QUOTED
COMPANIES
ALLIANCE

Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745
F +44 (0)20 7600 8288
mail@theqca.com

www.theqca.com

IFRS Foundation / IASB
First Floor
30 Cannon Street
London, EC4M 6XH

info@ifrs.org

9 July 2013

Dear Sirs,

IASB – Exposure Draft ED/2013/3 – Financial Instruments: Expected Credit Losses

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the expert group is at Appendix A.

Response

We welcome the opportunity to respond the Exposure Draft ("ED").

We commend the Board for responding to the operational difficulties highlighted by responses to the earlier 2009 ED. Whilst we recognise the conceptual weaknesses in the revised ED (the use of an arbitrary 12 month time horizon for immediate recognition of losses, the double counting of those losses which have already been considered in the financial asset pricing, etc), we believe the proposals achieve a more appropriate balance between operational costs and the reflection of the underlying economics when compared to conceptually superior model of the earlier ED.

As the majority of IFRS preparers – being non-financial institutions with relatively simple balance sheets (which includes many small and mid-size quoted companies) – will not hold extensive financial instruments, we ask that the standard be re-ordered such that the treatment of trade receivables and, given the similar practical expedient provided, lease receivables is set out first – preferably in a separate section of the standard to the full impairment model to be applied to broader financial asset portfolios. In our view, such a structure would significantly improve the relevance and comprehensibility for the majority of IFRS preparers.

Responses to Specific Questions

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) Whilst the approach of recognising a portion of credit losses initially has conceptual weaknesses and does not fully reflect the economic link between the pricing of financial instruments and the credit quality of initial recognition, we believe, in conjunction with the requirement to recognise lifetime losses only where there is a significant deterioration in credit quality, it is a pragmatically acceptable solution to:

- Address the weaknesses of an incurred loss model;
- Meet the demands for earlier recognition of losses generally; and
- Avoid the operational difficulties of applying the conceptually superior approach of the 2009 Exposure Draft (“ED”).

We believe the tiered approach will also provide useful information to users on significant changes in the credit quality of an entity’s financial instruments.

(b) One of the conceptual weaknesses in recognising a portion of the credit losses initially is that it effectively double-counts the impact of expected credit losses that will have been priced into the financial asset. Such a weakness would be compounded further if a lifetime credit loss approach as proposed by FASB was followed leading to excessive front-loading of credit losses. For this reason we do not agree that the alternative approach faithfully represents the underlying economics of financial instruments.

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) As discussed in our response to question 1 above, we agree that the recognition of 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.

(b) Whilst the approaches in the 2009 ED and the Supplementary Document ("SD") were conceptually superior, the cost of estimating losses on a continual basis under those approaches (especially given the subjective nature of the inputs needed to drive estimations) would not be justified. For that reason, we consider the approach in current ED achieves a better balance between faithful representation and the cost of implementation.

(c) No, we do not 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. Furthermore, we think such an approach is likely to be more costly (as the entire lifetime losses will have to be estimated for all relevant financial instruments) and a less faithful representation of the underlying economics. As a result, it will result in excessively early recognition of losses and more double-counting of losses already reflected in the pricing of the financial instrument.

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?

(a) Yes, we agree with the proposed scope of the Exposure Draft.

(b) We agree that a single model for the measurement and recognition of expected credit losses should apply to both financial assets measured at amortised cost and those 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?

We believe measuring the loss allowance at an amount equal to 12-month expected credit losses is operational and, moreover, is more easily implemented than an approach based on estimating expected lifetime credit losses on all relevant financial assets. However, we do have concerns on the rate used to reflect the time value of money, to which we discuss in our answer to question 5.

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) We agree with the proposed requirement to recognise a loss allowance equal to lifetime expected credit losses when there is a significant increase in credit risk. Such an approach provides useful information to users on changes in credit quality and ensures losses that were not reflected in the initial pricing of the instrument are recognised. Limiting the change in approach to those occasions where there is a significant change in credit risk avoids the excessive operational costs that would arise if expected credit losses on all financial instruments were subject to continual re-estimation.

However, we do not agree with the time value of money being based on a rate somewhere between (and including) the risk-free rate and the effective interest rate (B29(a)). There appears to be little, if any, conceptual basis for permitting choice over such a range, nor is there any guidance on determining which specific rate within that range to use. Furthermore, it appears inconsistent with the rest of the proposed model that uses the effective interest rate for calculating interest revenue and amortised cost.

(b) We welcome the extensive guidance to aid the assessment as to whether there has been a significant increase in credit risk. Clearly, such assessments will carry some subjectivity and be a matter of judgement in individual cases. However, this is superior to an approach that set out more prescriptive thresholds or "bright line" divisions.

(c) One of the operational benefits of the approach compared to previous proposals is that consideration need only be given to the probability of default rather than a need to continually re-estimate expected losses. For this reason we agree with the assessment as set out.

(d) We agree with the simplification in respect of financial assets that still have an internal credit rating equivalent to investment grade. However, we are unclear as why the rebuttable presumption that a significant increase in credit risk occurred when payments are more than 30 days overdue constitute an operational simplification. The time period is an arbitrary one and may be of little significance to specific instruments. In such cases, additional work will be required to rebut the presumption. Operational indicators are best devised by individual entities that reflect the specific facts and circumstances of the financial contracts to which they party to.

(e) We agree that the model should be symmetrical, with the approach reflecting the current assessment of credit risk. If the assessment of expected credit losses reflects those anticipated in the initial pricing of the instrument then it is appropriate to adjust the loss allowance to that which would have been recognised if there had been no temporary deterioration in credit quality.

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) (and (b)) We agree that, when there is objective evidence of an impairment of a financial asset, credit quality has deteriorated so significantly that any interest revenue should be calculated on the net carrying amount as this better reflects the economic reality.

(c) Yes, as with our answer to question 5 (c), we believe the model should be symmetrical.

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?

(a) It is clear that the nature of the new expected loss model increases the need for disclosures so users can understand the judgements made in assessing the credit quality of financial assets. We welcome the inclusion of paragraph 29, which we believe will encourage preparers to consider the information content and its usefulness in presenting relevant disclosures rather than taking a purely compliance perspective. We also welcome the option to cross-refer to other parts of the financial statements or to other documents which will help reduce duplication and improve the clarity of information.

(b) We have no specific comments on this.

(c) We do not recommend the inclusion of any additional specific disclosures as we consider the requirement to provide such additional information as is necessary to meet the disclosure objectives is sufficient.

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?

We agree with the proposed treatment.

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) We agree with the application of the general model to loan commitments and financial guarantee contracts.

(b) We have no specific comments on this.

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?

Whilst we agree, in principle, with the simplifications, a full understanding of the impact on the treatment of leases can only be gained once we have been able to review and assess the latest leases ED.

However, given there are far more companies recognising trade receivables than, for example, loan receivables (i.e. there are more non-financial institutions than financial institutions), we believe it would be beneficial to present the requirements for trade receivables and lease receivables first in the standard, preferably in a separate section to that applicable to the accounting for loans receivables and similar assets by financial institutions. We believe this will make the standard more relevant and comprehensible to the majority of IFRS preparers.

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?

As discussed earlier, we believe the approach set out for financial assets that are credit-impaired on initial recognition (consistent with the general model in the 2009 ED) is conceptually superior to that set out in the current ED as the general model. However, we reiterate our view that this should not be applied as the general model of impairment due to the high costs of implementation.

Where there is objective evidence of impairment at initial recognition (which would be a minority of cases), we believe the benefits of conceptually superior model outweigh the operational costs. Therefore, we agree with the proposals for financial assets that are credit-impaired on initial recognition.

Question 12

(a) What lead time would you require to implement the proposed requirements?

Please explain the assumptions that you have used in making this assessment.

As a consequence, what do you believe is an appropriate mandatory effective date for IFRS 9?

Please explain.

(b) Do you agree with the proposed transition requirements?

Why or why not?

If not, what changes do you recommend and why?

(c) Do you agree with the proposed relief from restating comparative information on transition?

If not, why?

(a) We believe there should be a lead time of at least three years to enable preparers to implement any required system changes. We also believe the mandatory date of application of other phases of IFRS 9 should be amended so as to make the entire standard (including impairment and hedging) mandatorily applicable at the same time.

(b) (and (c)) We agree with the transitional requirements and reliefs. If the lead time is extended as we suggest, we would expect less entities to apply the transitional reliefs, thus improving comparability and consistency.

Question 13

Do you agree with the IASB's assessment of the effects of the proposals?

Why or why not?

Overall, we believe the proposals will achieve the objective of earlier recognition of expected credit losses. We also agree that the approach will impose fewer costs than previous conceptually superior models. We believe the balance between reflecting economic reality and costs of compliance has been appropriately struck.

If you would like to discuss this in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Financial Reporting Expert Group

Matthew Stallabrass (Chairman)	Crowe Clark Whitehill LLP
Anthony Appleton (Deputy Chairman)	BDO LLP
Edward Beale	Western Selection Plc
Anthony Carey	Mazars LLP
Peter Chidgey	BDO LLP
Jack Easton	UHY Hacker Young
Bill Farren/Ian Smith	Deloitte LLP
David Gray	DHG Management
Usman Hamid	Ernst & Young LLP
Matthew Howells	Smith & Williamson Limited
James Lole/Nick Winters	RSM Tenon Group PLC
Paul Watts/Jonathan Lowe	Baker Tilly
Niraj Patel	Saffery Champness
Nigel Smethers	One Media IP Group plc
Chris Smith	Grant Thornton UK LLP