believe that the objective of amortised cost and impairment is appropriate.

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Question Three
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 agree that the emphasis should be on the measurement principles accompanied by application guidance. We believe that it would not be appropriate to include additional implementation guidance and illustrative examples within the standard itself. However, as noted above, although we support the formation of an Expert Advisory Panel (EAP), we are concerned at the due process and lack of opportunity for constituents to comment on the conclusions of the EAP in relation to any further guidance that may be considered necessary.

Question Four
(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?

Yes we agree with the measurement principles in theory. However, we note that there will be significant practical difficulties for financial institutions in applying these principles – including the difficulty in estimating credit losses over the life of the instrument and incorporating such data into the EIR reporting models. This will involve a significant change to the way financial institutions operate.

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

None

Question Five
(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?

We believe that the objective needs to be more clearly linked to the objective of measurement. We propose the following wording:

"An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effect of interest revenue and <u>expense on the expected future cash flows</u>, and the quality of the financial assets including credit risk."

(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 draft is appropriate? If not, why? What objective would you propose and why?

Yes we believe that the objective of presentation and disclosure is appropriate.

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

Overall we agree with the proposed presentation requirements. However, we are concerned with the application of these requirements to non-financial institutions whose main financial assets will be trade receivables. These entities generally do not factor interest revenue into the price of their goods and services and therefore we question whether the presentation requirements will result in decision-useful information in the financial statements of such entities.

For financial institutions, we believe that the presentation requirements are appropriate. However, for non-financial institutions we believe that there is a need for more relevant presentation requirements – perhaps through the use of practical expedients for presentation as well as measurement.

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

We agree overall with the proposed disclosure requirements. However, we do believe it is necessary to try to reduce the disclosures made by non-financial institutions where this is appropriate.

The Committee does not agree with the proposals for disclosures on stress testing. We do not believe that this disclosure adds decision-useful information and could simply result in boilerplate disclosures that lengthen the financial statements without adding any tangible benefit. The disclosures under the heading "Estimates and changes in estimates" would include reference to stress testing where this is relevant. Stress testing is merely one method of assessing the potential impact of a change in assumptions and therefore explicit disclosures are not appropriate.

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

We do not consider it is necessary to add further disclosure. However, we believe it would be useful for the standard to make clear the link between the IFRS 7 disclosure requirements on credit risk and the requirements within the proposed standard.

Question Eight
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 believe that the operational complexities of implementing the proposals, in particular for the large financial institutions, are such that a three year timeframe would be necessary. We also note that the implementation of the new requirements will be more beneficial for preparers and users were the complete proposals relating to the reporting of financial instruments to have the same mandatory effective date.

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Question Nine

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

We agree in principle with the proposed transition requirements. However, given the practical difficulties in applying the proposed measurement principles – including the difficulty in estimating credit losses over the life of the instrument - we believe it is necessary to assess whether it is operationally possible to apply the proposals retrospectively to comparative information in the timeframe available. We believe this is one area where the Board should consider the findings of the EAP.

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

As explained above, we believe it is necessary to consider the findings of the EAP.

(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.

See response above.

Question Ten

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

We agree with the proposed disclosure requirements, subject to the consideration of the restatement of comparative information as discussed above. In principle we believe restated comparative information is preferable for the user.

Question Eleven

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

We are concerned about the use of the term "immaterial" in the guidance on practical expediency. In order to demonstrate that the impact of the calculations is not material, it would be necessary to perform the calculations in the first place. We therefore suggest that the terminology is clarified or the wording revised so that references to materiality are deleted.

Question Twelve

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?

See the response to Question 11, but other than that no.

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I hope our comments are useful to you. If you wish to discuss anything further please do not hesitate to contact me.

Yours sincerely

KAREN SHAW
Assistant Director, Accounting and Auditing
Secretary to the Accounting Standards Committee

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