

International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom

31 March 2011

## Re: Supplement to Exposure Draft on Financial Instruments: Impairment

**Dear Sirs** 

The Roche Group has a turnover of CHF 47 bn. a year (EUR 37 bn.) derived from our worldwide healthcare business - pharmaceuticals and diagnostics - and employs over 80,000 worldwide. We have a market capitalisation (end 2010) of CHF 118 bn. (EUR 95 bn.) We have been preparing our consolidated financial statements according to IFRS/IAS since 1990 and therefore have a substantial interest in how these develop, so we appreciate this opportunity to give input on this Supplement.

We would like to recall that our main concerns with the Exposure Draft *Financial Instruments: Amortised Cost and Impairment* ('ED') stemmed from its almost exclusive concentration on the situation of financial institutions. Specifically, we felt that the proposed model of presentation would be quite unsuitable for trade receivables and other operating financial assets – assets whose existence does not derive from purely interest-earning grounds. Also, we thought that the proposed disclosures had apparently been conceived primarily to give sufficient information on credit situations in banks and similar organisations and would be disproportionate in a normal corporate environment, leading to further problems of the kind experienced by corporates with IFRS 7.

We welcome the IASB's efforts to find operational solutions for the difficulties identified in respect of the ED model. We also appreciate that the scope of the Supplement excludes consideration of individual and closed-portfolio assets as well as short-term trade receivables. However, as the Supplement also raises questions about applicability to financial assets other than those held in open portfolios, we have reviewed the new proposals in a somewhat broader context.

The Board has encouragingly made appreciable efforts to consider some of the input received from constituents on the ED. It is clear that the scope of the Supplement is limited to financial assets at amortised cost managed in an open portfolio and specifically excluding short-term trade receivables. It is therefore directly oriented primarily to financial institutions, though industrial and commercial entities (hereinafter "corporates") might also be directly affected, e.g. in respect of investments in marketable debt securities.



Depending on the meaning of "portfolio" in a corporate environment, which is not totally clear for us, we might also be affected in respect of other financial assets.

Our main concerns relate, however, to the potential application of the Supplement's approach to other financial assets not within its scope, as indicated by the questions on suitability for single assets and closed portfolios. Here, as with the ED, we are extremely concerned that an approach which is apparently being tailored to financial institutions could be imposed across a wide range of corporates' operating financial assets (including trade receivables) for which it would be completely inappropriate. We voiced our considerable unease about the ED's almost exclusive focus on financial institutions in our comment letter of June 28, 2010 and can only repeat it here as the Supplement has not alleviated that unease for corporates – which, as the Board will be aware, actually constitute the overwhelming majority of IFRS issuers. It would naturally be ideal to have a single impairment model for all financial assets at amortised cost, but the differences in nature between the business models which give rise to e.g. bank loans and those which give rise to e.g. trade receivables are so fundamental that this would not be possible on the basis of the current proposals without significant negative effects on meaningful information in corporates' financial statements and substantial, unnecessary extra costs.

# **Direct impact of proposals**

In this section we consider the Supplement's proposals as they could *directly* affect Roche, e.g. for our open portfolio of investments in marketable debt securities.

- 1. The proposed "de-coupling" of asset and risk management would mean that the allowance for credit losses would be appreciably simplified from a practical systems point of view, and we warmly welcome the suggestion. It is a major improvement on the ED and should be applied to all financial assets at amortised cost.
- 2. There seems to be an implicit assumption in the Supplement's proposals that the financial asset generates interest revenue. As we emphasised in our comment letter, this is far from true, particularly in corporates where financial assets generate different forms of revenue (e.g. sales.) Where sales revenues are immediately recognised in income as is generally the case there is no need to attempt a matching of expected credit losses with the corresponding revenues on a time-apportioned basis. This also changes the nature of, and justification for, the whole good book/bad book distinction. We suggest that, if the time-apportioned method of recognising expected credit losses were to be retained in the final standard, it should be strictly limited to assets which generate interest revenue.
- 3. We have some difficulties with understanding three of the concepts introduced in the Supplement as applied in a corporate environment:

"Portfolio" (cf. Appendix A): While the meaning of this term may be obvious in a banking environment, its applicability in other activities appears to us insufficiently clear. What is "managed on a collective basis"? To what extent can a group of trade receivables be regarded as a "portfolio", for instance? An entity's credit management policies should presumably play a role in the definition. "Good book"/"bad book": The criteria for "bad book" (para. 3) do not appear to be sufficiently flexible to take account of the different risk management approaches which may be in operation. While the terms may be common in financial institutions, they do not appear to be immediately translatable to corporate activities. Also, entities and industries differ considerably in their approaches to the management of financial assets, and this fact does not seem to be adequately reflected in the concept. We understand that it was the Board's intention for the distinction to be based on the entity's business model and policies, but we would appreciate this being made much more explicit.

"Foreseeable future" (para. 2): We understand some users' discomfort with such a broad concept and suggest that the definition might be more appropriately made in terms of "the next 12 months unless a longer period can be justified (with disclosure.)"



4. With regard to the concept of the "floor" we can understand the need to avoid over-valuations of assets where initial expected losses from interest-generating assets would otherwise be time-apportioned. However, to avoid the necessity for entities to carry out *two* valuations of all good-book assets, we would rather support the IAS 36 approach whereby calculation of a floor would only be necessary where there are indications that simple time-apportionment might lead to an over-valuation of assets. Such an indication ("trigger") would be e.g. historical experience of higher front-end losses. It should be borne in mind that we are dealing here with "good-book" items, so that situations should not be frequent. Also, the measurement attribute being applied for the assets concerned is amortised cost, so any adjustments superimposed on that have the nature of exceptions and should be treated as such.

#### **Indirect impact of proposals**

In this section we consider the potential *indirect* impact of the Supplement's proposals, i.e. if they were to be extended beyond the stated scope to single assets and closed portfolios.

- 1. The points made above under "Direct impact on corporates" are equally valid for assets affected by any potential extension.
- 2. For many types of operating financial assets we are concerned at the lack of availability of historical data on which to base estimates of expected future losses. Also, for open portfolios with assets of differing nature, we would have to determine the lifetime expected losses for each group of assets with similar characteristics and compute the weighted-average ages and remaining lives of such portfolios at each reporting date in order to determine the loss allowances in "the good book". Further, it would be necessary to distinguish in these different portfolios between assets in good and bad books and compute the allowance for each book separately. This seems to mean effectively that we would have to retain the processes to record incurred losses for the bad book, while being required to develop additional new processes to compute the time-apportioned amount and the floor for the good book. Perhaps this would be no problem for financial institutions, for corporates it would generally be a substantial new and on-going increment in compliance costs
- 3. We do not believe that an adequate case was made in the ED, or can be identified in this Supplement, that the proposals would produce benefits for users of corporates' financial statements. We would urge the Board to give positive consideration to retaining at least for operating financial assets without any interest-revenue element the present IAS 39 requirements (para. 64 plus AG87-91). We believe that experience over the years has shown that these provide users with sound decision-useful information in the most relevant and reliable manner. In our estimation they would not in any case lead to significantly different results from the core of the proposed measurement approach.

## Trade receivables

We note that the Supplement specifically scopes out short-term trade receivables and that they would be considered in the Revenue Recognition project. We strongly emphasise here the demand we expressed in our comment letter on the ED not to change the current practice of treating credit losses on trade receivables as an operating expense and not as a reduction of revenues. Current practice best reflects the way in which credit risks and losses on trade receivables are managed in most corporates and corresponds to the way in which most investors wish to see revenues presented, so that they have a clear picture of the level of economic activity. We trust that our requirement will be forwarded to the Revenue Recognition project team.

## IASB-only proposals on Presentation and Disclosure

We remain concerned about the level of disclosures. These continue to be pitched at a level presumed necessary for financial institutions. We hope that, in the final standard, the Board will be able to incorporate sufficient flexibility to enable corporates to avoid – or at least minimise - excessive, immaterial disclosures. In any case a co-ordinated, coherent review of IFRS 7 in the light of the changes will be absolutely vital.



Sincerely,

F. Hoffmann-La Roche AG

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