

30 June 2010

International Accounting Standards Board  
1<sup>st</sup> Floor 30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sirs,

**RESPONSE TO EXPOSURE DRAFT – FINANCIAL INSTRUMENTS: AMORTISED COST AND IMPAIRMENT**

The Institute of Certified Public Accountants of Singapore (ICPAS) appreciates the opportunity to comment on the above exposure draft (ED) issued by the International Accounting Standards Board (IASB) in November 2009.

**General comments**

Overall, we are supportive of the use of the expected loss impairment model to replace the incurred loss model. However, we have some concerns on certain aspects of the ED and these are enunciated below.

Our comments on the specific questions in the ED are as follows:

**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 are of the view that this ED should only address financial assets and not financial liabilities, as the concept of impairment do not apply to financial liabilities. Accordingly, paragraph 3 of the ED should exclude the phrase “financial liability”. The rest of the ED should also be amended to be consistent with paragraph 3 to exclude financial liabilities. To add further clarity to the purpose of the ED, we recommend that the IASB rename the ED to “Financial Assets: Amortised Cost and Impairment”.

## **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 agree that the overall objective of amortised cost as set out in paragraphs 3-5 of the ED is appropriate for that measurement category. However, we are of the view that the proposal in paragraph 5 of the ED to include the initial estimate of expected credit losses as part of the effective return (ER) should be revisited. Firstly, most non-financial entities may not view that there is a credit spread component to every sale which results in receivables. Secondly, while most financial institutions (FIs) may have some expectations of the credit spread for certain financial assets, they may not necessarily view the interest income from such financial assets, say loans, as being earned net of the credit spread. In other words, to them interest rate risk and credit risk are managed separately. As such, it may be more appropriate to reflect the credit allowance as a separate line item which is recognised over the life of the loan on a basis consistent with the ER which is unadjusted for the initial estimate of expected credit losses.

We also noted that the main body of the ED did not cover the purpose of introducing the expected loss impairment model, and the reasons of its superiority over the incurred loss model. In this respect, we believe that to aid the reader's understanding of the ED, some of the contents in the basis for conclusions (BC), in particular paragraph BC11 should be incorporated into the main body of the ED.

## **Question 3**

**Do you agree with the way that the exposure draft is drafted, which emphasizes 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 ED should emphasise measurement principles accompanied by application guidance rather than provide detailed implementation guidance and illustrative examples given the variety of financial assets subject to this ED and that each entity may have different historical loss information and also different models to estimate expected loss.

However, we believe that additional application guidance should be provided to assist entities to understand the flexibility of the practical expediency allowed in estimating the expected credit losses. For instance, how far into the future should the impairment loss be estimated? While it would not be possible to provide specific guidance on the different models to cater for different circumstances, it would be useful if the ED can provide a framework to arrive at a reasonable basis, e.g. combination of Basel and market / peer data, combination of historical loss over full credit cycle and market / peer data etc.

We also believe that it may be useful to have some application guidance on key concepts such as how to determine the probability-weighted possible outcomes relating to cash flows,

as required by paragraph 8 of the ED. However, this application guidance should only clarify the principles, and not provide examples.

#### **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?**

We noted that paragraphs 6-10 make reference to the terms “effective interest rate” (EIR) and “effective interest method”. We would like to see some consistencies of terminologies within the ED as we noted that the term “effective return” is used in paragraphs 3-5 of the ED.

We agree with the measurement principles set out in the ED except for the following:

- We would like IASB to clarify whether the original EIR (after factoring in credit losses) is allowed to be revised at each reporting date for the remaining life of the financial asset. This is important as under the current IAS39, the original EIR is "untouchable" during the life of the financial instrument measured at amortised cost.
- The ED states that the allowance for expected losses should be built up over the life of the financial asset. However, we are concerned that this may not address the situation where the expected losses occur earlier than expected.

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

We are of the view that there is some ambiguity in paragraph 8 of the ED relating to the concept that the cash flow inputs are expected values based on probability-weighted possible outcomes. It is unclear whether these expected values are based on consideration of the impact of historical experience and current information (i.e. as at balance sheet date) on future cash flows, or are based on the expectations of future developments on future cash flows. The former is closer to the United States’ Financial Accounting Standards Board’s model and the incurred loss model. The latter appears to edge towards the expected loss model as it considers future development of cash flows. It is also not clear from the ED whether the future expectations are based on entity specific expectations or there is a hierarchy to follow when market expectations are available for certain instruments. Hence, further guidance on this matter will be useful to clear the ambiguity.

#### **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?**

We are of the view that the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the ED is clear.

**(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?**

We are of the view that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the ED is appropriate.

### **Question 6**

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

We are of the view that while the separate presentation of (i) initial expected credit loss allocation and (ii) change in expected credit loss (as per paragraphs 13(b) and 13(d) of the ED) may be useful information to some analysts, this presentation requirement may cause the implementation costs to outweigh its benefits.

While we support the Board's move to adopt the expected loss approach, the merits of such move can be enhanced if more meaningful information can be provided to users of financial statements. Although it can be argued that any credit losses are embedded in the interest revenue, this is in many ways akin to other expenses like, provision for warranty costs being factored into revenue. However, these costs are more appropriately presented as separate charges to revenue, clearly distinguishing between revenue and expenses. On the same note, any initial expected credit losses should also be presented separately as an expense as opposed to a reduction to gross revenue. We further illustrate our basis with the extreme case of receivables that are not held for the purpose of generating interest revenue. Strict application of the proposed presentation requirements to such non-interest earning financial instruments would imply that any initial estimate of expected credit loss is presented as a reduction of gross interest revenue. This will potentially result in negative net interest "revenue" that is counter intuitive, which we believe is not the IASB's intention. Hence, to increase the decision-usefulness and relevance of information to users, we strongly feel that any estimates for expected credit loss should be presented as a provision charge in the statement of comprehensive income, separate from interest revenue.

### **Question 7**

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

We agree with the proposed disclosure requirements except as follows:

- The ED proposes extensive disclosures in the notes to the financial statements of the estimates and changes in estimates. Practically, it may be difficult to disaggregate the gains and losses resulting from changes in estimates into credit or other factors (e.g. changes in prepayment rates) when both events occur together.
- There should be more specific guidance on the type of stress testing information required and the extent of validation required on the information disclosed. In

addition, an entity may perform numerous simulation and scenarios for the purpose of internal risk management and it is not clear what would qualify as "stress testing" under the ED.

- The proposed disclosure of vintage information for year of origination and the year of maturity will result in the need for more extensive credit collation and the information on a standalone basis may be of limited use to users of financial statements. Disclosure by vintage should not be made applicable across the board. There may be useful information on certain asset classes only, e.g. US subprime, residential mortgage loans.
- The information required by the Application Guidance, paragraph B24 may not be useful to users of the financial statements. It may be too onerous and the costs of providing the information may exceed its benefits, if any.

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

At this point of time, there are no other disclosures which we prefer, whether in addition to or instead of, the proposed disclosures.

### **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?**

We are of the view that a mandatory effective date of about three years after the date of issue of the IFRS will allow sufficient lead-time for implementing the proposed requirements. However, this depends to a large extent on the sufficiency, appropriateness and practicality of the practical expedients introduced.

### **Question 9**

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

IN11 of the ED states that the ED will not become mandatory until about 3 years after it is issued. As such, if the proposed standard on amortised cost and impairment is issued on say 31 Dec 2010, it will only be effective for annual periods beginning on or after 1 January 2014. As the effective date is one year after the mandatory effective date for the IFRS 9 that is currently issued (i.e. for annual periods beginning on or after 1 January 2013), we propose that the cut-off date for early adoption in order to enjoy exemption for restatement of comparatives (1 Jan 2012 for the IFRS 9 that is currently issued), accordingly be one year later. This should be explicitly stated in the proposed standard.

In this respect, we are of the view that the proposed standard on amortised cost and impairment should be consistent with the IFRS 9 that is currently issued, in that the proposed

standard should explicitly state that for entities applying IFRS 9 on or after 1 Jan 2011, the date of initial application should be the beginning of the first reporting period (IFRS 9.8.2.2b). The first reporting period can be the beginning of any reporting quarter and not necessarily the beginning of the annual reporting period.

**(b) Would you prefer the alternative transition approach? If so, why?**

We do not prefer the alternative transition approach as we are of the view that the use of the transition adjustment to the effective interest rate previously determined in accordance with IAS 39, would lead to more complexity as the determination of the amount of the translation adjustment is very subjective.

**(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.**

We are of the view that similar to the requirements under IAS 39, comparative information need not be restated on first time adoption of the proposed standard. (i.e. the proposed standard should be applied prospectively).

**Question 10**

**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 in relation to transition.

**Question 11**

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

We are of the view that the proposed guidance on practical expedients is appropriate.


**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 are of the view that the proposed guidance on practical expedients is sufficient at this point of time and hence no additional guidance is necessary.

Should you require any further clarification, please feel free to contact Mr Andrew Chua, Technical Manager, at the Institute of Certified Public Accountants of Singapore via email at [andrew.chua@icpas.org.sg](mailto:andrew.chua@icpas.org.sg)

Yours faithfully,



Janet Tan  
Executive Director

Established in 1963, the ICPAS is Singapore's national accountancy body that develops, supports and enhances the integrity, status and interests of the profession. Today, ICPAS has over 21,000 members.

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