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Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
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Dear Mr Stevenson

ED 210 *Financial Instruments: Impairment (proposed amendments to AASB 7 and AASB 139)*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the International Accounting Standards Board (IASB) Supplementary Exposure Draft: *Financial Instruments – Impairment*.

HoTARAC is concerned about the short comment period the IASB have issued and its effect on the IASB pursuing high quality standards. However, HoTARAC does appreciate the opportunity to provide further comments on operational practicality of the revised expected loss model.

Whilst HoTARAC advocates a modified incurred loss model, it considers the proposed approach to be an improvement on the initial proposal in IASB ED 2009/12 *Financial Instruments: Amortised Cost and Impairment*. Despite the improvements, HoTARAC still has a number of concerns with the proposed expected loss model in relation to its subjectivity and openness for manipulation by management, as well as its reduced comparability. In particular:

- with regards to the subjectivity relating to the use of forecast information, which is inconsistent with other accounting standards, and the 'foreseeable future period';
- the 'good book'/'bad book' distinction should be based on objective auditable evidence and not solely an entity's internal risk management policy; and
- the flexibility of discount rates and the option not to discount for assets with a remaining life of greater than 12 months; with the choice being based on what is 'reasonable' rather than what is 'appropriate'.

HoTARAC proposes that the IASB approach should be modified for the 'good book' to include an accelerated allocation option to reflect portfolios with early loss patterns. In this instance, there would be no reason for a 'floor' to be required. This approach would have several benefits: it would be simpler, remove the need for two calculations to determine the 'higher of' the time-proportional and the 'floor' amount, reduce disclosure and be less subjective.

Additionally, HoTARAC considers the proposed minimum disclosure requirements to be onerous. HoTARAC considers these should be principles-based.

Comments by HoTARAC on questions from the supplementary exposure draft are attached.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 02 6215 3551.

Yours sincerely



Grant Hehir

CHAIR

**HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY
COMMITTEE**

17 March 2011

Encl

HoTARAC Response to AASB ED 210: Financial Instruments: Impairment (proposed amendments to AASB 7 and AASB 139)

Reduced Disclosure Requirements

HoTARAC is aware that the AASB will issue a separate consultative document in relation to AASB's Tier 2 disclosure proposals. HoTARAC notes that it is less likely that Tier 2 entities would hold financial assets included in the scope of this document; they would generally hold short-term trade receivables that have been specifically excluded. In the instance that Tier 2 entities hold such assets, then in general HoTARAC considers the IASB proposed disclosures are onerous and unnecessary for Tier 2 entities.

AASB Specific Matters for Comment

1. whether, overall, the proposals would result in financial statements that would be useful to users;

HoTARAC still supports a modified incurred loss model, but considers the proposed approach to be an improvement on the initial proposal in ED 2009/12. HoTARAC considers that the approach as proposed would not result in financial statements that would be useful to users on the grounds of relevance, subjectivity and comparability; however, HoTARAC believes that if its concerns are addressed, the proposed expected loss approach could provide useful information for users. These concerns are outlined in the response below.

The proposal includes forecast estimates and a high level of subjectivity based on management discretion, particularly with regards to the foreseeable future period determination, the selection of discount rates and the distinction between the 'good book' and the 'bad book'. HoTARAC offers some suggestions for modification to improve the proposed method (refer to HoTARAC's response to IASB/FASB question 5 and IASB-Only section question 18Z).

The proposed model is inconsistent with other accounting standards and the measurement of financial liabilities (refer to HoTARAC's response to IASB/FASB question 1). It is also inconsistent with the AASB Framework paragraph 70, because income and expenses are defined as increases/decreases in future economic benefits 'during the accounting period'. Whereas, the proposed approach recognises 'anticipated increases/decreases in future periods'.

See also HoTARAC's response to question 5 to the IASB submission.

2. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(a) not-for-profit entities; and

No comment.

(b) public sector entities;

HoTARAC believes the disclosures will be onerous and would prefer a principles-based approach (i.e. relevant information) rather than the proposed extensive minimum disclosure requirements. HoTARAC would like the AASB to note that there are public sector entities with open portfolio financial assets measured at amortised cost, such as loans, receivables and debt securities. The implementation of the proposals is likely to have a significant impact on these entities.

3. whether there are any implications for GAAP/GFS harmonisation;

GFS does not generally recognise allowance accounts and this represents an existing GAAP/GFS harmonisation issue.

4. whether the proposals are in the best interests of the Australian and New Zealand economies;

No comment.

5. unless already provided in response to specific matters for comment 1 – 4 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

HoTARAC considers there to be significant cost for entities in transitioning to and implementing the proposed expected loss model, particularly in relation to preparing forecasts and the additional disclosures. The benefits of moving to an expected loss model (i.e. not recognising losses too late) are greatly reduced by the subjective nature of the proposed model (i.e. foreseeable future period, the flexibility of discount rates, the good book/bad book classification) leading to greater opportunities for manipulation by management and reduced comparability.

HoTARAC Response to IASB Supplement to ED 2009/12: Financial Instruments: Impairment

General Comments

HoTARAC understands that this is a supplement to ED 2009/12 and notes that the IASB regards the additional consultation to be beyond that required by its due process requirements. HoTARAC also notes that the IASB has a set deadline due to the global financial crisis and the IASB/FASB convergence. HoTARAC commends the IASB for re-exposing for additional information on operational practicality. However, HoTARAC continues to have concerns with the IASB's due process and considers that the 60 day comment period is insufficient for developing high quality standards. Additional time is required to comment on the supplementary document, as respondents need to assess how this document links to the original Exposure Draft and how impairment requirements may apply more generally.

HoTARAC strongly supports a single impairment model for financial assets at amortised cost. At this stage, however, we are unclear how the supplementary document fits within the overarching impairment model and, as a result, we are concerned about the potential for multiple impairment approaches. This concern is compounded by the fact that the 'common model' put forward in the supplementary document is essentially a compromise model that attempts to satisfy the different objectives of the IASB and FASB.

Furthermore, the proposed model appears to be inconsistent with other accounting standards, including requirements for the measurement of financial liabilities. As per HoTARAC's earlier submission on the original ED, we prefer the 'incurred loss' approach, modified by eliminating the impairment trigger requirements, to the 'expected loss' approach, as it is more conceptually appropriate and consistent with other Accounting Standards.

Notwithstanding the above, HoTARAC supports the IASB's efforts to reduce the likelihood of losses being recognised too late. If the 'expected loss' proposal for financial assets managed in an open portfolio does proceed, HoTARAC is of the view that the IASB/FASB common approach is better than the initial proposal, in particular with the 'decoupling' amendment. Nonetheless, HoTARAC still holds significant concerns as follows.

In terms of measurement, HoTARAC is concerned about the high level of subjectivity based on forecast estimates and management discretion, particularly with regards to the foreseeable future period determination, the selection of discount rates and the distinction between the 'good book' and the 'bad book'.

HoTARAC recommends that the approach be improved by setting the distinction between 'bad book' and 'good book' using objective evidence such as the current impairment

indicators, requiring the use of the effective interest rate as the appropriate discount rate for all assets/portfolios with a life greater than twelve months.

Furthermore, HoTARAC is of the view that the IASB approach should be modified for the 'good book' to include an accelerated allocation option to reflect portfolio profile with early loss patterns, in addition to the straight line and the annuity methods. In this instance, there would be no reason for a 'floor' to be required. This approach would have several benefits: it would be simpler, would remove the need for two calculations to determine the 'higher of' (time proportional and 'floor'), reduce disclosure and would be less subjective (i.e. based on the asset life).

The disclosure requirement should be based on relevant information that is useful for users, which is principles-based, rather than prescribing extensive minimum requirements.

IASB and US FASB Joint Invitation to Comment

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?

While HoTARAC agrees that the proposal should bring forward the recognition of expected credit losses as previously noted in response to the original ED, HoTARAC considers that the incurred loss model, modified by eliminating the need for a loss trigger, is preferable to the proposed expected loss approach. HoTARAC acknowledges that the approach has been improved by the inclusion of an allowance account. However, with the amended 'common solution' approach, HoTARAC still holds concerns as it relies heavily on an entity's ability to forecast events and conditions that will exist in the future.

Additionally, HoTARAC considers the proposed approach to be inconsistent with other standards:

- As per HoTARAC's response to the original ED:
 - IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that future operating losses cannot be provided for;
 - IAS 17 *Leases* uses contractual rights rather than expected revenue; and
- The measurement of financial liabilities.

Practical issues with the proposed approach include:

- difficulty and subjectivity in obtaining and deriving forecast information;
- profit smoothing; and
- onerous disclosure requirements.

This may mean that because of forecasting deficiencies and differences in expertise across different entities, expected credit losses may be inconsistently and sometimes inappropriately recognised (or not recognised at all).

Refer to HoTARAC's response to questions 3 – 11 below for additional discussion of our concerns.

Scope – 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.

HoTARAC strongly supports a single impairment model for financial assets at amortised cost, and is not aware of any major impediment in applying this approach to closed portfolios or single assets.

However, in considering a wider scope than currently proposed, we believe that it may be conceivable that different implementation approaches may be appropriate depending on the entity and its circumstances. For example, the concept of time proportional expected credit losses used for the ‘good book’ seems more appropriate to a portfolio of assets, rather than a single asset, where there is insufficient historic information.

At this stage, we are unclear how the supplementary document fits within the overarching impairment model, which was outlined in the original Exposure Draft. Any final proposal will need to clearly describe the overarching model and make clear that any simplifications, such as the distinction between the good book and bad book, or other guidance for single assets or closed portfolios, are provided as a means to operationalise the overarching model, in a manner that is consistent with its objectives.

Differentiation of credit loss recognition (paragraphs 2, 3 and B2–B4)

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?

In principle, HoTARAC supports the ‘good book’/‘bad book’ approach for open portfolios, which acknowledges the different level of risks associated with each group. However, we have concerns about the proposed model.

HoTARAC is concerned with the inclusion of forecasts in the measurement of expected losses for both the ‘good book’ and the ‘bad book’ financial assets.

In particular, the proposed common solution appears to be a provision for a possible (not necessarily probable – as these are ‘good book’ financial assets) future credit loss. The

movement of 'probable' from recognition to measurement is an issue HoTARAC raised in response to ED 2010/1 *Measurement of Liabilities in IAS 37*.

In addition, the availability of various measurement approaches (i.e. discounted/undiscounted, risk-free rate/effective interest rate/anywhere in between) decreases comparability and provides opportunities for potential management manipulation.

Refer to HoTARAC's response to questions 4 – 11 below for additional comments/concerns.

Question 4

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

Generally, the time-proportional amount would likely be operational for open portfolios, where there is sufficient historic evidence.

However, HoTARAC acknowledges that estimating lifetime credit losses for the purposes of calculating the time-proportional amount may be more difficult for financial assets with longer lives, or more complex financial assets such as Collateralised Debt Obligations (CDOs). There may be some issue on how a time-proportional approach would work for financial assets that do not have a maturity date (or similar) such as consumer lines of credit and margin loans.

As mentioned in question 3, HoTARAC notes that, given the 'higher of' requirement, at least two calculations will be required to be performed. This imposes additional costs that may outweigh the benefits, especially given the lower probability of losses for assets in the 'good book'.

Question 5

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

No. HoTARAC believes that the usefulness of the information resulting from the proposed approach will be limited as a result of consistency and subjectivity concerns (refer below). Notwithstanding, HoTARAC considers the 'decoupled' approach to be an improvement to the original approach proposed in the first ED.

Distinction between 'good book' and 'bad book'

To rely only on internal risk management practice is fraught with problems. The lack of robust criteria and independent evidence for the distinction between 'bad book' and 'good book' financial assets will impair the quality of information provided to users. This will poorly reflect on the usefulness for decision-making as it reduces comparability and faithful representation of the transactions, and provides an opportunity for management to smooth profits.

HoTARAC strongly recommends that the distinction between 'bad book' and 'good book' be based on current impairment indicators. As a result, the transfers between 'bad book' and 'good book' would be based on objective evidence, which is auditable.

Refer to HoTARAC's response to question 7.

Expected credit losses

HoTARAC is concerned that the meaning of 'expected credit losses' and the extent to which this includes forecast information is still unclear and this may impact on the usefulness of the information. This is covered particularly in paras B5-B7, which refers to 'available information', which includes historical data, current economic conditions and 'supportable forecasts' for future events and economic conditions. Further the draft states that 'expectations of future conditions' should be based on 'reasonable and supportable' information to substantiate those inputs and the expectations should be consistent with 'currently available information'. It is unclear what 'reasonable and supportable' means and this could be subject to a wide range of interpretations.

Foreseeable future period

HoTARAC is concerned that the concept of 'foreseeable future' is not clear and may result in perverse and inconsistent outcomes. That is, different entities will have varying views as to what is the foreseeable future. Also, as the estimate relies on the entity's ability to forecast, this implies that more expert entities may be able to forecast for longer periods and would calculate higher losses than less expert entities, which because they are less able to forecast, may hold lower impairment allowances.

It also seems difficult to differentiate between 'the entire amount of expected credit losses' and expected credit losses within the 'foreseeable future'. For example, some may argue, that expected credit losses cannot be reliably calculated for a period longer than the 'foreseeable future'.

Discounting

In HoTARAC's view, the use of an undiscounted estimate, which ignores the time value of money, is not acceptable for financial assets with a life greater than 12 months. Also,

additional inconsistency arises in the choice of the discount rate based on a 'reasonable rate' between and including the effective interest rate.

Refer to HoTARAC's response to question 11.

HoTARAC is of the view that the IASB approach should be modified for the 'good book' to include an accelerated allocation option, which would reflect portfolio profile with early loss patterns, in addition to the straight line and the annuity methods. In this instance, there would be no reason for a 'floor' to be required.

This would have several benefits: it would be simpler, would remove the need for two calculations to determine the 'higher of' (time-proportional and 'floor'), reduce disclosure and would be less subjective (i.e. based on the asset life).

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?

Yes, it is clearly described, but HoTARAC disagrees with the proposal to rely on internal risk management as the differentiating principle.

HoTARAC considers there is a need for the distinction to be auditable; comments on this are provided in our responses to questions 5 and 7.

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?

HoTARAC is of the view that the approach is operational (with concerns); however, HoTARAC does not consider it to be appropriate, nor readily auditable.

HoTARAC believes an objective and consistent set of factual indicators needs to be provided to assist in the auditability of the distinction between 'good book' and 'bad book'. The proposed differentiation between the two groups is subjective and open to manipulation given that the distinction is based on internal processes. For example, management can declare any loan to be 'doubtful' based on a subjective judgment (as discussed in Application Guidance B4).

HoTARAC suggests that the IASB considers using or adapting some of the current indicators for impairment in IAS 39; for example, financial difficulty, a default in payments, and a consideration of observable economic conditions.

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?

HoTARAC agrees, subject to the concerns outlined in our response to questions 5 and 7 above, that the 'good book' / 'bad book' distinction may be a useful implementation mechanism. However, we believe that overarching this should be a single impairment model capable of applying to all different types of financial assets, but supplemented with implementation guidance, to operationalise the model in different circumstances.

As discussed, HoTARAC believes that the recognition principle should be based on an incurred loss approach, which would incorporate the concept of incurred but not reported (as for insurance) and is modified to remove the need for a loss trigger.

Also, refer response to question 2.

Minimum impairment allowance amount (paragraph 2(a)(ii))

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.

HoTARAC believes that if the floor is attempting to address the possibility of a 'front-loaded' loss pattern, the issue could be better addressed by modifying the time-proportional amount to align with the expected portfolio loss pattern. This is consistent with the view of some IASB members, as discussed in BC74.

In addition, as previously discussed, there are other practical difficulties regarding the meaning of 'foreseeable future period', and the additional complexity of a model that requires two separate calculations.

Under this modified time-proportional method, a 'floor' would not be necessary.

For further details refer to question 5.

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.

No comment.

Flexibility related to using discounted amounts (paragraphs B8(a) and B10)

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?*

HoTARAC disagrees with both the flexibility of permitting to use either a discounted or undiscounted estimate, and the flexibility in the selection of a discount rate, based on a 'reasonable rate'.

Overall, the opportunities for flexibility decrease comparability and the option for the undiscounted rate (intrinsically lower than the risk-free rate) undermines the Boards'

proposal to require the selection of a 'reasonable rate' *between* the risk free rate and the effective interest rate. In addition, this flexibility provides an opportunity for manipulation by management.

(a) Option not to discount:

HoTARAC disagrees with retaining a no-discount option for financial assets with a life greater than 12 months, in contrast with the views of BC41, for the following reasons:

- Entities should not be given the opportunity to use an undiscounted estimate because the effect of time value of money should be considered where the remaining life is greater than 12 months. The use of an undiscounted estimate, which ignores the time value of money and risk premium does not provide faithful representation of the transactions and thus lacks relevance. To combine expected losses for different periods without discounting does not provide meaningful information.
- HoTARAC questions whether any entity would be so unsophisticated that it could not calculate the present value of a portfolio.
- Divergent practices reduce comparability. One of the objectives of the common solution was to improve comparability, but allowing the option not to discount does the opposite.
- The statement in BC 42 that "conceptually, the discount rate for cash flows of an asset cannot be below the risk-free rate" supports the use of discounted amounts and should be reflected in the proposal. An undiscounted amount is effectively a discount rate of zero, which will generally be below the risk-free rate.

(b) Choice of discount rate:

HoTARAC has concerns with the proposal (further explained in BC42) for the following reasons:

- HoTARAC agrees that the discount rate cannot be below the risk-free rate (BC42), but then HoTARAC also notes that it can be 'undiscounted' (BC41) (technically, this is below the risk-free rate). This additional option blemishes the credibility of choosing a discount rate anywhere between (and including) the risk-free rate and the effective interest rate and not below.
- IASB appears to agree that specifying a rate which includes the risk premium (i.e. the inherent interest rate *aka* effective interest rate) is more conceptually appropriate. HoTARAC can see no reason why the effective interest rate or an appropriate proxy should not be referred to. While there may be practical difficulties in calculating an effective interest rate for an open portfolio, we expect that an appropriate proxy can be determined in most (if not all) instances.
- The IASB notes that entities will still need to calculate the effective interest rate. Therefore, HoTARAC is additionally uncertain as to the perceived benefits in providing a choice of interest rates. There is no adequate justification, sound basis, or

relevance for allowing entities to pick any rate in between especially when the effective interest rate still needs to be calculated.

- HoTARAC considers it improper for the IASB to suggest that the choice of discount rates need only be 'reasonable'. The selection of a discount rate needs to be more specific, it needs to be 'appropriate' (as the IASB was discussing at the beginning of BC42). The appropriate rate should be based on the effective interest rate, as the expected cash flow of the asset and the expected losses would therefore be discounted on a consistent basis.

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?

HoTARAC considers that the IASB approach, which requires an allowance account based on a time-proportional amount, results in a *less* subjective outcome when compared to the common approach but it does not alleviate all of HoTARAC's concerns.

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?

In terms of providing a practical implementation approach, HoTARAC prefers both the common proposal and the IASB approach over FASB's approach. This is because HoTARAC believes that the 'good book' / 'bad book' distinction (used in both the IASB approach and common proposal) may be a helpful implementation tool to assist in the calculation of the impairment loss.

Further, HoTARAC supports the IASB time-proportional method over the FASB 'foreseeable future' method.

Refer also to response to question 5.

IASB-Only Invitation to Comment (Presentation and Disclosure – Appendix Z)

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?

HoTARAC agrees that there should be separation between accounting for the effective interest rate and expected credit losses.

In response to the original IASB ED, HoTARAC disagreed with the proposal to incorporate expected credit losses in the calculation of the effective interest rate. Therefore, HoTARAC supports and commends the IASB's new 'decoupled' approach.

Incorporating expected losses in the effective interest rate calculation would reduce understandability, relevance and comparability. Additionally, it would be onerous for reporting entities for little or no gain. Errors in original estimates (which are likely due to their nature) will be carried through the life of the asset, as the initial estimated effective interest rate is used for discounting revised estimates of cash flows during the life of the asset. There would also be the possibility of negative interest income in certain circumstances, which would further reduce understandability for users without a detailed knowledge of the standard.

Scope – Loan commitments and financial guarantee 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?

HoTARAC was unable to consider and provide comment in details on this matter due to the short consultation timeframe set by the IASB; however, in principle, in any cases where an entity is able to recognise a financial asset in respect of a loan commitment, or a financial guarantee, from another entity, HoTARAC can see no reason why the same impairment proposals would not be appropriate.

Question 16Z

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

Refer to HoTARAC's response to question 15Z.

Presentation (paragraph Z5)**Question 17Z**

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

HoTARAC supports the proposed presentation requirements and considers these to be of a more simplified approach than that of the original ED and aligns with the 'decoupled' approach the IASB has taken.

Disclosure (paragraphs Z6–Z15)**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?*

HoTARAC considers the proposed disclosures to be onerous as the minimum requirements are more in the nature of a rule-based approach than a principles-based one. It is also unclear how the proposed disclosures fit within the context of the existing disclosure requirements in IFRS 7 and we believe that this needs to be reviewed, to ensure that the level of guidance in that standard is appropriate across all areas.

It is HoTARAC's view that the disclosures arising from paragraph Z7(b) should not be required. Disclosure should be provided on the method applied for determining the amount presented in the financial statements, not on the other options available. This will add further clutter to the already lengthy financial instruments disclosures with information that is unlikely to be useful to users. For example, if the amount of credit losses for the foreseeable future was not used as the basis for the impairment allowance, it appears excessive to provide detailed disclosures about credit losses within the foreseeable future (as described in paragraphs Z10 and Z14(b)(ii)).

Also, if HoTARAC's proposed amendments to good book/bad book criteria are adopted these disclosures will become redundant.

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?

HoTARAC disagrees.

HoTARAC believes that a better approach would be to transfer no related allowance amount, but once the assets are transferred then the total allowance accounts for each book at the end of the reporting period needs to be reassessed based on the new composition of the book. Otherwise, the allocation of the transferred amount does not reflect the current expected credit loss and is not meaningful, as the overall allowance is assessed on a portfolio basis.

Additional Comments

HoTARAC's additional comments are as follows:

- The scope: This should only outline the impairment requirement for financial assets measured at amortised cost, except for short-term trade receivables, managed on an open portfolio basis.
- As per HoTARAC's comment on the initial proposal, HoTARAC supports the scoping out of short-term trade receivable, but notes that paragraphs BC13 and BC3(c) imply that all short-term receivables would arise from revenue that would fall in scope of the *Revenue from Contracts with Customers* project. However, particularly in the public sector, short-term receivables can arise from transactions (for example, grants and contributions or tax collections) that would not fall within the scope of that project (based on the scope of the exposure draft).

Comments on IASB-only Appendix Z:

- In general: HoTARAC suggests that the IASB clarify the transitional requirement for the first time implementation of this Standard, particularly in relation to implementation of paragraph Z8, which requires disclosure of previous four annual periods as comparatives without the benefit of hindsight.
- Z8: Should be based on portfolio rather than individual financial assets.
- Z14: Disclosure by financial assets or by portfolio? It needs to be clear at which level the disclosure is required.
- Z15(b)(iii): If the transfers between good book and bad book are based on an objective set of indicators as suggested in the HoTARAC response, this disclosure will be unnecessary as the reconciliation for each book will be sufficient to provide asset transfers between 'bad book' and 'good book'.

- Appendix AZ: Should include a definition of ‘credit risk rating grade’ used in paragraph Z14, and how this differs from ‘internal credit rating grade’ used in paragraph Z15(b)..
- BZ19: This is principles-based but HoTARAC is uncertain as to how it would fit with the proposed minimum requirements.
- BCZ101: HoTARAC does not support the IASB proposal to require quantitative analysis only if the entity already performs ‘back testing’, this statement should not be part of a high quality standard and the criteria should be based on relevance.
- Paragraphs IE8: The calculations allocate expected credit losses for the remaining average life across the total average life of the portfolio. HoTARAC is unsure why, if the expected credit losses only relate to the remaining life, a portion of these losses is attributed to that part of the life that has already elapsed.
- Table immediately preceding paragraph IE14:
 - HoTARAC queries how the present values for portfolios Z and W could be the same. While the expected credit losses and discount rates are the same, the remaining average lives of each portfolio are quite different
 - The annuity figure for portfolio W is incorrect – it should be 10.15.
 - HoTARAC questions whether the hypothetical circumstances described in the footnote to this table are realistic. Demonstrating the calculations under a scenario where losses occur evenly over the life of the portfolio would be more useful.