中国会计准则委员会

China Accounting Standards Committee

April 11, 2011

Ms. Leslie Seidmen

Chairman

Financial Accounting Standards Board

United States

Chairman Sir David Tweedie and Mr. Leslie F. Seidman,

We, the Ministry of Finance (MoF), China and the China Accounting Standards Committee (CASC), appreciate the opportunity to respond to the *Joint Supplementary Document* (SD) on Financial Instruments: impairment issued on 31 January 2011 by IASB and FASB (the Boards). We do not entirely agree with the proposed model in the SD and call for the Boards to reconsider the proposal and the co-efforts in convergence of impairment standards of financial instruments from the Boards (see the Appendix for detailed comments).

We believe that the SD was drafted in response to the hot-debated and complex issues arising from the financial crisis and will become a working focus in improving the International Financial Reporting Standards (IFRS), which demands a relatively long period in order to come up with a high-quality standard solution. Emerging markets require a considerably amount of time to comprehend the new model accompanied with detailed field testing and studies. Furthermore, we recommend that the Boards will make the standards subject to relatively minimal changes once finalized by considering the relatively high implementation and regulatory oversight costs.

We suggest that the IASB exercise prudence in finalizing the standards and give San Li He St., Xicheng District, Beijing 100820, People's Republic of China

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full consideration to the operationality and auditability of the impairment model, especially the difficulties that emerging markets may encounter in implementation.

If there is anything that you would like to discuss with us concerning our comments, please contact Mr. Leng Bing (Tel: +86 10 6855 3016, E-mail: lengbing@mof.gov.cn).

Yours faithfully,

Yang Min

Director General

Accounting Regulatory Department of Ministry of Finance of People's Republic of China

Member

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## **Appendix**

## Ministry of Finance, People's Republic of China China Accounting Standards Committee

## Comments on IASB/FASB Supplement to ED/2009/12

# Financial Instruments: Impairment

## I Overall comments

Our overall comments and recommendations regarding the SD are as follows,

## 1. A re-exposure draft on amortized cost and impairment accounting

We recommend a common impairment approach that applies to all financial assets (excluding short-term receivables) measured at amortized cost, considering the implementation challenges and disadvantages of applying different impairment models to the financial assets. We do not agree with the current phased-in approach concerning impairment accounting of financial instruments at amortized cost. We think it may result in a fragmented impairment project and hinder a comprehensive review of issues raised by various stakeholders. We suggest that the Boards work towards an impairment model that applies to all financial instruments measured at amortized cost in their convergence efforts and seek comments on a re-exposed draft of impairment of financial instruments measured at amortized cost.

In addition, we would like to reiterate our views in our responses to the 2009 Exposure Draft in which we suggest the Boards to establish a separate approach for impairment of short-term trade receivables. We recommend the Board to consider a simple method such as impairment analysis of trade receivables based on ageing analysis.

# 2. How to distinguish 'Good Book' and 'Bad Book' and the floor requirement should be removed

We generally support the Boards' proposal to differentiate between 'good book' and 'bad book', however, we believe that the Boards should include clear guidance on how to strictly differentiate between "good book' and 'bad book'. The SD requires an

entity to recognize expected credit losses over the life of the instrument, the allowance amount would be determined at the higher of: (i) expected credit losses applying the time-proportional approach; and (ii) credit losses expected to occur in the foreseeable future. We do not agree with the proposal to require the minimum floor allowance amount (i.e., the 'floor') for the 'good book', as the concept of the 'floor' may result in series of conflicts and increase the challenges in operation and audit. In our view, the early loss pattern that trigger the need for 'floor' is rare in practice and can be mitigated by periodical re-estimation of the expected credit losses and clear guidance on how to transfer from 'good book' to 'bad book'. We are especially concerned that, without a common view as to the foreseeable future periods for different classes of assets, the intention to include a 'floor' to ensure that a sufficient allowance is recognized for asset classes that experience higher default rates early in its life will be reduced. In the mean time, the introduction of 'floor' will result in considerable complexity in impairment accounting of financial instruments and lots of side-effects. Those side-effects include: preparers have to make estimation of expected credit losses based on 'floor' and time-proportional approach; auditors have to examine or test the amount estimated under 'floor' and time-proportional approach; regulators have to understand and compare amounts estimated under both approach. The SD did not specifically address aspects of operational challenges faced by preparers, auditors and regulators. We strongly suggest the removal of the 'floor' requirement based on the above reasons and following a cost-benefit approach, which will result in an estimation of expected credit losses for 'Good Book' under the time-proportional approach.

#### 3. Robust field testing

We strongly suggest that the final standard should only be published after the proposed model has been properly field tested by both preparers and auditors. We have concerns given the commenting period for the SD is so brief so that many stakeholders in China states that they have limited time to think through relevant issues, limited time to conduct robust field tests. We believe that IASB should leave enough time to stakeholders to fully consider and flied-test the proposed approach, rather than skipping necessary procedures and steps to meet the due date of planned June 30, 2011 to finalize the standard.

## II Responses to Questions in the SD

Our responses to the Questions in the SD and the IASB-only appendix to the SD are set out below. As our overall comments represent our views on the SD, the responses set out below are only responses to the specific questions, and shall not be construed as agreement with the particular approaches therein.

## **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 generally agree that the proposed model in the SD can address the weakness of delayed recognition of expected credit losses. However, as pointed out in our general responses, more guidance shall be provided to ensure the effect in practice.

We agree that the model for determining the allowance on assets in the 'bad book' (immediate recognition of expected lifetime losses) is an appropriate way of dealing with credit losses in respect of those assets. For assets in the 'good book', we believe the time proportional element of the model also helps to overcome the weakness of an impairment model based solely on incurred losses by accelerating the recognition of expected credit losses.

Meanwhile, we are aware that the effect of implementing the SD requirement depends on factors such as bank's understanding and interpretation of current impairment requirements in IAS 39 and the SD. Banks may need some time to set up the required model in the SD. In emerging economies, banks have limited experience in establishing models to capture historical data and calculate expected credit losses. We'd like to draw the Board's attention to that fact and consider the impact it may have on implementation.

**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 support applying the same impairment model to all financial assets measured at amortized costs (excluding short-term trade receivables), including single financial assets, closed portfolios and open portfolios. Having a uniform impairment model may prevent entities from arbitrages between different models, which is consistent with one of the aims in reducing the complexity of financial instrument accounting.

**Question 3** 

Do you agree that for financial assets in the 'good book' it is appropriate to recognize the impairment allowance using the approach described above? Why or why not?

We disagree. We believe that an entity should recognize an impairment allowance for financial assets in the 'good book' under the time-proportional approach. We think that this approach has satisfied the decoupling request of stakeholders in their responses to the November 2009 ED.

We noted that the approach in the SD may achieve a proper balance between the IASB's objective of using time-proportional approach to better reflect the pricing of portfolio of financial assets and FASB's objective of ensuring that the impairment provision are sufficient for expected credit losses from foreseeable future. Please refer to our overall comments with regards to the weakness of current proposal in the SD.

**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 SD should further elaborate on a number of operational issues,

which include how to measure the expected credit losses under the time-proportional approach; how to determine weighted average ages and expected weighted average

life of portfolio assets. We recommend that the Boards should permit entities to use

data already stored and warehoused in their operating systems.

**Question 5** 

Would the proposed approach provide information that is useful for

decision-making? If not, how would you modify the proposal?

Overall, we believe that the proposed approach provides information that is an

improvement from what was provided by the incurred loss model under current IAS

39. It enables regulators to recognize the expected credit loss in a more timely manner

and resolve the time lagging issue from incurred loss model. For users of IFRS

financial statements like investors, it provides additional information about preparer's

risk management and thus enables better valuation of relevant financial assets.

However, we do not entirely support the proposed approach, and believe that removal

of the 'floor' requirement would not reduce decision-making useful information.

**Ouestion 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?

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5

We believe that the guidance in paragraph B3 of "As the credit quality of a financial asset, or group of financial assets, deteriorates its collectibility reaches a degree of uncertainty that results in the entity's credit risk management objective changing from receiving the regular payments from the debtor to recovery of the financial asset. If the objective is the recovery of the financial asset(s), the management of the financial asset(s) typically becomes more active." provides the general principle to distinguish between 'bad book' and 'bood book' based on changes in credit risk management objective. The SD could be more useful if supplemented by guidance of what constitutes the change in the objectives of credit risk management in more complicated scenarios instead of providing a few simple scenarios that trigger the transfer from 'good book' to 'bad book'.

## **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 no, how could it be made more operational and/or auditable?

We consider that preparers and auditors are best placed to answer the question instead of accounting standard setters or regulators. However, we are of the view that current SD requirement is not operational and auditable (see our response to Question 6 for our rationale). We recommend the Boards to consider providing more guidance in linkage of credit risk management objectives or credit risk management activities with the distinction of 'Good Book' and 'Bad Book'. Chinese banks regulated by Chinese Banking Regulatory Commission are required to classify all bank loans into five categories: 'Pass', 'Special-mention', 'Sub-standard', 'Doubtful' and 'Loss'. Non-performing loans in China are defined to include all loans that falls into 'Sub-standard', 'Doubtful' and 'Loss' category. In terms of how to apply the principle in distinction of 'good book' and 'bad book', Chinese banks are seeking guidance from the Boards in determining whether to include 'Special-mention' class in 'good book' or 'bad book'.

## **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 agree and have the following recommendations:

(1) the Boards shall provide more specific guidance to address the distinction of 'good book' and 'bad book' under different circumstances. In some cases, portfolios of loans with incurred credit losses do initially belong in the 'good book', we so believe that better guidance is needed in respect of the point at which for accounting purposes the transfer from the 'good book' to the 'bad book' should occur. For example, for short-term small loans, occurrence of default may indicate loss-incurring; for long-term large loans, more specific evidence is needed for indicating whether the ability of debtor to repay the overdue amounts shall be taken into account for determining 'good' vs. 'bad' book.

(2) The Boards shall specify the minimum thresholds as an indicator of changes in credit risk management objectives. Such minimum threshold could be: Credit loss incurrence rather than criteria indicated in paragraph B4 such as days past due, whether expected return is below risk-free interest rate or when management identifies problem loans by forced sales of collateral or renegotiated loans.

## **Question 9**

The boards are seeking comment with respect to the minimum allowance amounts (floors) 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?

- (b) Alternatively, do you believe that the entity should be required to invoke a floor for the impairment allowance related to the 'good book' only in circumstances where there is evidence of an early loss pattern.
- (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?
- (d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?
- (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.
- (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 responses.

As noted in our overall comments, we have different views. Herein, we are only responding to the specific question.

- (1) We disagree. But we understand that the 'floor' concept is a compromised approach to partially remove the difference between IFRS and U.S. GAAP.
- (2) We disagree. We believe that the introduction of 'floor' will lead to conflicts in conceptual understanding. It adds additional complexity and cost to the operation of the model and needs to be backed by detailed guidance on how to identify and evidence an early loss pattern.

- (3) We do not agree that the minimum allowance amount be determined on the basis of losses expected to occur within the foreseeable future.
- (4) We do not agree with the 'floor' requirement. But we do agree that changes in economic conditions shall be considered in determining how further shall preparers look to determine foreseeable future period.
- (5) We do not agree with the 'floor' requirement. As for this question, we agree that the foreseeable future is typically a period of at least twelve months.
- (6) We disagree. As for this question, we believe that setting up a 'ceiling' for 'foreseeable future' does not comply with the Boards' underlying concept of 'expected loss' model. The minimum allowance for the 'Good Book' is to determine it on the basis of incurred losses under current IAS 39 and US GAAP rather than expected losses in the foreseeable future subject to any minimum or maximum.

#### **Ouestion 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.

We did not have sufficient time to conduct field testing as accounting standard-setters and regulators and hence we are not able to provide answers with solid ground. As previously discussed, we disagree with setting up the 'floor', but based on our observations we believe that the time-proportional allowance based on losses over the remaining lives of the assets will typically be higher than the losses in the upcoming shorter term period. However, the floor could be greater than the time-proportional amount in the following cases: (1) Portfolios of assets with early loss patterns;

(2) Growing portfolios to which the amount of new assets that are added exceeds the amount of old ones that are removed from the portfolios. However, we think that by re-estimating expected loss over the lifetime on subsequent reporting dates and

clear distinction between the 'Good Book' and the 'Bad Book' will mitigate negative impacts from insufficient provisioning or delayed recognition of loss provisioning.

#### **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?
- (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?
- (1) We agree on the basis of a consistent discounted or undiscounted estimate when applying the approaches described for open portfolios.
- (2) We agree with permitting flexibility in the selection of discount rate as long as the same basis for determining the discount rate is applied from one period to another. However, we do recognize the practical difficulty in calculating effective interest rate for open portfolios.

## **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?

Yes, we prefer the IASB approach. We believe that it better reflects the economic substance of loan lending business.

11

**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 prefer the model in the SD over the FASB approach. We believe that SD approach

is in line with the objective of amortized cost measurement and thus has the merit of

better representing the economics of lending transactions. The FASB approach is

operationally simple, but it does not appropriately reflect the economics of lending

transactions as it does not reflect the link between pricing of financial assets and

expected credit losses. IASB approach is operationally more challenge that the FASB

approach in defining foreseeable future and estimating expected credit losses over the

life of financial assets. In this respect, IASB approach is more effective in

determining expected credit losses than the FASB approach.

**IASB only Appendix Z:** 

**Ouestion 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 incorporates expected credit losses in the calculation of

the effective interest rate? Why or why not?

We believe that the determination of the EIR should be separate from the

consideration of expected losses., which is in line with the decoupling request from

most stakeholders in responses to 2009 Exposure Draft. The method proposed in 2009

Exposure Draft is too complex and provided limited useful information for

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decision-making and violates cost-benefit principle.

**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 agree because the underlying credit exposure of loans and written loan

commitments are the same and applying the same approach would also have the

benefit of better reflecting that credit risk management of loans to be originated (loan

commitment) and loans originated are the same. The same impairment requirements

for loans and loan commitments will help to estimate the credit losses on a more

unified and accurate basis.

**Question 16Z** 

Would the proposed requirements be operational if applied to loan

commitments and financial guarantee contracts? Why or why not?

We agree that the proposed requirement is more operational. When the IASB

considers the applicability of the SD to the financial guarantee contracts, we

recommend the Board to consider applying the same impairment model to financial

guarantees falls into the scope of financial instrument standard.

**Question 17Z** 

Do you agree with the proposed presentation requirements? If not, what

presentation would you prefer and why?

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12

13

We agree with the proposed presentation of separately present net interest income not adjusted for expected credit losses and a separate presentation of impairment losses as both includes useful information for users of financial statements.

**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?

We agree with the proposed disclosure requirements and we recommend that the Board consider,

(1) the alignment of the disclosure requirement of SD with the current IFRS 7

requirements.

(2) work with the FASB to harmonize the disclosure requirements under U.S GAAP

and IFRS in this area

**Question 19:** 

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 and why not? If not, would you instead prefer to

transfer all or none of the expected credit loss of the financial asset?

Yes, we agree that amount of the related allowance reflecting the age and expected weighted average life should transferred when transferring financial assets between the two groups.

We support that disclosure the amount of the allowance associated with an asset transferred between the books in accordance with paragraph Z7 in the SD.

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