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September 19, 2008

International Accounting Standards Board
30 Cannon Street
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Comments on the Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*

To the Board Members:

The Japanese Institute of Certified Public Accountants (JICPA) appreciates the continued efforts of the International Accounting Standard Board (IASB) on the financial instruments project and welcomes the opportunity to comment on the discussion paper, ***Reducing Complexity in Reporting Financial Instruments***.

The following is our response to the items in 'invitation to comment', including those asked in the FASB Preliminary Views document, with which we disagree or have questions or concerns.

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their auditors and the needs of users of financial statements? If not, how should the IASB respond to assertions that the current requirements are too complex?

Comment

We agree that it is necessary to change current requirements for reporting financial instruments, derivatives and similar items. However, we believe that the Board should examine sufficiently to what extent the current requirements should be changed with respect to, for example, elimination of the held-to-maturity or available-for-sale category, and simplification of hedge accounting requirements by taking into account the impact of changes on the entire financial statements.

Question 2

(a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3. (b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?

Comment

We agree to the ideas expressed in both (a) and (b). However, we believe that the Board should examine sufficiently to what extent the current requirements should be changed under intermediate approaches with respect to, for example, elimination of the held-to-maturity or available-for-sale category, and simplification of hedge accounting requirements by taking into account the impact of changes on the entire financial statements.

Question 3

Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

Comment

Approach 1 emphasizes reducing complexity. However, it does not take into account sufficiently the perspective about whether the change provides more relevant information, as set forth in paragraph 2.2(a). We believe that no conclusion has been made regarding whether elimination of the held-to-maturity or available-for-sale category leads to more relevant information for users of financial statements. Accordingly, we believe that the Board should not draw a conclusion regarding what changes should be made or not.

We believe that among the criteria set forth in paragraph 2.2, that of (a) should be regarded as the most important criterion. Therefore, in making a judgment about a proposed change, the primary consideration should be whether it provides more relevant information and more easily understandable information for users of financial statements. However, it appears that Approach 1 has been examined mainly from the perspective of reducing complexity, but has not been examined sufficiently from the perspective of relevance. We have not achieved any consensus regarding whether valuation difference should be reported in earnings directly as a result of eliminating the held-to-maturity or available-for-sale category, which provides more relevant information to users of financial statements. On the other hand, diversity of reporting valuation difference would only retain categories based on holding purpose and would not reduce any complexity of accounting.

Question 4

Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.

(a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?

(b) How should instruments that are not measured at fair value be measured?

(c) When should impairment losses be recognised and how should the amount of impairment losses be measured?

(d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?

(e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?

Comment

We have a question how complexity will be reduced by replacing the existing standards with a principle plus some optional exceptions. We believe that such replacement does not affect on the reduction of complexity in the application of accounting standards. Moreover, it may harm comparability of financial statements to provide preparers with optional exceptions, and it cannot provide users of financial statements with more relevant and understandable information.

Question 5

Approach 3 sets out possible simplifications of hedge accounting.
(a) Should hedge accounting be eliminated? Why or why not?
(b) Should fair value hedge accounting be replaced? Approach 3 sets out three possible approaches to replacing fair value hedge accounting.
(i) Which method(s) should the IASB consider, and why?
(ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure that your comments are consistent with your suggested approach to changing measurement requirements.

Comment

We believe that hedge accounting should not be eliminated.

We believe that the Board should continue to require hedge accounting in the accounting standard by examining the possibility of simplifying them, as discussed in Question 6.

We understand that hedge accounting will avoid accounting mismatch in earnings in certain situations. Although we acknowledge that hedge accounting is a major factor for complexity in the accounting of financial instruments, it would be unreasonable if hedge accounting were not permitted, especially for cash flow hedge, as changes in the fair value of hedging instrument are directly reported in earnings even there is almost perfect hedge relationship.

We also believe that complexity in hedge accounting is not an inherent in hedge accounting, but caused by complex requirements of existing standards for hedge accounting. Therefore, the reduction of complexity is not directly linked to the elimination of hedge accounting.

Question 6

Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required. (a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified? (b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary? (c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity. (d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?

Comment

(a), (b) and (d):

We believe that the Board should examine whether hedge accounting requirements in existing standards are excessively strict or not. For instance, with respect to the requirement of highly effective hedge relationship between a hedging instrument and a hedged item, the Board should examine whether such requirement is necessary even if the ineffectiveness of the hedge is recognized in earnings.

(c):

We have not reached any consensus regarding this issue.

Question 8

To reduce today's measurement-related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments.

Do you believe that using a single method to measure all types of financial instrument within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement-related problems in the long term? If so, what is it?

Comment

We believe that the Board should examine sufficiently whether it is appropriate from the perspective of decision-usefulness to employ a single method to measure all types of financial instruments within the scope of standard for financial instruments.

Since it may significantly affects on the entire financial statements to employ a single method to measure all types of financial instruments, we believe that the Board should also examine the impact on components of financial statements other than financial instruments.

Question 9

Part A of Section 3 suggests that fair value seems to be the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments.

(a) Do you believe that fair value is the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments?

(b) If not, what measurement attribute other than fair value is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Why do you think that measurement attribute is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Does that measurement attribute reduce today's measurement-related complexity and provide users with information that is necessary to assess the cash flow prospects for all types of financial instruments?

Comment

We acknowledge that if a single measurement were to be applied, fair value is the only measurement attribute appropriate for all types of financial assets. However, it is another issue whether the valuation difference should be reported in earnings or not.

Moreover, we have a question that fair value is the only measurement attribute appropriate for financial liabilities.
From the perspective that it is important to provide certain information about expected future cash flows to users of financial statements, fair value may provide more useful information than cost with respect to the value of financial instruments to be recognized in the balance sheet.
However, we believe that this does not lead to a conclusion that valuation difference should be directly recognized in earnings. We believe that it is another issue to be examined from the perspective of what earnings should be reported, and provide users of financial statements with decision-useful information.

Moreover, we have concerns to recognize the effect of changes in own credit risk in earnings, since it is exceptional to recognize gain or loss on transfer of financial liability. Therefore, we have doubts about the idea that fair value is the only measurement attribute that is appropriate for financial liabilities and that “cost-based” measurements should be eliminated.

Question 10

Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 3? If so, what are they and why are they matters for concern?

Comment

We believe that the Board should address the following concerns:

- No sufficient explanation has been provided regarding why fair value disclosure is insufficient with respect to distinct presentation between of unrealized gains and losses arising from market factors between realized gains and losses, and from unrealized gains and losses arising from changes in credit risk or contractual cash flows.
- The Board should examine further the recognition of unrealized gains and losses and the measurement of them.
- Whether it is appropriate to recognize in earnings a valuation difference resulting from the fair value measurement or not. Which presentation category should be applied to the valuation difference if it is recognized in earnings. Whether the diversity of reporting valuation difference would cause increasing complexity.
- What solution should be provided for the paradox arising from fair value measurement of financial liability

Question 11

Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.

(a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?

(b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement? If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?

Comment

With respect to (a), we believe that it is necessary to deliberate what information should be represented by earnings, that is, the purpose of earnings presentation. It is also necessary to deliberate carefully what presentation categories should be adopted.

In addition, with respect to the scope of application, we believe that the board should further deliberate principle-based scope.

(b) We believe that there are no issues that do not have to be resolved.

With respect to presentation, the Board has examined that distinction between changes in fair value attributable to those in the market condition and credit risk and changes in fair value attributable to those in contractual or transaction cash flows. We believe that the Board should carefully examine it since distinction of presentation categories depends on both decision-usefulness for users of financial statements and availability of recognition and measurement for preparers and auditors. If the examination results in distinct presentation for assets held for trading purposes and interest income/expense arising from them, assuming that they are useful to investors, it would not differ from the existing accounting requirement (i.e., current accounting practice in which financial instruments are classified between those to be measured at fair value through profit or loss and those to be measured at amortized cost without fair value measurement, and fair value disclosure is required for financial instruments). In that case, complexity in preparing such disclosure information would not be reduced. In such circumstances, we believe that the Board may reconsider whether measurement of all financial instruments at fair value thorough profit or loss would lead to appropriate accounting information or not, as reduction in complexity would no longer be an issue.

In addition, if many exceptions and additions are attached to the rules, reducing complexity is unlikely to be achieved. Therefore, the Board should further deliberate principle-based scope.

Yours faithfully,

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