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**International Accounting Standards Board**

30 Cannon Street - London EC4M 6XH - United Kingdom

**Financial Accounting Standards Board**

401 Merritt 7, PO Box 5116 - Norwalk, CT - 06856-5116, USA

**RE: Supplement to Exposure Draft Financial Instruments: Impairment**

**Dear Sir/Madam,**

The Comitê de Pronunciamentos Contábeis - CPC<sup>1</sup> welcomes the opportunity to comment on the Supplement to Exposure Draft (ED) 2009/12 named Financial Instruments: Impairment.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

This response summarizes the views of our group designated to study this Exposure Draft, which may be supported by the opinions of external parties, sent to us for analysis and to enhance the discussion on the subject matter. We have also made efforts to encourage other external parties to send comments directly to the IASB/FASB.

If you have any questions about our comments, please contact **Idésio S. Coelho** ([idesio.s.coelho@br.ey.com](mailto:idesio.s.coelho@br.ey.com)).

Yours sincerely,

**Edison Arisa Pereira**

Technical Coordinator - Comitê de Pronunciamentos Contábeis (CPC)

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<sup>1</sup> The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Brazilian Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

## **Financial Instruments: Impairment**

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### **General**

#### **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?

#### **Comments on Question 1**

The proposed model certainly anticipates the loss recognition in comparison with current USGAAP and IFRS standards, mainly in respect with the criteria of full provision for all expected losses for the bad book and the higher of time-proportional amount and the floor for good book. In this particular aspect, the Supplementary Document (SD) achieves its purpose.

We believe that the proposed approach deals with the problem of late recognition of credit losses, especially in the case of financial assets classified in the bad book. We also understand that the requirements set out in the supplementary document should only be applied for groups of financial assets managed on an open portfolio basis, in response to the difficulties entities might encounter in applying the original requirements for open portfolios.

We also understand that the original requirements in the ED Amortised Cost and Impairment have conceptual advantages over the proposed in the supplementary document, such as recognition of initial expected credit losses over the life of the financial asset, reflecting the economic reality, economic substance and the pricing of the instrument.

### **Open portfolios**

#### **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.

## Comments on Question 2

In theory, we support the idea of applying the impairment allowance criteria for closed portfolios and single assets. However, we believe that additional guidance should be provided to the financial statements preparers in order to make it operational. It seems that the estimation of expected losses could be reasonably performed for closed portfolios and single assets, but the floor and time-proportional allowance calculation may be difficult in practice. In order to address this concern, we believe that closed portfolios and single assets should be grouped together and floor applied to this larger group aiming to ensure comparability among the impairment allowance determination for single assets, open and closed portfolios.

Although we are concerned with the importance of having a single impairment approach for all relevant financial assets, we believe that the proposed approach in this supplementary document would not be suitable and appropriate for closed portfolios and single financial assets because this approach doesn't meet the object of reflecting the substance of the lending transactions, nor does it reflect the pricing of the financial assets when the entity makes lending decisions. In regarding of that, we believe that the original approach in the ED Amortised Cost and Impairment best reflects the conditions and events of lending transactions for closed portfolios and single financial assets, as well as it reflects the economic reality and interaction with interest revenue recognition. Moreover, we think that applying the requirements of this supplementary document for closed portfolios and single financial assets would not be operational.

Because of the relevant difficulties that entities might encounter in applying the requirements of the original ED for open portfolios, we reckon that the requirements of this supplementary document would be suitable to deal with that fact. But we think that many non-financial entities might not be familiar with the concepts used to calculate the time-proportional expected credit losses, as such portfolios' age, portfolios' expected life, weighted average age, weighted average life, annuity etc., as these are more commonly used in the financial entities' environment. We think it would be appropriated to add more additional guidance to address this point.

## **Differentiation of credit loss recognition**

### **Question 3**

Do you agree that for financial assets in the 'good book' it is appropriate to recognise the impairment allowance using the approach described above?

Why or why not?

### **Comments on Question 3**

We support the convergence between IASB and FASB, and we consider that the adoption of the impairment allowance approach described above for good book is part of said convergence, but, as mentioned above, we understand that the proposed approach should only be required for groups of financial assets managed on an open portfolio basis.

However, we point out that in some instances there might be some incurred but not reported losses, which may not be captured by the time-proportional approach whether such losses occur at the beginning of the portfolio life. In addition, it might be hard to determine the estimated portfolio life for short-term receivables, such as credit cards or overdrafts.

### **Question 4**

Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

### **Comments on Question 4**

Although we noted improvements in comparison with the original IASB Exposure Draft, such as the "decoupling" of interest revenues and expected credit losses, some aspects of the SD are still unclear, such as the definition of "foreseeable future" and the exact timing of transfer of an asset from good book to bad book (refer to comments to question 6).

We are also concerned that some non-financial entities might have difficulties in applying the concepts of the time-proportional expected credit losses. It would be suitable to add additional guidance and examples to facilitate the understanding.

In order to make the proposed impairment approach operational and be able to meet all disclosure requirements, entities will need to enhance their internal control environment and information system capabilities, demanding significant financial disbursements.

## **Question 5**

Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

### **Comments on Question 5**

We expect that IFRS financial statements' users will be benefited due to the anticipated timing of impairment allowance recognition. However, it is still unclear how the FASB will address presentation and disclosure matters.

## **Question 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?

### **Comments on Question 6**

We agree that it makes sense in certain circumstances to recognise the entire amount of the future expected credit losses immediately in profit or loss, while in others the approach based in allocation over time best reflects the economic characteristics of the financial instruments.

We believe that under the current language of paragraph 3 and clarifications found in B2 to B4, entities might find difficulties in differentiating the two groups, as B2 mentions that "an entity shall differentiate the two groups on the basis of its internal credit management". Such unclear position may lead to different interpretations of the approach. In addition, there is no specific guidance for renegotiated/restricted assets or those that are changing status (transitioning from regular payment to recovery status). We would suggest that some examples covering those issues be added to the final document.

We are also concerned that some problems may arise in practice among entities that are more or less proactive in relation to their credit risk management procedures. An entity that has more proactive procedures related to its credit risk management may anticipate the recognition of a credit loss allowance in comparison to other that is less proactive, in relation to a financial asset that is economically the same.

### **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 not, how could it be made more operational and/or auditable?

### **Comments on Question 7**

Please refer to the comments on question 6. Considering the level of judgement applied to differentiate the two groups, it might be difficult to audit for example two different approaches for a similar environment.

### **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?

### **Comments on Question 8**

We agree with such requirement, in particular with the requirement to recognize all expected losses for bad book.

Please see comments on question 6.

### **Minimum impairment allowance amount**

#### **Question 9**

The boards are seeking comment with respect to the minimum allowance amount (floor) 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 an entity should be required to invoke a floor for the impairment allowance related to the 'good book' only in circumstances in which 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 response.

### **Comments on Question 9**

- (a) We support the initiative of requiring a floor for good book, but emphasize that convergence between IASB and FASB in this case is needed.
- (b) We believe that floor should be required in all circumstances. We agree with the requirement of accelerating the timing of loss recognition only in the cases in which credit losses are expected to occur in the nearer term.
- (c) The concept of foreseeable future may vary among jurisdictions and even among entities within the same jurisdiction, as larger entities could benefit from their internal control environment, and be able to prepare more accurate forecasts. Those factors may generate discrepancies in the application of the approach. At the same time, more specific guidance should be provided for the definition of losses (i.e., is a loss determined at the moment of the write-off of an asset, at the moment of delinquency?)
- (d) There is definitely a correlation between the economic scenario and the determination of the foreseeable future period. However, the concept of foreseeable future should be clarified as mentioned above.
- (e) It is hard to determine whether twelve months is a reasonable period of time. It may depend on the jurisdiction and specific economic scenarios, as well as on the level of internal controls of a specific entity. In Brazil, even financing for acquisition of consumer products may have a three-year term, reaching up to seven year for car financing.
- (f) Refer to comment (c) and (e) above.

### **Question 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.

### **Comments on Question 10**

We believe that the time-proportional amount could be lower than the floor in situations on which there are early losses, composed by short-term assets, deteriorated collectability but still considered in the good book.

## **Flexibility related to using discounted amounts**

### **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?

### **Comments on Question 11**

We do not agree with the flexibility permitted to use either a discounted or undiscounted estimate. Based on our experience in an environment with higher interest rates in comparison with developed countries, there might be significant distortions in the application of the model if such flexibility is allowed. We support the requirement to incorporate time value into the financial asset credit impairment model, as this approach might result in a greater level of comparability. We also point out that the final document should require extensive disclosures about the assumptions applied to determine the discount rate and economical forecasts.

## **Approaches developed by the IASB and FASB separately**

### **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?

### **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?

### **Comments on Questions 12 and 13**

Please see comments on questions 1, 2 and 3.

We believe that the proposed approach in the supplementary document deals with the problem of late recognition of credit losses, especially in the case of financial assets



classified in the bad book. We also understand that the requirements set out in the supplementary document should only be applied for groups of financial assets managed on an open portfolio basis, in response to the difficulties entities might encounter in applying the original requirements for open portfolios.

For close portfolios and single financial assets, we understand that the original requirements in the ED Amortised Cost and Impairment (ED/2009/12) have conceptual advantages over the proposed in the supplementary document, such as the recognition of expected credit losses over the expected life of the instrument, which meets the primary objective of reflecting the economic reality, economic substance and pricing of the instrument. This approach is also aligned with the interest revenue recognition.

As mentioned above, we support the convergence between IASB and FASB, and believe that the adoption of a floor to compute the allowance in good book is reasonable for adoption in both frameworks, once our concerns listed in comments 6, 7 and 9(c) are addressed by the Boards.

We also would like to suggest to the Boards that, whichever approach is commonly adopted, some field tests should be made to ensure an effective and smooth transition before the final document is issued.

## **Impairment of financial assets**

### **Question 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 incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

### **Comments on Question 14Z**

We agree with such proposal, since most information systems do not have integrated effective interest rate determination and expected losses features.

We do not agree with the separation of initial expected credit losses from the calculation of the effective interest rate, because doing so would not reflect the economics of the lending transactions and the pricing of the instrument. We understand that the inclusion of the initial estimate of expected credit losses in the financial assets' initial measurement is important because it reflects the way in which the entity prices the asset. In other words, it best reflects the economics of the transaction.

## **Scope – Loan commitments and financial guarantees contracts**

### **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?

### **Comments on Question 15Z**

We support the initiative in allowing institutions to use the same impairment approach for all loan commitments (such as loans, commitments and guarantees), as they share common risk patterns. In addition, we believe that loan commitments that are not in the scope of IAS 39 should be included in the scope of IFRS 9 for measurement harmonization.

### **Question 16Z**

Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

### **Comments on Question 16Z**

We support the initiative to adopt the same impairment approach for loans and loans commitments, but we believe that treatment for financial guarantee contracts should still be the current one required in paragraph 2(e) of IAS 39, which leads to either the adoption of IAS 39 or IFRS 4 (insurance contracts).

## **Presentation**

### **Question 17Z**

Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

### **Comments on Question 17Z**

We agree with the proposed presentation requirements, considering that they result from a convergence effort between the Boards.

## **Disclosure**

### **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?

### **Comments on Question 18Z**

We agree with the disclosure requirements, but suggest to the Boards to consider the current IFRS 7 requirements in the final document.

### **Question 19Z**

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 or why not? If not, would you instead prefer to transfer all or none of the expected credit loss of the financial asset?

### **Comments on Question 19Z**

We believe that a reasonable approach should be to consider the amount determined by the computation of the weighted average age and life of the transferred (group of) financial asset.