Patrick Mommens

From: Signe Haakanes [Signe.Haakanes@revisorforeningen.no]
Sent: 01 April 2011 17:48
To: director@fasb.org
Cc: CommentLetters
Subject: File Reference No. 2011-150 - comment letter Impairment supplement
Attachments: Impairment ED 2009 12 supplement.pdf

Re. File Reference No. 2011-150
Please find enclosed the comment letter from Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) on Exposure Draft, Supplement ED/2010/12 Financial Instruments: Impairment

Regards,
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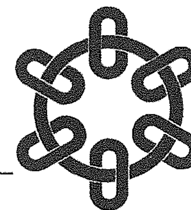
Norsk RegnskapsStiftelse



International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Cc: EFRAG

Oslo, April 1th, 2011

Dear Sir/Madam

Exposure Draft, Supplement ED/2010/12 Financial Instruments: Impairment

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) welcomes the opportunity to submit comments on the supplement exposure draft Financial Instruments: Impairment (the ED). While our detailed comments and basis for our conclusions are set out in the appendix to this letter, we would especially like to bring the following point of view to the attention of the IASB.

We have concerns about the scope of the ED. The scope of an amortised cost impairment model should include all financial assets measured at amortised cost and not only a subset of financial assets managed in an open portfolio. To achieve the objective of reducing complexity it is important that measurement of impairment is kept principle based, that the number of impairment models are limited to one and that any regulated practical concessions are limited to those that yield results approximately similar to the one principal model.

We stress the importance that an impairment model is to work as an integrated solution within a coherent IFRS 9 standard.

The model now proposed by the IASB do in many ways take up the principles proposed in an alternative model presented in Annex A of our comment letter (se CL 104) to ED/2009/12. We continue to support the concepts underlying that alternative model.

We agree with the ED that it is no longer appropriate to recognise expected credit losses over a time period if the collectibility of a financial asset, or group of financial assets, becomes so uncertain that the entity's credit risk management objective changes for that asset or group thereof from receiving the regular payments from the debtor to recovery of all or a portion of the financial asset.

We agree with the basic premise in the ED that when the credit risk management objective has shifted from that of receiving the regular payments from the debtor to that of recovery of all or a portion of the financial asset, then the objective of the business model is no longer to hold the relevant assets in order to collect contractual cash flows.

However we note that the Board in the ED does not follow the consequences of a change in the risk management strategy, but continues to propose an adjusted amortised cost measurement, when such a measurement attribute is no longer appropriate. We do not agree with the proposal of using an adjusted amortised cost measure when the risk

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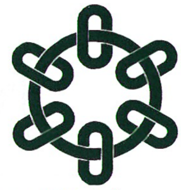


management objective has changed from collecting contractual cash (the regular payments) from the debtor to recovery of all or a portion of the financial asset.

We do not support the concept of introducing a minimum allowance amount (floor). We think this is counterintuitive to the basic effective interest rate concept of applying amortised cost in IFRS 9. Amortised cost is the more relevant measurement criterion when the basis for holding the financial asset is to receive contractual cash flows. To the extent that the entity does not hold an asset with the basis assumption of receiving all contractual cash flows, as indicated by transferring the asset to a "bad book", amortised cost is no longer the more relevant measurement criterion. However as long as amortised cost is the more relevant measurement criterion it becomes inconsistent to adjust amortised cost for the expected timing of an unexpected (loss) outcome. If for a specific instrument there is an expected timing of a loss event then amortised cost is not the correct measurement criterion.

We consider that the basic premise in IFRS 9 is to measure financial instruments at fair value through profit or loss with exceptions for (a) most financing non-derivative liabilities not held for trading and (b) certain assets with defined cash-flow characteristics that are hold to collect contractual cash flows, where amortised cost is considered the more relevant measurement criteria.

For most financial assets or liabilities initially recognised as current financial assets or current financial liabilities, where cash flows are fixed or determinable <u>and expected to be realised</u>, the difference between amortised cost and fair value will be insignificant and amortised cost can be seen as a mere practical approximation to fair value. Our recommendation is thus that the IASB should not spend efforts to develop an amortised cost model for such financial assets and liabilities. A more stringent conceptual solution would be to state fair value as the measurement principle for all financial instruments initially recognised as current financial assets or current financial liabilities.

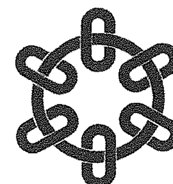
The exceptions to measure financial assets at fair value through profit or loss would thus be limited to business models, strategies or activities in which intra-period changes in fair value are not considered relevant.

To introduce an adjusted amortised cost model to financial assets, for which the business strategy is to secure and recover maximum values as opposed to collect contractual cash flows, would add further complexity into both the IFRS 9 and the amortised cost model.

Further explanations to our points of views and concerns to the exposure draft are laid out in our detailed comments to the questions in the order suggested by you in the appendix to this letter. Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response, or related issues, further.

Yours faithfully,

Erlend Kvaal
Chairman of the Technical Committee on IFRS of Norsk RegnskapsStiftelse



Question 1
Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

We believe that the approach for recognition of impairment described in the ED deals with the weakness currently in IAS 39 of delayed recognition of expected credit losses.

Question 2
Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

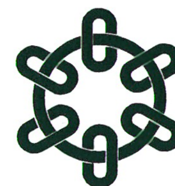
Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

We believe that IFRS 9 should be principle based with limited exemptions. We believe that the proposed approach to assets in a "good book" open portfolio can be at least as operational for closed portfolios and individual instruments. We do not believe that an amortised cost approach should be developed for other instruments like guarantee contracts as amortised cost is not the most relevant measurement attribute for such instruments.

Question 3
Do you agree that for financial assets in the 'good book' it is appropriate to recognise the impairment allowance using the approach described above? Why or why not?
We do not agree with the higher of concept proposed in paragraph 2. The argument underlying the higher of concept is that the expected timing of unexpected losses does matter. We disagree with this argument. The underlying assumption for the use of the amortised cost model is that for certain assets the intra-period changes in fair value are not considered relevant. A higher of concept is in conflict with this underlying assumption and should thus not be a part of an amortised cost measurement. We further believe the proposed model should reflect the link between the pricing of the asset and the expected credit losses. The proposed higher of concept is inconsistent with such an approach as it might result in day one losses. Hence, we disagree with the higher of concept proposed in paragraph 2.

If it the Board nevertheless finds a need to recognise a pattern of early or late loss recognition we believe this issue should be addressed by requiring a time proportional approach based on expected loss profiling that ensures that a provision is built up faster (slower) where there is evidence of a pattern of early (later) loss emergence in the particular type of portfolio. We believe this approach will be principle based, will mitigate the risk of inadequate provisions and ensure that link between the pricing of the asset and the expected credit losses are retained (reflect the economic substance of the transaction).

Provided that the Boards decide to proceed with the proposed lower of test, we encourage the Boards to clarify why a floor is needed in the "good book", given that all expected credit losses will have to be recognised of any bad loans identified within the portfolio (to be transferred to bad book). We presume that the purpose with the lower of test is not to provide for identified losses on individual loans (to be transferred to bad book), but adjust for a front-loaded allocation (profiling) of losses expected for that particular type of loans in general.



Question 4
Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

We believe that the proposed approach specified in B8-B10 in the ED is operational. It is our understanding that the minimum information required to conduct such an approach is easily available from most system managing portfolios of non-current financial assets with fixed or determinable cash-flows.

Question 5
Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

We believe that the proposed approach will provide information that is useful for decision making. We have however concerns about the usefulness of information provided under a higher of model as such information due to different time horizon might not be comparable between entities and over time.

Question 6
Is the requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

Amortised cost is a management driven exemption for which there will inevitably be some judgement on the borderlines. We believe that the requirement to differentiate between the "good book" and the "bad book" is sufficiently clearly described.

Question 7
Is the requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

We believe that the requirement to differentiate between the "good book" and the "bad book" is operational and auditable to the same extent as other accounting regulations that are driven by management intent, business model and internal organisation.

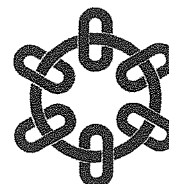
Question 8
Do you agree with the proposed requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

We strongly agree with the proposed requirement to differentiate between a "good book" and a "bad book". However when we regard this requirement, to differentiate, necessary for application of the correct measurement attribute rather than necessary for the purpose of determining the impairment allowance.

Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this model. Specifically, on the following issues:

(a) Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?



As described above we do not agree with the proposal to require a floor for the impairment allowance related to the “good book”.

See our answer to question 3.

(b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the ‘good book’ only in circumstances in which there is evidence of an early loss pattern?

See our answer to question 3.

(c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?

We do not agree with the proposed minimum allowance amount and hold no firm position on how such a minimum allowance is to be determined. We see positive arguments for a fixed horizon (comparisons between entities and over time) and a non-defined horizon (signalling from advanced entities with a long horizon, and not hiding anything just behind a pre-defined horizon).

(d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

No answer.

(e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.

No answer.

(f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a ‘ceiling’ should be established for determining the amount of credit impairment to be recognised under the ‘floor’ requirement (for example, no more than three years after an entity’s reporting date)? If so, please provide data and/or reasons to support your response.

See answer to question 9(c).

Question 10

Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

No answer.

Question 11
The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

(a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?

We believe that the estimation uncertainty in regard to the estimate of expected losses will be such that it dominates any "error" from discounting. We believe that the standard should describe the principle, but should not regulate details that affect the recognised amounts less than the minimum measurement errors.

(b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

As described above we believe that the standard should focus on principles and not on detailed regulation of the practical application of the principle. Thus we believe that the standard should state the principle and not the details of possible applications of the principle.

Question 12
Would you prefer the IASB approach for open portfolios of financial assets measured at amortised cost to the common proposal in this document? Why or why not? If you would not prefer this specific IASB approach, do you prefer the general concept of the IASB approach (ie to recognise expected credit losses over the life of the assets)? Why or why not?

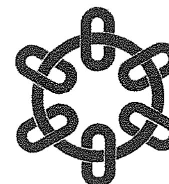
We would recommend the general concept of the IASB that is to recognise expected credit losses over life of the assets.

Question 13
Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific FASB approach, do you prefer the general concept of this FASB approach (ie to recognise currently credit losses expected to occur in the foreseeable future)? Why or why not?

We do not prefer the FASB approach. To us the FASB approach is counterintuitive and not aligned with the principles for when amortised cost should be applied.

Question 14Z
Do you agree that the determination of the effective interest rate should be separate from the consideration of expected losses, as opposed to the original IASB proposal, which incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

We support the operational merits of separating the determination of the effective interest rate from the consideration of expected losses. We believe that the resulting figures for the financial assets sitting in a good book (provided that the higher of concept is not maintained) will not materially differ from the figures resulting from the original IASB proposal. It is our understanding that the proposed separated model will have a cleat cost benefit advantage. The more principle based solution would however be to indicate the proposed model as one practical expedient that might fulfil the underlying measurement principle of amortised cost as defined in the original ED.



Question 15Z
Should all loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37) be subject to the impairment requirements proposed in the supplementary document? Why or why not?

We do not support that a standard should enforce the proposed impairment requirements to loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37). We do not believe that amortised cost is the more relevant measurement criteria for loan commitments, thus we see no merit in a standard that requires the use of an impairment model applicable to financial assets measured at amortised cost to loan commitments.

Question 16Z
Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

We believe fair value to be the more relevant measurement criteria for loan commitments and financial guarantee contracts. We have no comments on to the issue of whether the proposed requirements will be operational if applied to loan commitments and financial guarantee contracts.

Question 17Z
Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

We agree with the principle that impairments on financial assets measured at amortised cost should be reported next to interest revenue from the same financial assets. We support that the board regulate this in the standard.

Question 18Z
(a) Do you agree with the proposed disclosure requirements? If not, which 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) for the proposed impairment model and why?

(a) As we do not agree with the proposed measurement criteria for the bad book and the higher of concept,we do not agree with the proposed disclosure requirements in Z7.

(b) We would prefer disclosure requirements related to the principles guiding the classification and reclassification of financial assets into the good book and the bad book. To help users assess the quality, frequency and timing of financial assets transferred from the good book to the bad book, we would prefer disclosures related to the amortised cost, fair value and number of financial assets reclassified from the good book to the bad book for the current annual period and the four previous annual periods. To help users assess the timing of losses we would prefer disclosures related to the relative age of the assets that are transferred from the good book to the bad book relative to the average duration of the good book. To help users assess the development of the bad book, we would prefer disclosures of the nominal values of the financial assets in the bad book (this is a part of the disclosure requirement of Z7(c)).

Question 19Z
Do you agree with the proposal to transfer an amount of the related allowance reflecting the age of the financial asset when transferring financial assets between the two groups? Why or why not? If not, would you instead prefer to transfer all or none of the expected credit loss of the financial asset?

As stated previously in this reply we believe an amortised cost measurement would not be appropriate when the objective has changed from collecting contractual cash flows to a recovery of all or a portion of the asset. Based on this we would like to see an approach were such instruments were measured at fair value on the date of transfer between the two groups. In situations were assets are transferred from bad book to good book we believe the fair value on the transfer date should be represented as the amortised cost. Given that the Board continues with the proposed adjusted amortised cost measurement for assets transferred to bad bookwe agree with the proposal to "transfer" an amount of the related allowance reflecting the age of the financial asset when transferring financial assets from the good book to the bad book. We believe that this will provide transparency to the quality of the management in identifying the financial assets to be transferred to the bad book.