

BELGIAN ACCOUNTING STANDARDS BOARD



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Our reference
C-065

Your reference

Date
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Dear Sir,

Invitation to comment – IASB ED *Financial Instruments: Amortised Cost and Impairment*

The Belgian Accounting Standards Board (BASB) is pleased to respond to the Exposure Draft on Financial Instruments: Amortised Cost and Impairment issued by the IASB (the "Board") in November 2009 (hereinafter the "ED").

After deliberation, the BASB agrees with the Board's decision to propose an expected loss approach to determining impairment of financial assets measured at amortised cost; and hence we are also supportive towards the decision of the Board not to proceed with possible alternative impairment approaches like fair value based approaches or through-the-cycle approaches as indicated in paragraphs BC 15 – BC24.

The BASB understands from paragraph BC57 that the Board acknowledges the fact that significant judgment is required in order to determine the amortised cost; which might ultimately result in potential options for earnings management. Therefore the BASB would like to propose a more detailed approach with respect to the disclosure requirements and hence integrate more disclosure guidance in the *Application Guidance* of the new Standard.

Although, conceptually the BASB is supportive towards the expected loss approach, we also believe that the enforcement and implementation of the proposed model for trade receivables is too complex as the related income and expense of these financial instruments are regarded as operating items and often these financial instruments are not held for short or long term interest gains.

Hence we are of the opinion that reporting entities will not provide user-relevant information by applying an expected loss approach for trade receivables. Therefore we would suggest reconsidering the overall measurement model of non-interest bearing short-term trade receivables.

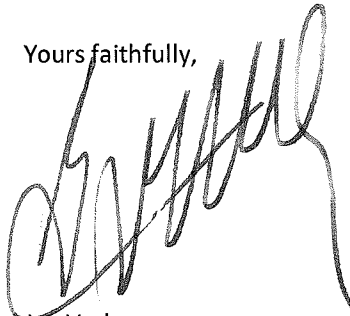
Besides our comment with respect to short-term receivables, we would also like to raise our concern regarding the operational aspects of applying the expected loss approach. In contrary to financial institutions, many corporations do not always have access to the widespread of (mainly historical)

information required for applying the expected loss approach. In this context we encourage the Board's initiative in establishing an *Expert Advisory Panel* in order to meet the operational challenges that will arise; but we would also like to encourage the Board to incorporate more non-financial institutes representatives as well.

Overall we believe that Board has retained the correct conceptual impairment model for financial instruments measured at amortised cost, but we would like to encourage the Board to continuously align the view of the *Expert Advisory Panel* during the due process in order to meet the operational challenges in applying the expected loss approach.

Our answers to the specific questions raised in the ED are included in the attached appendix to this letter. Should you wish to discuss the content of this letter with us, please contact Jan Verhoeve at jan.verhoeve@cnc-cbn.be.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'Jan Verhoeve', written in a cursive style.

Jan Verhoeve
Chairman BASB

Appendix 1

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?

We believe that the objective of amortised cost measurement in paragraph 3 of the ED is clear

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?

We believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category, except for short-term trade receivables. As for short-term trade receivables, the effective return is often irrelevant as these financial instruments are related to the operating activities of an entity and hence managed as such. We do understand however that with respect to financial institutes the effective return remains relevant even for short-term receivables, but we would suggest to provide this information if it incorporates user-relevant information.

Currently, the Board has decided that the effective return approach allocates interest revenues and expenses over the expected life of the financial instruments, besides this *income approach*, we also believe that the effective return approach will provide relevant information about the potential cash flow generation / absorption capabilities of the related instrument. This concept should be expressed more prominently in paragraph 3 of the ED.

While we consider that expected losses can be reliably estimated on large loan portfolios with similar risk profiles, we think that it is not operational to estimate expected losses on a loan by loan basis and would expect this issue to be addressed by the *Expert Advisory Panel*.

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?

The BASB has always been supportive with respect to including thorough application guidance and an extended Basis for Conclusion. However, due to the specific endorsement mechanism that exists in the European Union, we would like to point out, as we did in previous comment letters, that only the corpus of the Standard and its application guidance can be endorsed and hence we believe that the Basis for Conclusions should only comprise background information. We suggest removing paragraph BC 35 and 36 from the Basis for Conclusions into the corpus of the new Standard.

Secondly, given the complexity of the proposed model, we are of the opinion that not enough illustrative examples are currently included in the ED. Although, amortised cost in its current form, is widespread among preparers, we would encourage the Board including more guidance with respect to the current implementation issues that might arise. In this respect we suggest including guidance on floating rate instruments and the treatment of issuance costs during the amortization process (i.e. the catch-up mechanism), the measurement of inflation-linked debt and the measurement of instruments combining both fixed and variable elements. Those examples should always accompany the Standard.

By the issuance of the ED, we are of the opinion that the Board has developed a theoretical model, we hope that as a result from the interaction with the *Expert Advisory Panel*, more operational aspects from the new methodology will be included in the Standard. Currently, the ED does not include enough operational guidance and thus the risk of an entity-specific impairment measurement approach is certainly valid; we are of the opinion that this cannot be the objective of principles-based accounting. Currently, we do not understand how the Board will continue its further due process of the new Standard; will the inclusion of the operational comments of the *Expert Advisory Panel* give rise to a new re-exposure of the ED?

Question 4

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

The move from the current incurred loss approach to the new expected cash flow approach does not change the amortised cost measurement concepts (e.g. effective interest rate) except for the inclusion of the expected credit losses. However, the continuous re-estimation of credit losses during the lifecycle of the related instrument differs significantly from the current loss event driven approach. The BASB welcomes this new approach as we believe that from a user's point-of-view, the incurred loss model often resulted in the recognition of impairments rather late, whereas the expected cash flow model will indicate in an earlier stage the quality of the financial assets measured at amortised cost.

With respect to the measurement principles, we believe that more judgment (e.g. financial assets with significant maturity dates) will be needed in assessing expected future credit losses. One of the main challenges in transitioning from an incurred loss approach to an expected cash flow approach will be to obtain the expected cash flow data and make forecasts about future cash flows. While historical data can be useful, history is not always a good guide to the future. The estimation of future expected cash flows and credit losses, would inevitably, be subjective. Therefore, we are of the opinion that reporting entities should disclose both quantitative, including sensitiveness information, and qualitative information in relation to the more judgmental areas of the expected cash flow approach.

Paragraph B7 of the ED states that a reporting entity may need to consider a wide range of information in order to assess the effect of credit losses on expected cash flows. The effect of changes in these estimates made by management need to be recognised in profit or loss; which will eventually lead to an increased volatility of the income statement; an alternative view could be that only the part of the change relating to the current and previous period should be recognised in profit or loss, whereas the part relating to the future cash flows would be amortised over the remaining economic life as it relates to future events. In a period of economic downturn, the full recognition (historical, current and future) of the effects of changes in estimates in the income statement might trigger adverse macro-economic responsiveness.

Paragraph 8 of the ED states that the estimates for the cash flow inputs are expected values. Hence, estimates of the amounts and timing of cash flows are probability-weighted possible outcomes. The Standard should clarify whether expected values based on probability-weighted possible outcomes include worst-case scenarios as these "unexpected losses" are often considered in the context of *stress testing* and prudential provisioning.

Question 5

(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?

(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?

The BASB is of the opinion that the current disclosure and presentation requirements are only relevant for all financial instruments carried at amortised cost, except for short-term trade receivables. We also refer to question 2.

Question 6

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

We agree that the proposed presentation requirements provide transparency about the different factors affecting interest revenue, interest expense and experience adjustments from revising cash flow estimates. However, the BASB believes that the proposed presentation requirements do not provide relevant information for short-term trade receivables, as impairment charges for these receivables is deemed to be an operating expense, hence we are of the opinion that the presentation requirements for these financial instruments should be aligned to their operational character.

Question 7

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

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

We refer to the previous question and believe that the disclosure requirements for short-term trade receivables should be reduced where appropriate. However, based on the ED, we are of the opinion that the comparison of credit loss allowances against the cumulative write-offs (i.e. *loss triangle*) will provide user-relevant information about the applied model for estimating future credit losses.

We do not understand why reporting entities still need to provide separate stress testing information (if prepared for internal risk management purposes) because we are of the opinion that the *loss triangle disclosure*, in relation to the allowance account, provide the same level of information.

Secondly, we are also concerned about the comparability and potential discrimination of the entities that will be required to disclose the stress testing information. We therefore suggest removing the stress testing disclosure.

With respect to the disclosures in paragraph 17 on estimates and changes in estimates, the Board has opted to disclose more qualitative than quantitative information. In comparison with the IFRS 7 sensitivity disclosures, we are of the opinion that also for the estimates and changes in estimates section quantitative information with regard to sensitivity of the applied inputs and assumptions in determining credit losses will provide user-relevant information. From our understanding, this will also reduce the possibility of earnings management.

With respect to paragraph 17 (b) of the ED, we suggest that additional guidance should be included on assessing when a credit loss is changed *significantly*.

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?

In our view, a mandatory effective date of about three years after the date of issuance of the IFRS would generally allow sufficient lead-time for implementing the proposed requirements. The final standard should be mandatory for annual reporting periods beginning on or after 1 January 2014 at the earliest, which would then differ from the implementation date of the first phase of IFRS 9. Based on the current developments, we are of the opinion that a phased implementation of IFRS 9 may be inevitable, but the Board should indicate its view on the application approach (phased or integrated application) in the Standard. However we have concerns on the Board's proposal related to earlier application. In order to ensure comparability, we consider that early application should not be allowed before the completion of the 3 phases of IAS 39 replacement.

Question 9

- (a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?
- (b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?
- (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.

In general we agree with the proposed transition requirements. However, we would encourage the Board to include more guidance and illustrative examples on how the transition needs to be measured, accounted and disclosed for.

Question 10

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

We refer to our answer on *question 9*.

Question 11

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

The implementation of the expected loss model represents a significant operational challenge for many financial and non-financial reporting entities. We therefore welcome the Board's general decision to address these concerns by allowing the use of practical expedients in calculating the amortised cost, if the overall effect is immaterial and the expedients are consistent with the principles of paragraph 15. However by, asking that the impact of practical expedients remains immaterial may make it impossible for entities to implement them in practice.

Although the BASB supports the Board's decision, we also question how materiality in this context should be determined. We would encourage the Board to provide additional guidance on the definition of materiality in this respect.

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 believe that more guidance should be included in the final Standard based on the outcome of the *Expert Advisory Panel* and more specifically in relation to non-financial institutes.