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

Dear Sir David:

re: Comments on Exposure Draft
"Financial Instruments: Amortized Cost and Impairment"

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on the exposure draft, "*Financial Instruments: Amortized Cost and Impairment*" put out by the International Accounting Standards Board (the Board). The SAAJ is a not-for-profit organization providing investment education and examination programs for securities analysts. Its certified members exceed 23,000. The CAC is a standing committee of the SAAJ composed of 14 members, most of whom are users including equity and credit analysts, and portfolio managers, while a few others are academicians and public accountants. Before drafting this comment letter, the SAAJ sponsored a study session on the discussion paper, inviting an ASBJ (the Accounting Standards Board of Japan) staff member as a lecturer. Some 168 certified members of the SAAJ participated in the session. A questionnaire was subsequently sent to session participants and 84 responded, making for a 50% response rate. This comment letter takes full consideration of the views expressed in the questionnaire replies as well as discussion among CAC members. The survey results are attached as an Appendix to this letter.

General Remarks

We are divided over the expected loss model proposed by the exposure draft because we are not comfortable with accounting standards straying into a domain for which prudential regulators should inherently take responsibility, namely stabilizing financial systems. Moreover, if we had to rely on overly arbitrary assumptions for expected cash flows, we would have difficulty making inter-company comparisons, which we think is

the biggest problem attaching to the expected loss model.

On the other hand, the exposure draft proposes enhanced disclosure requirements, which we highly evaluate. We believe it indispensible to further enrich disclosure content and make the format easier for financial statement users to understand. This would address the problem just mentioned.

Below you will find our survey results and our comments on some questions in the exposure draft.

Responses to Questions in the Exposure Draft

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?

Our opinions are divided over paragraph 6 of the exposure draft, measurement principles, defined as "*amortized cost is the present value calculated using the following inputs: (a) the expected cash flows over the remaining life of the financial instrument; and (b) the effective interest rate as the discount rate*".

We asked if the proposed expected loss model better reflected the reality of financial institutions' business. Survey responses were: "Yes" 31.0%, "No" 26.2%, and "Cannot judge at this moment" 42.8%. (See Q1 of our Survey questions and answers in the Appendix.)

To the question whether the expected loss model was effective in enabling earlier recognition of impairment, one of the objectives of the exposure draft, survey responses were: "Yes" 40.5%, and "No" 34.5%—not a significant difference. (See Q2)

Moreover, to the question which model offered more useful decision-making information for corporate analysis, the expected loss model or the incurred loss model used in IAS 39, survey responses were 28.6% for the expected loss model and 25.0% for the incurred loss model, which does not indicate any meaningful difference. The top 46.4% response was "Cannot judge at this moment". (See Q3)

Why is the expected loss model unpopular as evidenced above? We can say that many SAAJ respondents are not comfortable with accounting standards straying into a domain for which prudential regulators should inherently take responsibility, namely stabilizing financial systems. Moreover, while they admit the usefulness of the expected loss model in analyzing financial institutions, most do not think it practical to put such

a heavy burden on all preparers as, if this model is implemented as proposed, the short-term account receivables of non-financial institutions would have to be valued by this mode.

Therefore, we propose to IASB that it should be stipulated that the practical expedients in Application guidance B15-17 of the exposure draft are applicable to items such as the short-term account receivables of non-financial institutions. Also, regarding Question 7 (b), we would like more simplified disclosure to be considered for those financial instruments to which practical expedients can be applied. We believe relieving the preparers of non-financial institutions of the burden of cumbersome procedures will lead to better understanding and broader support of the exposure draft among a wide range of preparers.

The survey shows that a majority (72.6%) of respondents think the biggest problem is that assumptions for expected cash flows can be arbitrary, making inter-company comparison difficult (See Q4). If assumptions for expected cash flows are overly arbitrary as to make inter-company comparison difficult, it would even jeopardize the fundamental objective of the exposure draft, "to present useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of future cash flows". To avoid such a risk, we think there will be no way other than to disclose detailed assumptions for expected cash flows.

Question 6

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

We support the four line items in the comprehensive income statement presentation as proposed in paragraph 13 of the exposure draft. They are: (a) gross interest revenue (before deduction of the expected loss), (b) the portion of initial expected losses allocated to the period, (c) net interest revenue, and (d) gains and losses resulting from changes in estimates. To the question, "Do you think this would contribute to an improved analysis of financial institutions?" 13.1% of respondents expect "a significant contribution" and 58.3% "a slight contribution". About 70% of respondents favor this presentation for its usefulness in analysis. (See Q5)

Question 7

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

Regarding the detailed disclosure proposed in paragraphs 14-22 of the exposure draft, we asked, "Do you think the proposed disclosure would contribute to an improved analysis of financial institutions?" 28.6% of our respondents answered "a significant contribution" and 51.2% "a slight contribution". As a whole, about 80% of the respondents favor this disclosure requirement because of its usefulness in analysis. (See Q6)

While we highly evaluate the proposed disclosure requirements, we believe it indispensible to further enrich disclosure content and make the format easier for financial statement users to understand in order to eliminate their deep-rooted suspicion of arbitrary assumptions and resultant difficulty in making inter-company comparison.

Question 7

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

In order to attract support from financial statements users, we would like to propose the following additional disclosures:

- As for the grouping of financial instruments into classes in paragraph 14, the disclosure of assumption/presumptions in classifying should be mandatory.
- The structure of internal ratings for financial instruments and amounts at each rating should be disclosed.

We believe additional disclosure as proposed above would lead to more usefulness in the analysis of financial institutions. On the other hand, we would like IASB to further pursue simplification of disclosure content for those financial instruments to which practical expedients can be applied in order to mitigate the burden and resistance of preparers at non-financial institutions as stated in Question 4 (a) above.

Concluding Remarks

The Financial Accounting Standards Board of the US (FASB) published an exposure draft entitled *Accounting for Financial Instruments* on 26 May 2010. When we asked, "Which would give more valuable information for corporate analysis, IASB's exposure draft or FASB's", only 27.4% of our respondents favored the IASB one and 29.8% the FASB one. The top 42.8% response supported "Cannot judge at this moment". (See Q8)

In addition to such divided opinion as evidenced above, we also consider it quite serious that there is such an enormous difference in content between IASB and FASB exposure drafts, where the former adopts an amortized cost method and the latter a modified incurred loss model. We understand IASB and FASB are cooperating to finalize the MOU project by June 2011. We sincerely hope that both bodies will soon align in the area of financial instrument impairment as well.

If you have any questions or need further elaboration, please do not hesitate to contact Sei-Ichi Kaneko, Executive Vice President, SAAJ (s-kaneko@saa.or.jp).

Sincerely yours,

Keiko Kitamura
Chair
Corporate Accounting Committee

APPENDIX

Results of SAAJ Survey on
'Financial Instruments: Amortized Cost and Impairment'

Background and methodology

The Securities Analysts Association of Japan (SAAJ) sponsored a study session on IASB's exposure draft *Financial Instruments: Amortized Cost and Impairment,* inviting a lecturer from the Accounting Standards Board of Japan (ASBJ). Some 168 certified members of the SAAJ participated in the session held on 26 May. A questionnaire was subsequently sent to session participants and 84 responded, making for a 50% response rate. The respondents were also invited to make comments. The survey, although small in size, focused on a cohort with the same background (certified members of the SAAJ) and same knowledge level (participation in the study session). This focus and very high response rate gives credibility to the reliability of the survey.

Survey questions and answers

Q1: The exposure draft presents new measurement principles which are defined as "*amortized cost is the present value calculated using the following inputs: (a) the expected cash flows over the remaining life of the financial instrument; and (b) the* ***effective interest rate*** *as the discount rate*", and it proposes the "expected loss model" which is completely different from the "incurred loss model" used in IAS 39. Do you think the expected loss model better reflects the reality of financial institutions' business?

A1:

Yes.	26	31.0%
No.	22	26.2%
Cannot judge at this moment.	36	42.8%

Q2: One of the objectives of the exposure draft, based on experiences of the financial crisis, is to enable earlier recognition of impairments. Do you think the expected loss model is effective in achieving this objective?

A2:

Yes.	34	40.5%
No.	29	34.5%
Cannot judge at this moment.	21	25.0%

Q3: Which offers more useful decision-making information for corporate analysis, the expected loss model or the incurred loss model?

A3:

The expected loss model.	24	28.6%
The incurred loss model.	21	25.0%
Cannot judge at this moment.	39	46.4%

Q4: In your opinion, what are the problems with the expected loss model?

A4:

The burden on preparers in terms of accounting treatment and disclosure.	17	20.2%
Assumptions for expected cash flows can be arbitrary, making inter-company comparison difficult.	61	72.6%
No problems.	3	3.6%
Cannot judge at this moment.	3	3.6%

Q5: The exposure draft proposes including the following four line items in the comprehensive income statement: (a) gross interest revenue (before deduction of the expected loss), (b) the portion of initial expected losses allocated to the period, (c) net interest revenue, and (d) gains and losses resulting from changes in estimates. Do you think this would contribute to an improved analysis of financial institutions?

A5:

Yes, a significant contribution.	11	13.1%
Yes, a slight contribution.	49	58.3%
No contribution.	24	28.6%

Q6: The exposure draft requires detailed disclosure including amounts shown in the comprehensive income statement, input and assumptions used to calculate expected credit loss, and quality of financial assets measured by amortized cost. Do you think the proposed disclosure would contribute to an improved analysis of financial institutions?

A6:

Yes, a significant contribution.	24	28.6%
Yes, a slight contribution.	43	51.2%
No contribution.	17	20.2%

Q7: In regard to the disclosure requirements of the exposure draft, specify items that you think need further improvement.

A7:

Sensitivity analysis.
Fair value (in note).
Disclosure in a common format for inter-company comparison.
Past data (including credit loss experiences) used as assumptions for expected credit loss. (Plural answers)

Q8: FASB has published its exposure draft which uses a modified incurred loss model. Which of the exposure drafts, the IASB or FASB one, presents more useful information in analyzing financial institutions?

A8:

IASB	23	27.4%
FASB	25	29.8%
Cannot judge at this moment.	36	42.8%

Q9: What is the closest institution to which you belong?

A9:

A. Securities company	10	11.9%
B. Bank	15	17.8%
C. Investment company/trust	7	8.3%
D. Insurance company	14	16.7%
E. Other financial institution	4	4.8%
F. Accounting/tax firm	4	4.8%
G. Rating agency	3	3.6%
H. Research company/systems development/media	13	15.5%
I. Others such as manufacturing companies	6	7.1%
J. Other	8	9.5%

Q10: What is the closest to your job description?

A10:

A. Analyst, portfolio manager, risk management	29	34.5%
B. Corporate loan/risk analysis	3	3.6%
C. Marketing (Institutional/retail)	5	6.0%
D. Accounting/corporate finance/IR	17	20.2%
E. Public accountant/tax accountant	5	6.0%
F. Other	25	29.8%