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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Comments on the Exposure Draft of *Financial Instruments: Amortised Cost and Impairment*

To the Board Members:

The Japanese Institute of Certified Public Accountants appreciates the continued efforts of the International Accounting Standard Board (IASB) on the financial crisis and welcomes the opportunity to comment on the exposure draft of *Financial Instruments: Amortised Cost and Impairment*.

We share the view on the problem of the slow recognition of losses in the current incurred loss model, and that it is necessary to resolve this problem. However, given that there are concerns regarding feasibility of the measurement principles presented in the exposure draft, we hope that thorough consideration will be given through discussions at the Expert Advisory Panel (EAP) to adopt feasible measurement principles.

We also have concerns as to whether the exposure draft would increase the accounting complexity of financial instruments. In particular, we believe it is necessary to give thorough consideration to this, so that the introduction of standards intended to apply mainly to financial institutions would not lead to excess costs, over related benefits, for entities other than financial institutions.

As the exposure draft dramatically changes the current requirements of IAS 39, we hope that thorough consideration will be given in the final standardization stage, together with comments on the exposure draft related to hedge accounting for financial instruments to be issued later.

The following is our response to the items in 'invitation to comment' with which we disagree or have questions or concerns.

Objective of amortised cost measurement

Question 2

Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

Comment:

We do not believe it is appropriate on the following grounds.

If amortised cost is applied to financial assets such as trade receivables, that are not expected to generate contractual interest income, such trade receivables will be measured based on initial recognition at the invoice amount less the initial estimate of undiscounted expected credit losses. In light of the objective of providing information about the effective return by allocating interest income over the expected life of the financial instrument, we believe it is not relevant to apply this approach to such financial assets, as short-term trade receivables when the source of revenue is not a financial transaction.

Measurement principles

Question 3

Do you agree with the way that the exposure draft is drafted, which emphasizes measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

Comment:

We do not agree with the way proposed in the exposure draft.

The measurement principles of amortised cost, proposed in the exposure draft, are concepts that do not exist in conventional accounting practice. Even if the objective of amortised cost measurement is clear, its implementation is expected to be unclear in many respects; unless there is adequate implementation guidance, there are concerns that implementation may vary and, consequently, affect the reliability of financial reporting. For example, there are cases in which the CESR's database of enforcement decisions, pointed out that the principles were also being mistakenly implemented to impairment of loans. (e.g. EECS0407-06 through 0407-10 "Individual assessment of impairment of loans".)

Therefore, we believe it is necessary to include adequate implementation guidance.

Question 4

(a)	Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?
(b)	Are there any other measurement principles that should be added? If so, what are they and why should they be added?

Comment:

There are concerns regarding the feasibility of the proposed measurement principle: "The estimates of the cash flows are expected values at each measurement date. Hence, estimates of amounts and timing of cash flows are the probability-weighted possible outcomes." We hope that thorough consideration will be given by through discussions at EAP to adopt a feasible measurement principle.

In the explanation about the present value technique, presented in Appendix C of the IASB's May 2009 exposure draft Fair Value Measurement (ED/2009/5), if probability-weighted average expected cash flow is used, the expected cash flow already reflects future default assumptions; therefore, it is necessary to use a discount rate commensurate with risks unique to the expected cash flow, and paragraph C16 of the exposure draft shows an example of simplified expected cash flow calculation. We share the view on the problem of the slow timing of loss recognition in the current incurred loss model and that it is necessary to resolve this problem. However, with respect to individual receivables, we believe it would be difficult to estimate the possibility of future credit losses at the initially stage. This would be at a time when no event has occurred, unrealistic for management to make a reasonable estimate, and would be difficult to verify the reasonableness of the probability distribution used in the estimation. We recognise that such difficulty to adopt expected loss model caused the IASB to set up the EAP, and hope that feasible measurement principles will be adopted through discussions at the panel, as a result of sufficient consideration to this matter..

Presentation

Question 6

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

Comment:

As indicated in response to Question 4, we have concerns regarding the feasibility of the proposed measurement principles set out in the exposure draft.

Assuming that the measurement principles set out in the exposure draft will be introduced, we agree with the proposed presentation requirements with respect to entities that apply the expected loss model. However, the presentation requirements in the exposure draft are based on the presumption that entities apply the expected loss model. Therefore, separate treatment should be considered with respect to entities that apply the expedients.

Furthermore, we believe that it should be clarified as to how an entity other than financial institutions presents revenue in the statement of comprehensive income as a result of applying such expected loss model.

Disclosure

Question 7

(a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirement do you disagree with and why?

(b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?

Comment:

Disclosures about stress testing are required only for entities preparing stress testing information for risk management purposes, and are not required for other entities, including alternative disclosures; thus, comparability is not ensured. We believe it would be appropriate to disclose such items in the form of a management commentary rather than as items in the notes to financial statements. Even assuming that disclosures about stress testing are required, the definition of stress testing itself needs to be clarified in the requirements. If such disclosures are required, we believe it would be appropriate to require such disclosures together with a statement about the limitation of information as prescribed in paragraph 41 of IFRS 7.

Furthermore, separate treatment of disclosures should be considered with respect to entities that apply the practical expedients

Practical expedients
Question 11

Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

Comment:
As stated in response to Question 2, we believe it is not relevant to apply the exposure draft to such financial assets as short-term trade receivables in which the source of revenue is not a financial transaction. However, we believe it would be appropriate to apply the exposure draft to other financial instruments, as the practical expedients presented in the exposure draft are in accordance with the current practice.

We believe that the provision of paragraph B16 of the exposure draft should be as an expedient applicable to entities other than those whose main source of revenue is consideration for credit.

Yours faithfully,

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Executive Board Member－Accounting Standards
The Japanese Institute of Certified Public Accountants