MAZARS

IASB
30 Cannon Street
London EC4M 6XH
UK

Paris, August 31st, 2009

Re: Request for Information – Impairment of Financial Assets: Expected Cash Flow Approach

Dear Sir or Madam,

MAZARS welcomes the opportunity to comment on the IASB Request for Information – Impairment of Financial Assets: Expected Cash Flow Approach. This letter provides general comments on this issue while appendix A presents our answer to the Request for Information questions and appendix B details the main principles on which an expected loss approach should, in our opinion, rely.

We welcome the Board's intention to develop an impairment approach taking into account an expected loss model on financial assets. We consider that an expected loss model would significantly improve the quality of financial reporting as it will lead to recognise expected losses in the same time pattern as interest revenue.

Moreover, we consider that periodic re-estimation of the expected loss is a significant improvement to the current incurred loss model. Thanks to this expected loss approach financial statements' users would have a better understanding of the credit risk exposure of the entity sometimes several years before the actual losses occurs. This approach will also minimise the difficulty of identifying an objective evidence of impairment.

An other benefit of an expected loss model could be a counter-cyclical effect. We agree that this effect is desirable but we consider it being less important than the relevance and the reliability of the financial statements' information.

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Nevertheless, implementing an expected loss model triggers major implementation issues and will necessarily imply significant development costs for entities. Consequently we recommend the Board to pay attention to the practical implementation issues faced by banking industry, which has to face a huge number of transactions, as well as other industries which may not have access to sufficient historical data and IT capacity. Therefore, we strongly recommend the Board to perform in depth field testing with each industry before publishing an amendment which will imply significant cost and IT development.

We are especially in favour of an amendment to IAS 39 that would favour pragmatism rather than conceptual solutions.

Our main concern regarding the proposed approach is the implementation complexity of an expected loss model based on the effective yield mechanism. We believe that such an approach is too complex to be implemented in practice without undue cost or important approximations leading to significant information reliability deterioration. Therefore, we would favour an expected loss model which would not create too much additional complexity by using the current effective yield and catch up mechanisms.

We consider that an expected loss model should not replace the current incurred loss model but rather complement it. In our view, it is important that an incurred loss impacts profit or loss on the period during which it occurs without being differed. Indeed, we are convinced that the information on incurred loss is key for financial statements' users and preparers. Differing the recognition of an incurred loss in profit or loss would result in flawed information. Thus we think that the cumulative loss recognised at the end of a period regarding the credit risk of a loan's portfolio should at least be equal to the amount of the cumulative loss incurred at that time.

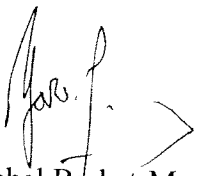
An expected loss approach would necessarily imply using an increasing number of inputs requiring judgement and subjectivity compared to the current incurred loss approach. As auditors, we therefore recommend the Board to include some safeguards in its proposal. It is important that the proposed approach requires both periodic back testing and taking into account for each set of estimates the result of previous back testing.

Eventually, we encourage the Board to remain with a principle based approach. We consider that the implementation of an expected loss model should be specific to an entity on the basis of its own environment and internal organisation, to the extent that its approach is compatible with the principles detailed in the Board proposal.

Our detailed answers are set out in the Appendices.

Do not hesitate to contact us should you wish to discuss our comments.

Best regards,



Michel Barbet-Massin
Head of Financial Reporting Technical Support

APPENDIX A

Question 1
Is the approach defined clearly? If not, what additional guidance is needed, and why?

We encourage the Board to remain with a principle based approach.

A retail bank would not implement exactly the same expected loss model as an other bank specialised in structured finance or a corporate with mainly trade receivables. We consider that the implementation of an expected loss model should be specific to an entity on the basis of its own environment (activity, IT Capacity, size etc) to the extent that its approach is compatible with the principles detailed in the Board's proposal.

Therefore we are not in favour of providing more detailed guidance. However, we recommend the Board not to focus only on bank issues but also to add guidance for other industries such as corporate. For example, guidance would be useful for entities which have not access to sufficient historical data of credit loss as banking industry could have thanks to Basel 2 requirements.

Question 2
Is the approach operational (i.e. capable of being applied without undue cost)? Why or why not? If not, how would you make it operational?

No, we consider that the proposed approach is not operational due to its complexity especially in the case of re-estimation of credit loss expectations. This complexity would also necessarily lead to significant costs.

In particular, it is not operational on a portfolio of hundred of thousand short term loans in a bank, or on a commercial receivables portfolio of a corporate which can not afford such IT development for receivables of 6 month maturity.

Consequently, we recommend the Board to extend the exemption of paragraph AG79 of IAS 39 to the expected loss scope. Indeed, we consider that the current incurred loss model is a sufficiently good proxy of an expected loss model for short-term receivables with no stated interest rate.

Question 3
What magnitude of costs would you incur to apply this approach, both for initial implementation and on an ongoing basis? What is the likely extent of system and other procedural changes that would be required to implement the approach as specified? If proposals are made, what is the required lead time to implement such an approach?

As auditors we have no specific information to provide concerning the magnitude of the costs. Nevertheless, based on our discussion with our banking clients we understand that the cost could be over tens of millions euros and the implementation process could last several years.

However, we consider that an expected loss model will require very significant IT and procedural changes such as developing new tools able to:

- Split the total contractual rate negotiated with the customer into the credit risk component and a residual;
- Collect sufficient historical data to provide an expected loss model with relevant input;
- Provide the information on clients credit quality required to perform periodic re-estimation of expected loss;
- Perform back testing and implement consecutive calibration adjustment for future estimations.

Question 4
How would you apply the approach to variable rate instruments, and why? See the Appendix for a discussion of alternative ways in which an entity might apply the expected cash flow approach to variable rate instruments.

Amortisation of upfront costs

We support approach A.

We consider that approach A should be favoured as approach B would trigger significant cost and too much complexity compared to the expected benefits.

Impairment of variable rate instruments

Approach A seems too complex to be applied on a large number of transactions.

We regret that approach B results in keeping the effective interest rate constant on a variable rate instrument.

We encourage the Board to explore a third alternative which could rely on an initially fixed expected credit spread and periodic resetting of the variable interest rate. This way the "catch up" mechanism would be limited to the credit spread component.

Question 5

How would you apply the approach if a portfolio of financial assets was previously assessed for impairment on a collective basis and subsequently a loss is identified on specific assets within that portfolio? In particular, do you believe:

(a) changing from a collective to an individual assessment should be required? If so, why and how would you effect that change?

(b) a collective approach should continue to be used for those assets (for which losses have been identified)? Why or why not?

We consider that the choice between the methodology (a) and (b) should remain with the entity.

We consider that the entity could elect either to monitor a defaulted loan individually, or to leave it within a global portfolio. This choice should be in line with the way the entity manages its counterparty risk.

If the defaulted loan is isolated, the way the portfolio composed of the remaining loans (on which no incurred loss has been identified) continue to be assessed for expected loss should take into account the fact the fact that a loss incurred. Therefore that entity may have to re-estimate its expected loss on the portfolio.

Moreover, if the impaired loan is isolated or transferred to a portfolio of distressed assets, part of the already recognised expected loss on the portfolio should also be transferred.

Question 6
What simplifications to the approach should be considered to address implementation issues? What issues would your suggested simplifications address, and how would they be consistent with, or approximate to, the expected cash flow model as described?

The recommendation we detailed in question 2 related to short term receivables would simplify the proposed approach.

APPENDIX B: Views on the main principles of an expected loss model

We address below the main principles on which an expected loss approach should rely on in our opinion.

We recommend the Board to remain with a principle based approach, leaving to each entity the possibility to implement the relevant expected loss mechanism given its specific activity and related risk profile.

Expected loss provision recognised on an accrual basis

Recognising the expected loss provision on an accrual basis leads to a better timing matching between the revenue recognition and the credit risk loss recognition compared to the current incurred loss model. Moreover, it avoids creating any difference at inception between the initial carrying value of the loan and cash proceeds.

Expected loss as a complement to the current Incurred loss model

As we already mentioned in the cover letter, the expected loss approach should be a complement to the current incurred loss approach, it should not replace it.

We consider that financial statements would be flawed if an incurred loss was not reported in the profit or loss of the period in which it occurs as the incurred loss information is key to the users and preparers of financial statements. Therefore, we disagree with the example 4 of the staff paper 5A issued in May 2009.

However, when an incurred loss is identified on a given loan, the relevant amount of expected loss provision already recognised should be reversed to profit or loss. Consequently, the incurred loss will impact profit or loss only if the expected loss provision is not sufficient to cover the incurred loss. This would be the case for example if the loss occurs at the beginning of the life of the portfolio.

In other words, the cumulative loss recognised at the end of a period regarding the credit risk of a loan's portfolio should at least be equal to the amount of the cumulative loss incurred at that time.

We acknowledge that this minimum incurred loss would potentially impair some of the benefits of an expected loss model, especially the timing matching between revenue and losses recognition. But we consider that the importance of the incurred loss information outweighs these potential drawbacks.

Point in time rather than through the cycle

A potential benefit of an expected loss model could be a counter-cyclical effect. We agree that this effect is desirable but we consider it as being less important than the relevance and the reliability of the financial statements' information. This position leads us to favour an approach in which the expected loss is assessed on the current economic environment (point in time) even if an expected loss assessed on a long period (through the cycle) could lead to better counter-cyclical effect.

We acknowledge that the "point in time" approach implies to analyse the current economic environment which is a tough issue (determining whether a crisis will occur during the life of loan, or if the crisis has already occurred when it will end etc.). However we consider that an approach "through the cycle" leads to similar difficulties such as isolating different cycles for different activities, identifying the duration of a cycle and performing back testing on such a long period.

Moreover an approach through the cycle implies that existing loans generate provisions based on losses expected on future loans which are not already recognised on the statement of financial position. We consider that this kind of information is misleading for the users of financial statements as it does not reflect the current exposure of the entity. For example we consider that a 2 year loan should not trigger an impairment taking into account a financial crisis expected to occur in 5 years.

Expected loss should be computed on closed portfolio

As mentioned in our answer to question 2, a loan by loan approach is not operational, especially in the banking industry which faces a huge number of transactions. Therefore it is necessary to perform an expected loss provisioning on portfolios.

We recommend using closed portfolios composed of one generation of loans that share similar risk profile at inception. This would ensure both that back testing of the expected loss provision is possible and that the recognised amount of the expected loss is consumed at the end of the life of the portfolio.

We do not favour opened portfolios which are reloaded at each new generation of loans. We consider that opened portfolios do not provide sufficient information on the way the provision is used.

Moreover, we consider that a "point in time" expected loss is more consistent with a closed portfolio comprising loans of a unique generation and thus the same initial economic environment.

Impact of expected loss re-estimates

Ideally, any re-estimation of the expected losses should imply a retrospective adjustment which would lead the entity to:

- Determine what would have been the already recognised expected loss on the date of the re-estimation if the correct estimate had been applied since inception. The difference between the actual expected loss provision and the one calculated as mentioned above should impact the profit or loss of the period.

- Recognise an expected loss provision in subsequent period on the basis of the new estimation

However we consider that this approach is too complex to be implemented in the case of frequent re-estimation on an important number of portfolios.

Therefore we would propose to consider that re-estimates of expected loss should impact profit or loss without being differed both in case of an increased or a decreased expected loss.