fei financial executives international canada

July 5, 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNIITED KINGDOM

Via "Open to Comment" page, www.iasb.org

RE: ED 2013-3, Financial Instruments: Expected Credit Losses

Dear Sir or Madam:

The Committee on Corporate Reporting of Financial Executives International Canada (FEI Canada) is responding to the International Accounting Standards Board's Exposure Draft (ED) 2013-3, Financial Instruments: Expected Credit Losses (the ED). We appreciate the opportunity to provide comments.

FEI Canada is the all-industry professional membership association for senior financial executives. With eleven chapters across Canada and 1,800 members, FEI Canada provides professional development, thought leadership and advocacy services to its members. The association membership, which consists of Chief Financial Officers, Audit Committee Directors and senior executives in the Finance, Controller, Treasury and Taxation functions, represents a significant number of Canada's leading and most influential corporations.

The Committee on Corporate Reporting ("CCR") is one of s of FEI Canada's advocacy. CCR is devoted to improving the awareness of issues and educatingfei Canada members on the implications of the issues it addresses, and is focused on continually improving the standards and regulations impacting corporate reporting.

We have provided responses to a number of the detailed questions in the ED in the attached Appendix A. We feel it is important, however, to outline some fundamental concerns that we have with the ED. While we acknowledge that the current guidance for the recognition of expected credit losses when applied to financial insitutions is not sufficient and is not resulting in timely recognition of those losses, we believe that the current IFRS guidance is sufficient and appropriate for non-financial institutions. The ED when applied to companies engaged in businesses such as manufacturing, energy or other industrial and non-financial companies will be difficult and costly to operationalize and will result in onerous disclosures which we do not believe will provide more meaningful information to users of financial statements.

For non-financial institutions the role of enterprise risk and credit risk management does not include a system to assess forward looking information such as expected losses in the way contemplated in the ED. The distinction between 12-month and lifetime credit losses is an arbitrary bright-line. Existing

practice is to assess credit losses on the basis of an incurred loss model. We believe that it would be operationally difficult and costly to establish a system to assess macroeconomic factors and economic cycles from acquisition through the life of an asset for a non-financial institution whose primary business is not the management of financial instruments. The ability to have an auditable process would be extremely challenging.

Lastly, when considering the EDs issued by both the IASB and the Financial Accounting Standards Board (FASB), we support harmonization for a single impairment standard applied globally and are disappointed that the two Boards could not issue converged standards. We strongly encourage the IASB to seek alignment with the FASB prior to issuing any final standard.

Thank you for allowing us the opportunity to respond to this proposal.

Yours very truly,

Gordon Heard
Chair – Committee on Corporate Reporting
FEI Canada

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Appendix A:

QUESTION 1

(a) **Do you agree that an approach that recognises a loss allowance (or provision) at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, will reflect:**

(i) **the economic link between the pricing of financial instruments and the credit quality at initial recognition**

(ii) **the effects of changes in the credit quality subsequent to initial recognition? If not, why not and how do you believe the proposed model should be revised?**

No we disagree. We acknowledge that the current guidance when applied to financial insitutions was not sufficient and does not result in timely recognition of expected credit losses. However we believe that the ED when applied to companies engaged in businesses such as manufacturing, energy or other industrial and non-financial companies will not provide more meaningful information to the users of those entities financial statements when compared with current guidance. We believe the existing guidance is sufficient and appropriate for these entities.

We do not agree with the approach for recognizing loss allowances at initial recognition because most instruments are priced to include credit risk at the time of issue. We believe an impairment model is meant to recognize changes in the underlying expectations of cash flows over time, and that it is not the role of financial statement preparers to assess the pricing of financial instruments. Changes in the expectation of a credit loss subsequent to initial recognition when an event has occurred to trigger an impairment should result in recognition of a loss at the time of the event.

For non-financial institutions the role of enterprise risk and credit loss management does not include a system to assess forward looking information such as expected losses in the way contemplated in the ED. The distinction between 12-month and lifetime credit losses is an arbitrary bright-line. Existing practice is to assess credit losses on the basis of an incurred loss model. We believe that it would be operationally difficult and costly to establish a system to assess macroeconomic factors and economic cycles from acquisition through the life of an asset for a non-financial institution whose primary business is not the management of financial instruments. The ability to have an auditable process would be extremely challenging. The proposed approach may work well for entities, particularly financial institutions that have a large portfolio of fixed income assets and a model, and supporting processes, that allow them to build a general provision with indicators of default based on GDP, economic conditions in regions/areas such as unemployment, etc.

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(b) Do you agree that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments? If not, why not? [FASB approach]

Please refer to our comments under Question 1(a) above. In addition we are concerned that FASB and the IASB have adopted different approaches to the measurement of credit losses. We would urge alignment.

QUESTION 2

(a) Do you agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation? If not, why not? What alternative would you prefer and why?

(b) Do you agree that the approach for accounting for expected credit losses proposed in this Exposure Draft achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD (without the foreseeable future floor)?

(c) Do you think that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than this Exposure Draft? [FASB approach]

Please see our comments under Questions 1(a) and (b).

QUESTION 3

(a) Do you agree with the proposed scope of this Exposure Draft? If not, why not?

Yes, we agree with the scope of financial assets included in the ED with the exception of loan commitments and financial guarantee contracts, and we are also concerned that lease receivables are included for non-financial institutions. We agree that in the case of financial institutions there is merit in earlier recognition of potential losses on commitments to lend which can be assessed on a portfolio or macro basis, however for non-financial institutions this would be operationally challenging and costly, and could result in the recognition of a loss before the underlying asset is recognized.

(b) **Do you agree that, for financial assets that are mandatorily measured at FVOCI in accordance with the classification and Measurement ED, the accounting for expected credit losses should be as proposed in this Exposure Draft? Why or why not?**

It is important that both the amortized cost category and the FVOCI category are subject to the same impairment requirements as this ensures comparability of amounts recognized in profit or loss for assets with similar economic characteristics.

QUESTION 4

Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognised from initial recognition should be determined?

No, it is not operational. We believe that this requirement is extremely difficult and costly to operationalize and would result in significant changes to existing practices for non-financial insitutions. Non-financial insitutions would need to develop a model to assess the 12-month expected credit losses, based on expected deteriorations in credit quality, probability of default and resulting expected credit losses. This model would be very subjective as non-financial institutions do not have access to the information required to assess, for example, changes in credit quality of non-quoted issuers or non-credit rated clients/entities. In addition, non-financial instutions lack historical experience or other statistical evidence on credit loss history and therefore the use of past data for modelling credit losses will be even more challenging.

QUESTION 5

(a) **Do you agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer?**

Yes, we agree changes in credit risk should be recognized subsequent to initial measurement, however for non-financial institutions the basis should be an incurred loss model rather than an expected loss model.

(b) **Do the proposals provide sufficient guidance on when to recognise lifetime expected credit losses? If not, what additional guidance would you suggest?**

No, they do not. The IASB has not defined the term "default event." This is a critical term for the measurement of expected credit losses. Although illustrative examples are provided in the ED, significant judgment will be required when applying the model.

In addition, the application of the exception identified in paragraph 6 of the ED will be complicated to operationalize and highly subjective. Furthermore, the 30 day rebuttable presumption may work well for financial institutions but for other industries it does not. It is common for receivables to be 60 or 90 days past due but not be impaired. It would be our preference that the number of days not be specified.

(c) Do you agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring, rather than changes in expected credit losses (or credit loss given default ('LGD'))? If not, why not and what would you prefer?

No, we disagree. We believe that the assessment should include changes in the probability of a default occurring and also changes in expectations of the amount of loss based on an incurred loss model. The recognition based only on probability could be applied to a portfolio of financial assets, however in the case of non-financial institutions, who may have single or few assets, this approach would not work.

(d) Do you agree with the proposed operational simplifications, and do they contribute to an appropriate balance between faithful representation and the cost of implementation?

Please refer to Question 1(a).

(e) Do you agree with the proposal that the model shall allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met? If not, why not, and what would you prefer?

Yes, we agree with the concept of impairment reversal. If an entity recognizes unfavourable changes in credit quality (which represents a potential economic loss), they should recognize favourable changes as well (economic gain) as the situation changes, as this reflects an increase in the probability of receiving future cash flows. Similar to impairment reversals in IAS 36.

QUESTION 6

(a) Do you agree that there are circumstances when interest revenue calculated on a net carrying amount (amortised cost) rather than on a gross carrying amount can provide more useful information? If not, why not, and what would you prefer?

Yes, we agree. When there is no objective evidence other than the forecast of deterioration in credit quality, we believe that interest revenue should continue to be recorded on a gross

amount. When there is objective evidence (ie. recoverable amount less than the carrying value), interest should be recorded on the net amount. This approach also allows entities to recognize interest income separately from credit losses which provide users with more meaningful information about a company's credit loss profile.

(b) Do you agree with the proposal to change how interest revenue is calculated for assets that have objective evidence of impairment subsequent to initial recognition? Why or why not? If not, for what population of assets should the interest revenue calculation change?

Yes, we agree – see comments above under 6(a).

(c) Do you agree with the proposal that the interest revenue approach shall be symmetrical (ie that the calculation can revert back to a calculation on the gross carrying amount)? Why or why not? If not, what approach would you prefer?

Yes, we agree.

QUESTION 7

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?
(b) Do you foresee any specific operational challenges when implementing the proposed disclosure requirements? If so, please explain.
(c) What other disclosures do you believe would provide useful information (whether in addition to, or instead of, the proposed disclosures) and why?

We believe that the proposed disclosures are likely to be excessive for non-financial insitutions, however are appropriate for financial institutions. Excessive disclosure may be confusing and therefore less useful for users.

QUESTION 8

Do you agree with the proposed treatment of financial assets on which contractual cash flows are modified, and do you believe that it provides useful information? If not, why not and what alternative would you prefer?

Please see comments under Question 1(a).

QUESTION 9

(a) Do you agree with the proposals on the application of the general model to loan commitment and financial guarantee contracts? Why or why not? If not, what approach would you prefer?
(b) Do you foresee any significant operational challenges that may arise from the proposal to present expected credit losses on financial guarantee contracts or loan commitments as a provision in the statement of financial position? If yes, please explain.

No, we disagree with the proposal to include loan commitments and financial guarantees for non-financial institutions. Please see comments under Question 3(a).

QUESTION 10

(a) Do you agree with the proposed simplified approach for trade receivables and lease receivables? Why or why not? If not, what changes do you recommend and why?
(b) Do you agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component? If not, why not and what would you propose instead?

Yes, we agree that a simplified approach for trade receivables and lease receivables is appropriate, however we believe that current IASB requirements are sufficient.

It is also our opinion that the scope (as identified in paragraph 12a of the ED) of the simplified approach needs to be extended to include trade receivables that result from transactions that are within the scope of IAS 11 – construction contracts.

QUESTION 11

Do you agree with the proposals for financial assets that are credit-impaired on initial recognition? Why or why not? If not, what approach would you prefer?

Yes, we agree with the proposals, however please see our comments under Question 1(a) with respect to non-financial institutions.

QUESTION 12

(a) **What lead time would you require to implement the proposed requirements? Please explain the assumptions that you have used in making this assessment. As a consequence, what do you believe is an appropriate mandatory effective date for IFRS 9? Please explain.**
(b) **Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?**
(c) **Do you agree with the proposed relief from restating comparative information on transition? If not, why?**

As commented above, we believe this ED poses significant difficulties and challenges for non-financial institutions and would require implementation of potentially costly new systems and processes. Therefore if the ED were to be adopted, non-financial instiutions would require sufficient lead time to prepare. The requirement to assess retrospectively increases the implementation effort. We believe that the effective date as proposed is too early. The relief from restating comparative information is helpful in that it reduces the amount of work that would be required to implement the ED as written. Our preference would be to provide a three year implementation period with an opening period adjustment so that comparative information does not require retrospective restatement.

QUESTION 13

Do you agree with the IASB's assessment of the effects of the proposals? Why or why not?

We agree that the model for recognition of credit losses when applied to financial insitutions was in need of improvement. However, we believe that the impact on non-financial institutions requires more analysis. Please see our comments under Question 1(a).

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