



**The Institute of  
Chartered Accountants  
of Pakistan**



CA/DTS/A/c. SC/2011-2061

April 1, 2011

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH

(By email: [director@fasb.org](mailto:director@fasb.org))

Dear Sirs

### RESPONSE TO SUPPLEMENT ON FINANCIAL INSTRUMENTS: IMPAIRMENT

The Institute of Chartered Accountants (ICAP) appreciates the opportunity to comment on the Supplement to ED/2009/12 Financial Instruments: Amortised Cost and Impairment issued by the International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) in January 2011.

#### Overview:

The main highlights of the Supplement are:

1. The original concept of Expected Credit Loss has been retained;
2. The portfolios will be classified as the "good book" and the "bad book" which will be based on internal credit risk management policies with the requirement that the financial assets will be transferred to the bad book when collectability of the assets becomes so uncertain that objective of the entity's credit risk management changes from receiving regular payments to recovery of all or portion of the assets;
3. As per paragraph 2 of the Supplement, at each reporting date, the impairment allowance will be total of:
  - For the good book, it would be higher of:
    - I. the time-proportional expected credit loss; and
    - II. the credit loss expected to occur within foreseeable future (this should not be less than 12 months with certain exceptions).
  - For the bad book, the entire amount of expected credit loss.
4. Entities will be required to estimate expected credit loss for the remaining life or the foreseeable future of the assets considering all the information including historical data, current economic conditions, and supportable forecasts of future events and economic conditions.
5. "Foreseeable future" has been defined as the period for which reasonable and supportable information exists to support specific projections of events and conditions of that period.

Contd. P/2

(Established under the Chartered Accountants Ordinance, 1961 - X of 1961)

HEAD OFFICE: Chartered Accountants Avenue, Clifton, Karachi-75600 (Pakistan). Ph: (92-21) 111 000 422 Fax: 99251626  
Website: [www.icap.org.pk](http://www.icap.org.pk) E-mail: [info@icap.org.pk](mailto:info@icap.org.pk)



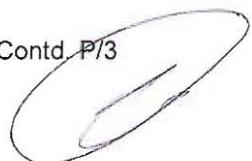
CONTINUED

-2-

**Comments:**

1. The Expected Loss model proposed for the purpose of determining 'impairment in amortised cost assets managed in an open portfolio' seems to be a deviation from the existing requirements / fundamentals in the Framework and the IFRS. Currently, IFRS prescribe accounting treatments which are based on either historical cost or fair value except for certain exceptions such as intangible assets having indefinite life including goodwill for which annual assessment is required for their recoverability and projections are prepared based on future events. We understand that this requirement has been kept in IFRS due to the element of indefinite life in such intangible assets. Otherwise, **IFRS do not allow consideration of and/or accounting for events for which conditions do not exist at the reporting date (non-adjusting events)**. Hence, this concept of expected loss appears to be deviation from the current IFRS requirements which if supported will result in birth of new accounting concept due to which a situation can arise in which IASB may bring such requirements into other standards also to make them consistent with this concept. However, we believe that a logical sequence should be to make amendments first to the Framework and introduce the concept of expected loss and then suggest changes to the specific standards.
2. Further, we understand that it will be difficult to implement the aforesaid requirements in the local environment due to the following reasons:
  - It appears that the proposed requirements in the Supplement include high level of estimates and subjectivity which may provide opportunity to entities to interpret and apply the requirements for purposes which benefit them the most. In the past, it has been seen that subjective requirement for provisioning under the Prudential Regulations of the State Bank of Pakistan creates a lot of resistance from financial institutions when the institutions are asked to recognize provisions on loans and advances on a subjective basis.
  - Determining expected loss for foreseeable future will require entities to prepare projections for which we understand that criteria used and factors considered for preparation of projections will vary from entity to entity which will completely distort comparability among entities. Variation will also result due to experience and expertise employed by each entity.
  - Implementation of the proposed requirements will require entities especially financial institutions to have high level of expertise and robust Management Information System. Since many entities in the country do not possess either the expertise or the MIS to generate the required information, entities have to incur additional cost in this respect that may force them not to support implementation of the new requirements in the country.

Contd. P/3





CONTINUED

-3-

- Even in the developed countries where sometimes it is difficult to rely on the historical data, it is difficult to ensure reasonableness and accuracy of information relating to future events and future economic conditions which are essential for preparation of projections for determining expected loss.
- Another major issue to consider before the implementation of the proposed requirements is how these will be audited. Although the audit related requirements are defined in the ISA relating to the 'Audit of Accounting Estimates', it seems that the requirements in that standard may need to be revisited in the light of introduction of the expected loss model. Further, it is obvious that these requirements will result in additional time and additional cost for auditors which entities may not be able to afford due to which resistance may be faced in implementation.

We hope that you will find the above comments helpful.

Yours truly

Muhammed Owais Mukati  
Senior Manager Technical Services