CIPFA The Chartered Institute of Public Finance & Accountancy

Exposure Draft ED/2012/3
Financial Instruments: Expected Credit Losses

response to exposure draft

15 July 2013

the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

Our ref: Responses/130715 SC0198
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
Submitted electronically to www.ifrs.org
July 2013

Dear IASB secretariat

Exposure Draft ED/2012/3

Financial Instruments: Expected Credit Losses

CIPFA is pleased to present its comments on the matters discussed in this Exposure Draft, which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

General comments

While CIPFA has an interest in financial reporting generally, we have a specific interest in public sector and wider not-for-profit reporting. We therefore have a particular interest in questions relating to the use of IASB standards by these entities.

The impairments considered in this ED range over various matters, including credit risk and losses for trade receivables, financial guarantees, loan commitments and loans.
Some public sector entities will have very little exposure to credit risk, although most of those which engage in trading activities will have trade receivables which attract a degree of risk.

Financial guarantees are a well established and important part of the public sector operational landscape in some countries: they may be provided in order to facilitate public infrastructure development which would otherwise be too risky for private sector contractors, and in some cases governments systematically provide guarantees to encourage specific policy objectives.

Relatively few public sector bodies directly act as lenders, although many countries do have state owned banks, whether these operate by analogy to private sector banks, or in the capacity of regulating the economy as a central bank.

Specific comments

Responses to the ED questions are attached as an annex.

I hope this helps the Board in its development of IFRS 9.

Yours faithfully

Paul Mason
Assistant Director
Professional Standards and Central Government
CIPFA
3 Robert Street
London WC2N 6RL
t: 020 7543 5691
e:paul.mason@cipfa.org
www.cipfa.org

Questions for respondents
Question 1 **(a) Do you agree that an approach that recognises a loss allowance (or provision) at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, will reflect:** **(i) the economic link between the pricing of financial instruments and the credit quality at initial recognition; and** **(ii) the effects of changes in the credit quality subsequent to initial recognition?** **If not, why not and how do you believe the proposed model should be revised?** **(b) Do you agree that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments? If not, why not?**
(a) CIPFA agrees that this approach reflects both the link between pricing and credit quality at initial recognition and the effect of subsequent changes in credit quality. (b) CIPFA agrees that recognising discounted lifetime expected credit losses does not provide as faithful a representation as the approach in the 2009 ED, or the bridging approach proposed in this IASB ED. Recognising discounted lifetime expected credit losses also has other disadvantages, including increased subjectivity.

Question 2

(a) Do you agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation? If not, why not? What alternative would you prefer and why?

(b) Do you agree that the approach for accounting for expected credit losses proposed in this Exposure Draft achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD (without the foreseeable future floor)?

(c) Do you think that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than this Exposure Draft?

(a) Yes

(b) Yes.

(c) No.

Question 3

(a) Do you agree with the proposed scope of this Exposure Draft? If not, why not?

(b) Do you agree that, for financial assets that are mandatorily measured at FVOCI in accordance with the Classification and Measurement ED, the accounting for expected credit losses should be as proposed in this Exposure Draft?

Why or why not?

CIPFA agrees with the scope of this ED. It is however difficult to assess the full impact on including leasing transactions within the scope prior to the finalisation of the leasing standard.

It is preferable to use as coherent as possible an approach to impairment for all financial instruments. As such, we agree with the use of the same approach for financial assets mandatorily measured at FVOCI.

Question 4   **Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognised from initial recognition should be determined?**
The proposed approach is more operational than the 2009 ED or the current FASB proposals.
Question 5   **(a) Do you agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer?**   **(b) Do the proposals provide sufficient guidance on when to recognise lifetime expected credit losses? If not, what additional guidance would you suggest?**   **(c) Do you agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring, rather than changes in expected credit losses (or credit loss given default ('LGD'))? If not, why not and what would you prefer?**   **(d) Do you agree with the proposed operational simplifications, and do they contribute to an appropriate balance between faithful representation and the cost of implementation?**   **(e) Do you agree with the proposal that the model shall allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met? If not, why not, and what would you prefer?**
(a) CIPFA agrees with this proposal.   (b) and (c) We are aware that the UK Financial Reporting Council has some concerns over the adequacy of the guidance based on its discussions with UK stakeholders.   (d) CIPFA agrees with the proposed simplifications which improve the balance between faithful representation and the cost of implementation.   (e) CIPFA agrees with this approach.

Question 6

(a) Do you agree that there are circumstances when interest revenue calculated on a net carrying amount (amortised cost) rather than on a gross carrying amount can provide more useful information? If not, why not, and what would you prefer?

(b) Do you agree with the proposal to change how interest revenue is calculated for assets that have objective evidence of impairment subsequent to initial recognition? Why or why not? If not, for what population of assets should the interest revenue calculation change?

(c) Do you agree with the proposal that the interest revenue approach shall be symmetrical (ie that the calculation can revert back to a calculation on the gross carrying amount)? Why or why not? If not, what approach would you prefer?

(a) CIPFA agrees that where the credit quality of a financial asset has deteriorated significantly then presenting interest on a gross carrying amount basis does not provide the most useful information.

(b) Yes

(c) CIPFA agrees with reversion to gross carrying amount as described.

Question 7

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

(b) Do you foresee any specific operational challenges when implementing the proposed disclosure requirements? If so, please explain.

(c) What other disclosures do you believe would provide useful information (whether in addition to, or instead of, the proposed disclosures) and why?

CIPFA agrees with the proposed disclosure requirements, and specifically with paragraph 32 which allows cross-referencing to other documents reporting on related matters.

Question 8

Do you agree with the proposed treatment of financial assets on which contractual cash flows are modified, and do you believe that it provides useful information? If not, why not and what alternative would you prefer?

CIPFA agrees with the proposed treatment, which we consider provides useful information.

Question 9

(a) Do you agree with the proposals on the application of the general model to loan commitment and financial guarantee contracts? Why or why not? If not, what approach would you prefer?

(b) Do you foresee any significant operational challenges that may arise from the proposal to present expected credit losses on financial guarantee contracts or loan commitments as a provision in the statement of financial position? If yes, please explain.

(a) CIPFA agrees that a consistent approach should be taken to loan commitments and to financial guarantee contracts where in scope.

(b) CIPFA is not aware of any such challenges.

Question 10

(a) Do you agree with the proposed simplified approach for trade receivables and lease receivables? Why or why not? If not, what changes do you recommend and why?

(b) Do you agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component? If not, why not and what would you propose instead?

In principle a single impairment model for all financial assets would be preferable, but for cost benefit reasons CIPFA supports the proposed simplified approaches.

As noted earlier, it is difficult to provide a complete answer in the absence of a finished leasing standard.

Question 11 **Do you agree with the proposals for financial assets that are credit-impaired on initial recognition? Why or why not? If not, what approach would you prefer?**
CIPFA agrees with these proposals.