Supplement to Exposure Draft ED/2009/12 Financial Instruments: Impairment

Dear Sir/Madam,

Thank you for the opportunity to comment on your Supplement to Exposure Draft ED/2009/12 Financial Instruments: Impairment. The Volkswagen Group is one of the world's leading automobile manufacturers and the biggest carmaker in Europe. The Group currently operates 62 production plants in fifteen European countries and a further six countries in the Americas, Asia and Africa. Around the world, more than 400,000 employees produce about 25,000 vehicles or are involved in vehicle-related services each working day. The Volkswagen Group sells its vehicles in more than 153 countries. With our 100%-owned subsidiary Volkswagen Financial Services AG we are also the largest automobile financial services provider in Europe. On behalf of Volkswagen AG, Wolfsburg, we are pleased to provide you with the requested remarks to the proposed Supplement in response to your invitation to comment.

Many of the proposals made in the supplement contain improvements to the ED/2009/12 (see “Differentiation of credit losses recognition”). In general, the expected loss model leads to a better presentation of the credit risks of an entity compared to the incurred loss model. First and foremost the implementation of an expected loss model however must be practical. Finally there should be no lack between standard requirements and appropriate use of such a model.

Concerning the questions we present the following key statements:

- As mentioned before, more detailed guidelines on how the expected losses are estimated, is a fundamental prerequisite for the introduction of an expected loss model.
- The use of a decoupled approach is the only practical solution for all financial instruments including open portfolios (i.e. credit losses will be separately recorded from interest revenue)
The segmentation of the financial assets into two different groups (good and bad book) is understandable and useful. Further guidance would be preferable.

We see no need to use a “floor” during the calculation of the impairment amount. Consequently we prefer the IASB approach without the use of a floor. If the IASB implements a floor anyway, it is more practical to use a fixed period of 12 months in order to determine the time period for the foreseeable future.

The flexibility related to using discounted amounts complicates the comparability between entities. We prefer the use of discounted amounts, calculated on a straight line basis without any options.

We request the IASB to revise the overburdened disclosure requirements.

Below we address the issues which are of special relevance to us:

Q1: General
The proposed approach results in earlier recognition of impairment, because the expected credit losses must be recognized from the time on they are expected. Thus generally delayed recognition can be prevented. In sum, more useful information can be provided for the addressee. However, more instructions to determine the expected losses are needed. The general statement that all available information from both internal and external sources must be considered to determine the expected losses will lead to the use of different measuring methods. This results in a lack of comparability between entities. In our view, more detailed guidelines on how the expected losses are estimated, is a fundamental prerequisite for the introduction of an comparable expected loss model. Those guidelines should be oriented at existing practices in the banking or insurance business.

Q2: Scope – Open portfolios
We can see no major reasons against an expansion of scope. In our view, all financial assets measured at amortised costs should use the same impairment approach. If there are different approaches to determine the impairment allowance, addressees will have problems in understanding such impairment information. Therefore, we support the use of a consistent impairment approach, which may contain simplifications to ensure the implementation and the practical use.

Q3-Q5: Differentiation of credit losses recognition (determining the impairments allowance)
We agree that the expected losses should be calculated on the basis of the duration and composition of the portfolio (for good books). We prefer the proposed decoupled approach in which the credit losses will be separately recorded from interest revenue. By the formation of a time-proportional reserve the addressees might notice that it lead to credit defaults, even if all obligations are complied at the present time (i.e. useful information is provided). In our view, an integrated and effective interest rate calculation (consideration of the expected losses), especially for open portfolios, is neither practical nor understand-able.

If the IASB implements a floor, we have to consider, that the definition of “a foreseeable future” leaves room for interpretation (see our comments under Q9-10).
Overall, we believe that the proposals are operational with the limitation, that the estimate of the expected losses is more clearly determined. In summary, we welcome the acceptable simplification with regard to the original proposal.

**Q6-8: Differentiation of credit losses recognition (good books – bad books)**
The segmentation of the financial assets into two groups makes sense (i.e. the differentiation between a general reserve (good book) and a specific reserve (bad book)). However, occasionally it might be difficult to find a clear border if entities classify their credit loans in more than two groups. Thus there can be different opinions about the changing of the intent “to receive regular payments from the debtor” or “to recover the financial asset”. If there are many categories to estimate the default probability (major rating agencies), there must be a category in which a reclassification of good book to bad book is realized. The relative open-held classification leaves room for interpretation (different credit risk management practice); Thus additional guidance regarding classification would be helpful. The proposed disclosures (paragraph Z15(a)) may inform the addressee about the classification system of an entity, but it will be very difficult to identify the several differences. Finally there will be a lack of comparability between entities. Beside that, the immediate recognition of the entire lifetime expected losses for bad book financial assets is useful, since by definition (recovery of the financial asset) there is a significant higher probability of credit losses.

**Q9-Q10: Minimum impairment allowance amount**
We understand the concern to ensure that the expected credit losses are recognized in time (maybe because of the problems during the financial crisis). Therefore an entity shall recognize the higher amount of (1) the time-proportional expected credit losses or (2) the credit losses expected to occur within the foreseeable future (floor). However, we do not believe that the use of a floor serves the true and fair view maxim. The floor has to be estimated over the time period of a foreseeable future. The question is how the foreseeable future can be determined for each portfolio, since a clear guidance is missing. We do not believe that a time period of more than 12 months makes sense. The use of a longer time period might result in the immediate recognition of all expected credit losses of a portfolio (for short term loans). In addition, the flexibility to interpret the time period will result in non transparent and non comparable information, as entities have the opportunity to make earning management. In our opinion, in such cases it is more practical to use a fixed period of 12 months. As we consider both the determination of the foreseeable future and measurement of the floor will be very expensive, so we welcome the proposal, as only in circumstances in which there is an evidence of a significant early loss, a floor has to be determined. We request the IASB to give examples of such early loss emergence scenarios and develop corresponding guidance.

**Q11: Flexibility related to using discounted amounts**
We are against options regarding the use of discounted amounts, because it complicates the comparability between companies. We generally prefer the use of discounted amounts, which are calculated on a simplified basis.

**Q12-13: Approaches developed by the IASB and FASB separately**
In our opinion the IASB approach contains preferable simplifications. The FASB approach involves several difficulties as we described in Q9-10. In sum, we prefer the IASB approach without the use of a floor.
Q14Z: Impairment of financial assets
As we discuss under Q3-5, we prefer the decoupled approach.

Q15Z-Q16Z: Scope – Loan commitments and financial guarantee
No further comments on this point.

Q17Z: Presentation
We welcome the proposed presentation requirements as they are a simplification of the original proposals (see Q3-5). The proposal in the supplementary document requires the presentation of the interest revenue and the impairment losses in the statement of comprehensive income. This presentation should be used not only for open portfolios but also for closed portfolios. In the original proposal four line items have to be presented separately. We believe that many separate line items compromise the clarity and therefore do not improve the understandability of the comprehensive income.

Q18Z-Q19: Disclosure
We agree with the proposals if they are necessary to increase transparency and comparability. We do not believe that the requirement to disclose for “five” annual periods (paragraph Z8) leads to a better transparency or comparability. Furthermore the proposed disclosure should be adjusted with the existing disclosure requirements in IFRS 7. As explained above, we do not believe that too many disclosure requirements improve the financial reporting. So we request the IASB to analyze if the corresponding information could be disclosed at an aggregated level to keep the requirements practical.
We agree with the proposal concerning the transfer of financial asset(s) between the two books (i.e. the impairment allowances shall be determined in accordance with the weighted average age and life of the transferred financial asset(s)).

Best Regards

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