

1 April 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear David

AOSSG comments on IASB Supplement to Exposure Draft ED/2009/12
Financial Instruments: Impairment

The Asian-Oceanian Standard Setters Group (AOSSG) is pleased to provide comments on the Supplement to Exposure Draft ED/2009/12 *Financial Instruments: Impairment* (Supplement ED). In formulating its views, the AOSSG sought the views of constituents within each jurisdiction.

The AOSSG currently has 24 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Thailand, and Uzbekistan.

To the extent feasible, this submission to the IASB reflects in broad terms the collective views of AOSSG members. Other views that are consistent or otherwise with the overall AOSSG comments are also provided within this submission. Individual member standard setters may also choose to make separate submissions that are consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asian-Oceanian region and not to prevent the IASB from receiving the variety of views that individual member standard setters may hold.

This submission has been circulated to all AOSSG members for their comment after having been initially developed through the AOSSG's Financial Instruments Working Group. The AOSSG has not received any substantive contrary views from our constituents.

The AOSSG supports the IASB's efforts to develop an operational impairment model as proposed in the Supplement ED, as compared to the model in ED/2009/12. The AOSSG also understands the IASB's decision to require the consideration of more forward-looking information in determining financial asset impairment. However, the AOSSG has concerns

about the proposed common approach (between the IASB's time-proportionate loss method and the FASB's foreseeable future loss method).

The AOSSG considers the proposed common approach developed by jointly by the IASB and the FASB would not possess the measurement attributes of an amortised cost model, and accordingly, would be a mix of measurement models and not be helpful for decision-making purposes. The AOSSG also considers the lack of clarity around the measurement model might result in variability in impairment assessments and would not be an improvement on the current impairment model in IAS 39. Accordingly, some members have expressed support for the time-proportionate method only and some members have supported the foreseeable future loss method only.

The majority of AOSSG considers it may be premature to conclude that the incurred loss model is 'broken', and is not convinced that a completely new impairment model based on expected losses that incorporate forecast information would resolve the issue of some entities having under-provisioned for losses. To some extent, these members regard the proposed foreseeable future loss approach, except for the incorporation of forecast information in the assessment of foreseeable future loss, is probably closest in application to an incurred but not reported loss (IBNR) method. Accordingly, these members are of the view that the basis for recognising losses using the IBNR notion could readily be applied in an 'expected loss' context.

The AOSSG supports the IASB's proposal to differentiate between the good book and the bad book financial asset portfolios for the purposes of determining the impairment allowance. The AOSSG considers the good book and bad book allocation is reasonably aligned with the way in which entities, particularly financial institutions, manage financial assets and credit risk. However, some members are concerned about the non-comparable application of credit risk management practices among entities and the potential inconsistency in recognising full impairment losses (for bad book portfolios) and partial impairment losses (for good book portfolios).

The AOSSG considers that there continue to be significant conceptual and practical issues with the proposed supplement model on the basis that it does not generally reflect the manner in which non-financial institutions in AOSSG jurisdictions operate. In particular, credit risks are generally not explicitly included in the price of goods and services. This would appear to compel non-financial institutions to adopt a more complex impairment assessment process than would generally be warranted.

The AOSSG is keen to play a key role in the development of a global set of high quality financial reporting standards and trusts that the IASB finds our comments helpful in progressing the replacement standard for IAS 39.

The AOSSG views, as summarised above, and other views, are explained in more detail in the attached Appendix. At the end of the letter, we also attach the separate comments on certain

Islamic finance impacts of the proposals in the Supplement ED from the Islamic Finance Working Group of the AOSSG.

If the proposals in the Supplement ED were to proceed, in framing the relevant transitional requirements, the AOSSG urges the IASB to consider those emerging markets in the process of adopting IFRSs, and particularly those that might be adopting IAS 39 and IFRS 9 separately.

If you have any queries regarding any matters in this submission, please contact us.

Yours sincerely



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Chairman of the AOSSG



Kevin M. Stevenson
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Appendix**1 AOSSG position**

- 1.1 Overall, the majority of AOSSG members consider the proposed common approach, developed jointly by the IASB and the FASB, would not possess the measurement attributes of an amortised cost model, and accordingly, would be a mix of measurement models. Those members also consider the lack of clarity around the measurement model might result in variability in impairment assessments and would not be an improvement on the current impairment model. Accordingly, some of these members support only the time-proportionate method (IASB) and some members support only the foreseeable future loss method (FASB). Having said that, the majority of members consider the proposed common approach would be more operationally feasible than the ED/2009/12 impairment model.
- 1.2 Most members also consider the label 'incurred loss model' has been implied to have weaknesses that cannot be rectified. These members believe that an incurred loss model remains relevant and the weaknesses relate to the manner in which it is being applied. These members believe this problem can be rectified by providing greater clarification about a wider range of events that could be taken to have occurred, and conditions that exist, and which give rise to losses now or in the future.
- 1.3 The AOSSG notes that the relevant recommendation of the FCAG is that the IASB explore alternatives to the incurred loss model in IAS 39 that use more forward-looking information. Some members' view is that the IASB could follow the FCAG's recommendation by exploring amendments to the existing incurred loss model that would result in a greater use of current market inputs, or a greater consistency of the use of such inputs, than often occurs under the existing IAS 39 requirements.
- 1.4 Given that the focus is on determining the basis for amortised cost measurement, and given the FCAG's recommendation to explore models that use more forward-looking information, the IASB could usefully examine the notion of incurred but not reported (IBNR) losses. The notion of IBNR is widely used in accounting for insurance contracts, with insurers providing for claims liabilities that relate to events they know have occurred from general information about the claims environment, rather than from being advised of the occurrence of specific events.
- 1.5 In the context of the credit crisis of 2007/2008 it is probably fair to say that, although many banks found themselves under-provisioned, a number did not. Many banks in the Asian-Oceanian region have a practice of considering general information about the economic environment on an IBNR principle, for example, rates of unemployment, property price movements, asset price inflation and rates of economic growth are used to infer the occurrence of specific events that give rise to credit losses. Accordingly, a majority of members are of the view that the basis for recognising losses using the IBNR notion can readily be applied in an 'expected loss' context.
- 1.6 Accordingly, these members are not convinced that a completely new impairment model, in particular, one that uses a time-proportionate method or an expected cash flow method as in ED/2009/12 would resolve the issue of 'too little, too late'. These

- members consider that the IBNR model would achieve what the IASB wants an ‘expected loss’ model to accomplish if the extent to which forward-looking information is employed in the estimates of IBNR losses were better explained. In addition, those members consider an IBNR model would better reflect an amortised cost measurement, consistent with the alternative views of Robert P Garnett and James J Leisenring [paragraph AV6, Basis for Conclusions of ED/2009/12].
- 1.7 If the IASB proceeds with the proposed supplement impairment model, these members encourage the IASB to clearly identify its measurement attributes in the final Standard, even if it combines cost and fair value. These members consider that the measurement basis is not clear under the proposed impairment model and that lack of clarity might result in variability in impairment assessments and would not be an improvement on the current impairment model.
- 1.8 On the other hand, some members welcomed the IASB’s ‘expected loss’ model using a time-proportionate method and previously supported the proposed expected cash flow method in ED/2009/12. These members consider that, conceptually, the time-proportionate method would better reflect the economic substance of a financial asset (consistent with the IASB’s rationale in paragraph B15 of the Supplement ED), that is, interest income and impairment losses are recognised over the life of financial assets consistent with an entity’s objective to hold those financial assets in order to collect contractual cash flows. Nonetheless, these members are concerned about the operational aspects of the time-proportionate method.
- 1.9 Contrary to those members’ views in paragraph 1.8, other members have challenged the IASB’s rationale in paragraph BC15 of the Supplement ED and consider that, impairment loss recognition should be distinguished from revenue recognition. These members consider that impairment essentially represents a loss as a result of movements in the market, which may have no relationship to the entity’s initial expectations of future cash flows over the life of the assets. In contrast, the amounts determined as revenue would have been decided at initial recognition. Accordingly, these members do not support spreading the recognition of impairment losses over the life of the assets as a function of revenue recognition.
- 2 The use of forecast information in an amortised cost model (Questions 3, 4, 5, 9 and 10)**
- 2.1 Some members consider the supplement impairment model lacks a clear measurement attribute for financial assets held at amortised cost (as did the proposed model in ED/2009/12). In particular, the supplement model proposes that impairment (or expected loss) would be derived from using past, present and ‘forecasted’ information. However, these members consider that ‘forecasted’ information would not be appropriate for an amortised cost-based financial asset. This view is consistent with the IASB’s rationale, in paragraph BC109 of IAS 39 for concluding “that it was inconsistent with an amortised cost model to recognise impairment on the basis of expected future transactions and events”.

- 2.2 Some members note that paragraphs B5 and B7 of the Supplement ED state that, for shorter-term and medium-term periods, entities may develop projections of expected losses on the basis of specific inputs, such as forecasts of future events and economic conditions. Some members consider the implication that ‘projections’ include ‘forecasts’ to be inappropriate and potentially confusing, and that it could result in varied interpretations of the types of forward-looking information that should be used when assessing for impairment losses. Consistent with the mainstream literature on the topic of projections versus forecasts, these members consider that a ‘forecast’ is based on the assumptions reflecting conditions that are expected to exist and the course of action an entity expects to take. A projection relates to one or more hypothetical courses of actions or events based on conditions that currently exist. These members consider that, consistent with an amortised cost model, past and existing events and conditions, and not future events and conditions, should be used to assess impairment losses.
- 2.3 These members also consider the guidance in paragraphs B5, B6 and B7 of the Supplement ED is too broad and would not reduce diversity in application. They consider similar guidance to that in paragraphs 44, 45, 48 and 49, and examples as in Illustrative Example 6 of IAS 36 *Impairment of Assets* should be provided in a final Standard to distinguish between information that provides the basis for determining that particular events and conditions have already occurred and which gives rise to impairments (or reversals of impairments), from forecast information, which goes beyond an amortised cost measurement model.
- 2.4 Some members also note the proposed notion of ‘reasonable and supportable’ information when applying the proposed estimations of foreseeable future loss and the use of forecasted data. These members consider the IASB should clarify the notion of ‘reasonable and supportable’ and suggest the IASB provide guidance to the extent of paragraph 34 of IAS 36 to be included in a final Standard. In addition, these members consider the IASB should clarify whether the notion of ‘reasonable and supportable’ has any connection with:
- (a) the IASB’s recently developed notion of ‘verifiability’ in the context of the Conceptual Framework project; and
 - (b) the notion of ‘objective evidence’ in IAS 39. These members note that, paragraph BC110 of IAS 39 states that “Possible or expected future trends that may lead to a loss in the future... do not provide objective evidence of impairment. In addition, the loss event must have a reliably measurable effect on the present value of estimated future cash flows and be supported by current observable data”.
- 3 A time-proportionate method or foreseeable future loss method (Questions 3, 4, 5, 12 and 13)**
- 3.1 Consistent with their views on the ED/2009/12 impairment model, conceptually, some members do not support the IASB’s time-proportionate method in assessing for impairment losses. These members believe a time-proportionate method recognises

- losses via a smoothing mechanism over an asset's life. In this respect, these members share the views of the FASB, that impairment reserves tend to be at their lowest level when they are most needed at the beginning of a downward-trending economic cycle [paragraph IN6 of the Supplement ED] and as such, even a time-proportionate loss approach would not be able to provide sufficient allowance to cover all estimated impairment loss for the remaining life of an asset. These members note that the FASB's foreseeable future loss approach would introduce a requirement to establish a minimum loss allowance balance, and should address the loss allowance adequacy concern.
- 3.2 Some members also consider the foreseeable future loss method, except for the incorporation of forecast information in the assessment of foreseeable future loss, is arguably broadly similar to how larger financial institutions in their jurisdictions currently assess for impairment losses, and is probably closest in application to an IBNR model. This is on the basis that, under an IBNR model, having regard to past events and existing conditions, consideration is given to losses that may occur over the expected life, which would extend beyond a 12-month period.
- 3.3 On the other hand, some members consider that, conceptually, the foreseeable future loss method ignores business practice that lenders usually price in some level of credit risk into the credit spread of the financial assets which will be recovered over the life of the asset. Although losses are inherent in a pool of financial assets, lenders expect to be compensated for this risk in the form of a component of the interest return. These members are concerned that the immediate recognition of foreseeable future losses may not reflect the overall effective yield of the good book assets as net interest margin of the assets would fluctuate from period to period depending on the amount of losses estimated for each period even though the total loss amount could be constant. It may also result in recognition of day-one loss should the foreseeable future loss exceed the interest revenue for that period, which in their view, would be counterintuitive.
- 3.4 In addition, as the expected losses relate to assets under the good book, it represents expectations of losses occurring in the future (which should be distinguished from losses that have been incurred on those assets under the bad book), and should therefore not be recognised immediately in profit or loss.
- 3.5 As an alternative to the foreseeable future loss method, some members consider that, in situations where there is 'reasonable and supportable' evidence of early loss patterns for good book assets, the proposed impairment model based on a time-proportionate method should allow for a modified approach that accelerates losses for the period. These members believe that such a modification would address concerns about the sufficiency of impairment allowance for loans with early loss patterns.
- 3.6 From a practicability standpoint, the majority of members support the IASB's efforts to develop an operational impairment model as proposed in the Supplement ED, as compared to the model in ED/2009/12. However, these members consider the overall proposed supplement model to be complex as it would require the retention of two forms of systems or approaches when assessing for impairments on good book portfolios.

- 3.7 In addition, some members question the merits of determining losses in a ‘foreseeable future period’ as different entities would be likely to have varying capacities to assess losses in a ‘foreseeable period’. These members are concerned about diversity in application and the resulting impact on the comparability of financial results. Other members are of the view that entities would have a similar issue with estimating future losses under the proposed time-proportionate method.

4 Minimum impairment allowance (Questions 9 and 10)

- 4.1 Most members support the proposal to establish a minimum impairment allowance amount of at least 12-months ‘expected loss’ from reporting date for the reasoning provided in paragraph BC62 of the Supplement ED. These members also consider that a 12-month estimate is a common benchmark as required by other reporting and prudential requirements, for example, for the assessment of an entity’s ability to continue as a going concern under IAS 1.
- 4.2 Some members consider the IASB’s proposed ‘ceiling’ on the forecast term (which might limit the extent of incomparability) would conflict with the IASB’s principles for proposing an expected loss model. These members consider that, if losses are estimated over the life of the asset under the proposed time-proportionate method, attaching a ceiling or a cap on what those losses should be would undermine the proposed rationale for recognising lifetime losses. These members acknowledge that there may be diversity in the assessments about future losses between sophisticated and less sophisticated entities. Nevertheless, these members consider that entities should not be restricted from making loss estimations as far out as feasible, within the bounds of reliable measurement.

5 Flexibility related to using discounted amounts (Question 11)

- 5.1 From a conceptual perspective, the majority of AOSSG members support the use of discounting amounts in determining loss allowance amounts, if the effect of discounting is immaterial, as IFRSs generally require future cash flows to be discounted in respect of the time value of money. However, from a practicability perspective, these members acknowledge it would be difficult for entities to determine an appropriate discount rate for the assessment of expected loss for financial assets in open portfolios. Accordingly, these members do not object to the IASB’s proposal to permit flexibility in determining discounted amounts.
- 5.2 Some members consider similar guidance as in paragraph 47 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* should be provided in a final Standard to clarify that entities are required to use discount rates that reflect the time value of money and that do not reflect risks for which future cash flow estimates have been adjusted.

6 Reflecting an entity's internal credit risk management (Questions 6, 7 and 8)

- 6.1 The AOSSG supports the IASB's proposal to differentiate between the good book and the bad book financial asset portfolios for the purposes of determining the impairment allowance. The AOSSG considers the good book and bad book allocation is reasonably aligned with the way in which entities, particularly financial institutions, manage financial assets and credit risk. The AOSSG considers that, in order to operationalise the proposed supplement impairment model, it would be appropriate to associate the transfers between the good book and bad book portfolios with an entity's internal credit risk framework.
- 6.2 Some members note general concerns raised by some organisations about the difference in credit risk management practices among entities and the potential inconsistency in recognising full impairment losses (for bad book portfolios) and partial impairment losses (for good book portfolios). To reduce diversity in the application of an entity's internal credit risk framework, some members consider the IASB could include in its final Standard, examples of established industry practices when differentiating, and transferring losses, between the good book and the bad book, such as the examples in paragraphs 59(a)-(f) of IAS 39 relating to objective evidence of financial assets that are impaired. These members also consider those examples to be helpful for non-financial institutions as they often do not have established internal credit risk management policies to identify and differentiate financial assets between a good book and a bad book.

7 Application of the supplement model to other financial instruments (Questions 1, 2, 15Z and 16Z)

- 7.1 Some members support the proposed supplement impairment model for financial institutions only, as they consider application of both the proposed models in ED/2009/12 and the Supplement ED to be inappropriate for all trade receivables. These members consider that credit risks are generally not explicitly factored into the price of goods and services. Subjecting long-term trade receivables to the same impairment approach would conflict with the IASB's fundamental objective of developing an impairment model that is based on an entity's internal credit risk management framework or business model.
- 7.2 In addition, some members consider application of the proposed time-proportionate loss method on 'revolving' financial assets, such as credit card receivables, overdrafts and loan commitments, to be complex. These financial assets generally have no fixed maturity, and accordingly, these members consider the estimation of their expected lives would be difficult.
- 7.3 Overall, the AOSSG acknowledges the IASB's intention in focussing on developing an impairment model for financial assets that are managed on an open portfolio basis as a priority. The AOSSG is concerned that the complexity of the proposed supplement impairment model would entrench the need for multiple impairment models for short-

term trade receivables, lease receivables and other financial assets measured at amortised cost. The AOSSG also notes that such an outcome would indicate that the IASB has not met the recommendation of the FCAG for greater simplicity in accounting for financial instruments. Accordingly, the AOSSG would prefer an impairment model that is ‘transaction neutral’.

8 Net interest margin presentation (Questions 14Z and 17Z)

- 8.1 In relation to revenue recognition, most AOSSG lenders and users of their financial statements focus on the margin between the lending rates and the cost of funding – sometimes called the ‘net interest margin’. The AOSSG agrees with the IASB’s proposal to decouple (as compared to ED/2009/12) the effective interest rate and expected loss. Some members note their support for decoupling to be consistent with earlier views about the disconnect between financial institutions’ pricing of financial assets and expected loss, which is contrary to the IASB’s rationale in paragraph BC15 of the Supplement ED.
- 8.2 In addition, the AOSSG welcomes the IASB’s decision to retain the existing presentation requirement in IAS 39 and supports the IASB’s proposals in paragraph Z5.

9 Disclosure (Questions 18Z and 19Z)

- 9.1 The AOSSG received encouraging feedback from constituents, including preparers and users of financial statements, for proposing disclosures that associate the impairment loss amounts and the entity’s internal credit risk management. In particular, the AOSSG supports the IASB proposals to require:
- (i) an allowance account showing the reconciliation of changes in credit losses during the period separately for the good book and bad book portfolios [paragraph Z7 of the Supplement ED]. This information is consistent with the principle of providing meaningful information about the quality of assets. The AOSSG would expect that a succinct reconciliation that shows movements of credit losses, including any write-offs, to be helpful for users to appreciate the credit standing of assets. Furthermore, the mandatory use and disclosure of an allowance account would promote consistency compared with the present IAS 39. Other members are concerned that this proposed disclosure, particularly the requirement to transfer an amount of the related allowance reflecting the age of the financial assets that turned ‘bad’, would add complexity to the allocation or transfer between the good book and the bad book;
 - (ii) information that explains estimates and changes in estimates pertaining to the impairment model [paragraphs Z9 and Z10 of the Supplement ED]. This information is important to an understanding of judgements that need to be made in determining impairment losses. However, the AOSSG notes that this proposed requirement may duplicate paragraph 125 requirement of IAS 1 *Presentation of Financial Statements*, which requires disclosure of information about the assumptions made on estimates of uncertainty. The AOSSG considers that, if the

IASB proposes the same disclosure requirement about ‘estimates of uncertainty’ relating specifically to financial assets at amortised cost, that requirement, and an explanation about the relationship with the IAS 1 requirement, would be best located in IFRS 7 *Financial Instruments: Disclosure*; and

- (iii) information that explains an entity’s internal credit risk management processes, in particular, an analysis that describes the criteria used to determine how financial assets are managed to distinguish between good book and bad book portfolio assets [paragraphs Z13 and Z15(a) of the Supplement ED]. Members consider these proposed disclosures would address some of the concerns about the subjectivity involved in applying an entity’s credit risk management framework to the allocation of losses between a good book and a bad book.
- 9.2 The AOSSG was also advised that some of the proposed disclosures relating to internal credit risk gradings and credit loss development, in particular, paragraphs Z8, Z12, Z14 and Z15(b)-(d), would, in general, be overwhelming to users. In relation to credit loss development information, the AOSSG has been informed that historical data is generally not stored by financial institutions in a manner that would readily enable the information proposed in paragraphs Z8 and Z12 to be prepared. As such, entities may face significant challenges and increased costs to establish and maintain the information systems that would be required.
- 9.3 In addition, the AOSSG notes there was no basis provided in the Supplement ED for proposing these specific disclosures. Therefore, the IASB should reconsider the need for these disclosure requirements on the basis that the cost to provide the information might outweigh its benefits. Likewise, the AOSSG supports the IASB’s recent tentative decisions in February 2011 not to proceed with the ED/2009/12 disclosures on vintage information and stress testing.
- 9.4 Some members are concerned about paragraph BZ17, which allows disclosures to be provided in the financial statements or incorporated by cross-reference from the financial statements or other statements. These members consider the proposed disclosures should assist users to understand and evaluate the information presented in the financial statements, and accordingly, such information should be presented as part of the financial statements. These members also consider the location of such information should be determined under Phase E of the Conceptual Framework project *Boundaries of Financial Reporting and Presentation and Disclosure*, and not separately within each Standard.
- 9.5 Some of these members are also concerned about the audit implications of the proposal. They are concerned that auditors may need to audit the context of the cross-referenced information as well as the information itself in order to be satisfied that it is appropriately presented. As such, these members oppose any mandated information being able to be cross-referenced. Furthermore, due to the legal framework regarding the composition of financial statements, some jurisdictions would be unable to adopt (word-for-word) an IFRS requirement that allows information to be cross-referenced.
- 9.6 Overall, the AOSSG considers that the principle of ‘through the eyes of management’—that is, information that is reviewed regularly by the entity’s CODM—should be

considered in formulating disclosure requirements. The AOSSG is doubtful that the proposed information mentioned in paragraph 9.2 are regularly reviewed by the CODM.

10 Other

- 10.1 Some members note that ED/2009/12 proposed to reflect the value of collateralised assets when foreclosure is probable in the assessment of expected loss. However, it is not clear how collateralised assets would fit into the proposed supplement impairment model, in particular, when assessing for expected loss in the good book. These members are concerned about a potential over-provision of expected loss if collateralised assets are not considered in the good book expected loss but are subsequently factored into the bad book expected loss assessment. Accordingly, these members consider some clarity in a final Standard regarding the consideration of collateralised assets in the assessment of expected losses of a good book and a bad book would be useful.
- 10.2 The AOSSG is concerned about the IASB's recent piecemeal approach in developing a replacement for IAS 39 without providing a comprehensive exposure of all aspects of the proposals. Given the significance of the overall project to replace IAS 39, the AOSSG considers it is critical that sufficient time be provided for a robust review of the final Standard. In addition, some members consider field-testing of a near-final Standard would be useful before mandating adoption of the new Standard.