CBI
THE VOICE OF BUSINESS

INTERNATIONAL ACCOUNTING STANDARDS BOARD

FINANCIAL INSTRUMENTS : IMPAIRMENT : SUPPLEMENTARY DOCUMENT

CBI RESPONSE **MARCH 2011**

1. The Confederation of British Industry (CBI) is pleased to respond to the Board's consultation. We offer some general observations below from the standpoint of the impact on business generally, and do not respond to all the specific consultation questions, many of which are primarily directed at financial institutions.

2. We welcome publication of the Supplementary Document, which seek to address some of the concerns raised on the previous Exposure Draft.

3. We note that, as well as trying to make the original ED proposals more operational, the IASB's stated objective of the Supplement is to try to 'enhance comparability internationally', particularly with the US Financial Accounting Standards Board. However this has resulted in the proposals representing a compromise between two different approaches.
Whilst convergence is desirable, but not if the result is a poor standard arising from too much compromise. The ultimate aim must be to develop impairment requirements that are conceptually sound, and which produce results which are operationally effective and appropriate in practice, both for financial institutions, and businesses generally.

4. There are many aspects of the original exposure draft which are yet to be re-deliberated, and further consultation, outreach and field testing will be necessary. It is therefore important that the IASB remains open to changes to its approach, and that the final impairment requirements work appropriately, rather than that a particular deadline is achieved.

5. We note 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, although businesses generally will also be directly affected, for example, in respect of investments in marketable debt securities. Depending on the meaning of "portfolio" in a corporate environment, on which we are not totally clear, companies might also be affected in respect of other financial assets.

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6. As with the Exposure Draft, we are concerned that an approach which is tailored to financial institutions could be imposed across a wide range of businesses' operating financial assets (including trade receivables) for which it would be completely inappropriate. Whilst it would naturally be ideal to have a single impairment model for all financial assets at amortised cost, the differences in nature between the business models which give rise to, for example, bank loans and those which give rise to, for example, 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 companies' financial statements.

Direct and indirect impacts on business

- Direct

7. 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. This is a major improvement on the ED and should be applied to all financial assets at amortised cost.

8. There seems to be an implicit assumption in the Supplement's proposals that the financial asset generates interest revenue. However this is far from true, particularly in companies 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.

9. We have some difficulties with understanding certain of the concepts introduced in the Supplement as applied in a general business environment:

*"***Portfolio***"* : 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 they 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***"* : 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.

Floor : We can understand the need to avoid over-valuations of assets where initial expected losses from interest-generating assets are otherwise time-apportioned. However, to avoid the necessity for companies 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. 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 impacts

10. There are also various potential indirect impacts of the Supplement's proposals, i.e. if they were to be extended beyond the stated scope to single assets and closed portfolios.

11. For many types of operating financial assets many companies are most concerned at the lack of availability of historical data on which to base estimates of expected future losses. Also, entities with significant amounts of financial assets with differing characteristics that are managed as open portfolios would need 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".

12. 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 companies 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, but for companies generally it would be a substantial new and on-going increment in compliance costs.

13. 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 companies' financial statements. Many such users in fact would seem to prefer the greater reliability of the present incurred-loss model to the greater uncertainties involved in the proposals in the estimates of expected losses. 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. 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.

Trade receivables

14. We note that the Supplement specifically scopes out short-term trade receivables and that they would be considered in the Revenue Recognition project. As stated in our response to the Exposure Draft, there should be no change to 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 companies, 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.

Disclosures

15. 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 companies to avoid, or at least minimize, excessive, immaterial disclosures. In any case a coordinated, "joined-up" review of IFRS 7 in the light of the changes will be absolutely vital.

Outstanding issues and timetable

16. There are numerous issues that need to be completed before the Standard can be finalised. These include:

- the final solution to netting of financial instruments and the associated disclosures;
- the general and portfolio hedge accounting model;
- the final solution on impairment that is applicable to all different types of financial instruments;
- an overview of all the new disclosures introduced by the different phases of the project and how they interact with each other and the current requirements in IFRS 7, and to ensure there is no unnecessary overlap, or that they could be presented in a simpler way;
- a review of consequential changes to other Standards;
- transition arrangements and that sufficient time is available for implementation after the issue of the final standard.