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Email: commentletters@hkicpa.org.hk

Dear Simon

IASB Exposure Draft on Financial Instruments: Expected Credit Losses

Thank you for the opportunity to comment on the IASB ED/2013/3, Financial Instruments: Expected Credit Losses (ED). CPA Australia has considered the ED and our comments are set out below.

CPA Australia represents the diverse interests of more than 144,000 members in finance, accounting and business in 127 countries throughout the world. Our vision is for CPA Australia to be the global professional accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

This submission sets out our preliminary views based on our consultations to date. Many of the members and other stakeholders that we consulted with are focused on the deadline for the IASB ED and therefore they are in the early stages of considering the proposals. On that basis, after considering the proposed ED and the feedback of members and other stakeholders, we can accept the IASB proposal to move to an expected credit loss model that requires recognition of a 12 month expected credit loss at initial recognition and lifetime expected credit losses where there is a significant increase in credit risk at subsequent reporting dates rather than the recognition of lifetime expected credit losses at initial recognition (as in the FASB model) as the lifetime credit losses would have been incorporated in the interest rate. We believe that generally the FASB model is overly conservative and not reflective of the actual economics of expected credit losses on financial instruments.

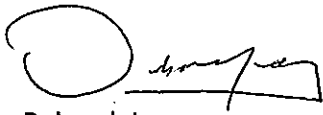
That said, we do have some significant concerns with the operability of the IASB model (see the Appendix to this letter). Further, some members have indicated their disagreement with the IASB view that lifetime credit losses are incorporated in the interest rate of every financial instrument. They believe this may not be true for modified consumer loans whereby the interest rate has not been modified but other terms have been modified (e.g., tenor, payment pattern, fees and waivers). We encourage the IASB to explore further the robustness of this view.

We urge the Board to encourage the IASB to continue to pursue convergence with the FASB on this topic as we believe a consistent methodology is important to improve the international comparability of financial statements.

More detail on our views follow in the Appendix.

If you require further information on any of our views, please contact Ms Deborah Leung General Manager - Greater China at CPA Australia via email at deborah.leung@cpaaustralia.com.au or Dr Mark Shying Senior Policy Adviser at CPA Australia via email at mark.shying@cpaaustralia.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Deborah Leung', written over a horizontal line.

Deborah Leung
General Manager – Greater China

APPENDIX – Comments on specific questions

Overall comments

While CPA Australia is supportive of the move to an expected credit loss model, we do have concerns in relation to a number of key areas of the ED which we believe require further consideration and refinement.

1. *Operational issues*

The ED contains both principles based requirements and prescriptive requirements. We believe that standards should be principles based wherever possible to allow entities to apply accounting that faithfully represents the economics of their businesses and transactions. We believe that in some instances it would be more useful to replace some of the prescriptive elements of the standards with principles that entities have to apply. In particular:

- **Practical expedients:** We believe that almost all entities will rebut the presumption that a debt which is more than 30 days past due has a significant increase in credit risk. This criterion is not reflective of the way that financial institutions or corporates manage their loan portfolios and most would not consider this to be a sign of a significant increase in credit risk. It could be easily assumed that debtors have overlooked payments rather than exhibiting credit risk. We believe that it would be preferable to replace this test with principles and more practical guidance for determining what constitutes a significant increase in credit risk. This will avoid the likely wide divergence that will occur in practice if entities simply rebut the 30 day test and maintain a higher degree of comparability in financial statements.

As for the other practical expedients, the investment grade exception would only be applicable to a subset of financial instruments, being rated financial instruments, with a tracking mechanism on an on-going basis. While the receivables accounting policy choice would eliminate the tracking and disclosure requirements it would result in higher impairment losses being recognised.

- **Twelve month expected credit losses and life-time credit losses:** The recognition of twelve month expected credit losses and life-time credit losses pose operational challenges, more so for entities without such processes and systems in place, which require:
 - Assessment of an increased volume of information particularly for initial determination and process setup
 - Determination of the unit of account for initial assessment – individual or aggregate basis

- Continuous tracking to determine the next course of action, including whether to:
 - retain the unit of account for the next assessment as determination of the unit of account can change based on new information
 - remain at 12 months or move to life-time loss if there is a significant increase in credit risk.
- Determination of application of “significant increase in credit risk” since no definition has been provided.
- Some members have indicated that modified consumer loans present a number of operational challenges in addition to the challenges that they present to the principle that lifetime credit losses are incorporated into the interest rate. The proposals require tracking of payment performance of modified loans to determine if a lifetime loss is no longer required. This again poses operational challenges. Also, there is no guidance for derecognised modified financial instruments.
- A number of members expressed concerns that the 12 month figure seems arbitrary and that there is uncertainty around the rationale for this requirement. A principles based requirement for determining the appropriate expected credit loss for assets which have not deteriorated significantly in credit quality may be more appropriate. Such a principle should be structured to deal with those loans where a loss has been incurred but not reported, as we do not consider that these have been adequately considered in the draft proposals.
- **Stage 2 trigger point:** The measurements required to determine whether a particular asset has reached the stage 2 trigger point may be difficult for less sophisticated entities (such as credit unions) to perform. Such entities do not currently have systems to provide the necessary inputs and as a consequence they may simply categorise assets as stage 1 or stage 3 as a work around. A practical expedient approach for less sophisticated entities that have loan portfolios could be considered. We also believe that definitions of “low credit risk” and “significant deterioration in credit quality” would be useful for all entities.

2. Disclosures

During our consultations a number of concerns were expressed about the length, detail and potential sensitivity of the proposed additional disclosures. The complexity of financial statements and disclosures is a growing concern for users and preparers. We believe that, particularly in light of wider disclosures projects being undertaken by standard setters globally, any additional disclosures must be considered carefully to ensure that they truly provide a benefit to the users and do not increase the disclosure burden on preparers unnecessarily. Disclosures that raised particular concerns include:

- Reconciliation of gross carrying amount of those assets with the loss allowance measured at an amount equal to lifetime expected credit losses (Example 12 in the

Illustrative Examples). These would be operationally challenging to provide and seem to lack a specific benefit for users

- The disclosures of loan portfolio split by credit rating (Example 13 in the Illustrative examples).

We also received feedback that the IFRS 7 ageing disclosures are considered beneficial and that it may be useful to consider retaining these.

Further, we have concerns in relation to allowing disclosures which are presented elsewhere to be provided in the financial statements by cross reference to other documents which are not necessarily provided to users with the financial statements even if they are made available in other locations such as websites. This presents operational challenges for auditors in being able to audit the complete financial statements. It also increases the risk that users will not read the additional disclosure by going to the other material and therefore will not have all the information they require for making their economic decisions. In addition, users may misunderstand the assurance provided on the separate disclosures or the rest of the information that the separate disclosures present. This may decrease the relevance of the disclosures to the users.

3. Fair value through OCI instruments

Some of the members we consulted do not support the application of the expected credit loss model to Fair Value through Other Comprehensive Income (FVOCI) assets. The FASB proposals include a practical expedient approach which allows these assets not to apply the model when their fair value is equal to or greater than their amortised cost and the expected credit losses are insignificant. These members believe the FASB approach better reflects the nature of these assets which are held for the purposes of selling and therefore should be held at their fair value. We recommend that the HKICPA submission to the IASB includes a suggestion that the IASB allow this approach for FVOCI assets.