



1 April 2011

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

Dear Sir David:

re: Comments on Supplement to Exposure Draft
“Financial Instruments: Impairment”

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on Supplement to Exposure Draft “Financial Instruments: Impairment” put out by the International Accounting Standards Board (IASB). The SAAJ is a not-for-profit organization providing investment education and examination programs for securities analysts. Its certified members number 24,000. 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. The CAC writes comment letters to global standard setters, including the IASB and Accounting Standards Board of Japan (ASBJ), and exchanges opinions with organizations including the ASBJ and the Financial Services Agency.

Before drafting this comment letter, the SAAJ sponsored a study session on the discussion paper, inviting an ASBJ staff member as a lecturer. Some 118 of our certified members participated. A questionnaire was subsequently sent to each participant and 57 responded, making for a 48% response rate. This comment letter fully takes into account the views expressed in the questionnaire replies as well as discussion among CAC members. The survey results are attached as an Appendix.

General Comments

The CAC appreciates the efforts by the IASB and the Financial Accounting Standards Board (FASB) to improve the exposure draft of December 2009 by incorporating the open portfolio concept widely used by financial institutions. However, the CAC is afraid that the supplement was issued without full deliberations between the IASB and the FASB,

otherwise there should be no need for the 'IASB only Appendix' (underlining added). Although the approach proposed in the supplement offers some improvements over the original expected loss model, there is still room for further improvements, including the reduction of arbitrary applications which are of concern to many financial statement users. Following are our answers to specific questions.

Question 1

Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

The CAC thinks the supplement ameliorates the problem of the delayed recognition of expected credit losses to a certain degree. In our survey, we asked '*The supplement proposes a new approach for impairment. Do you think this approach, by dealing with delayed recognition of expected credit losses, offers useful information for corporate analysis?*' (Question 1) to which 49% answered 'Yes', 18% 'No', and 33% 'Cannot judge at this moment'. The CAC is concerned that the proposed approach would reduce the comparability of financial statements as there is significant room for the arbitrary estimation of expected losses. Some members pointed out that the proposal involves the risk of inducing an overly optimistic or pessimistic estimate of losses influenced by phases of the business cycle. This could result in the delayed recognition of credit losses compared to the uniform standard of loss provisioning as companies are most likely biased to postpone impairments.

Question 6

Is the requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

The CAC thinks paragraph 3 of the supplement is obscure in clearly differentiating the two groups. In our survey, we asked '*The supplement proposes methods to differentiate the good and bad books. Do you think the method will differentiate the books properly and operationally to offer useful information for corporate analysis?*' (Question 2) to which 46% answered 'No', surpassing 'Yes' (35%).

Japanese financial institutions classify debtors into six categories, from normal to bankrupt, which are clearly defined in a Financial Services Agency manual. When debtors are classified into only two categories, good and bad, where to draw the line in the six categories is up to the interpretation of each respective financial institution, making

inter-company comparisons difficult. The CAC thinks paragraph 3 is too abstract for practical application and proposes expanding the paragraph to include more specific guidance based upon the current practices of financial institutions in various parts of the world. In the past, as the definition of bad debt was obscure, many Japanese financial institutions postponed necessary impairments. Based on this experience, the CAC emphasizes the need for detailed guidelines and disclosure requirements.

Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this model. Specifically, on the following issues:

(a) Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?

In our survey, we asked *'The supplement proposes to use minimum allowance amount (floor) for 'higher of test'. Do you think this approach is an improvement in impairment accounting?'* (Question 4). Answers were almost equally divided, 'Yes' (32%), 'No' (39%), and 'Cannot judge at this moment' (30%). According to comments to the question, many respondents thought calculation of the floor could be arbitrary as the foreseeable period was not clearly defined, which would cause difficulties in inter-company comparisons.

Question 11

The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

(a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?

(b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

The CAC is against the flexibility proposed in the supplement. In determining time-proportional expected credit losses, paragraph B8 gives three methods: (a) a straight-line method using a discounted estimate, (b) a straight-line method using an undiscounted estimate, and (c) an annuity approach. The CAC thinks allowing the three options would make calculations complex, enable arbitrary selection of available options, and, as a result, make inter-company comparisons difficult.

In our survey, we asked, *'The supplement proposes, as the first step in the 'higher of test', to calculate time-proportional expected credit losses using a straight-line approach or an annuity approach. Do you think the proposal will be operational in offering useful information for corporate analysis?'* (Question 3). The majority answered 'No' (54%),

well surpassing ‘Yes’ (21%), and ‘Cannot judge at this moment’ (25%).

Question 12

Would you prefer the IASB approach for open portfolios of financial assets measured at amortised cost to the common proposal in this document? Why or why not? If you would not prefer this specific IASB approach, do you prefer the general concept of the IASB approach (ie to recognise expected credit losses over the life of the assets)? Why or why not?

Question 13

Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific FASB approach, do you prefer the general concept of this FASB approach (ie to recognise currently credit losses expected to occur in the foreseeable future)? Why or why not?

The CAC does not think either of the two proposals is superior. In our survey, we asked, ‘Which one of the original approaches, by the IASB and the FASB, do you think will offer more useful information for corporate analysis?’ (Question 6). Responses were almost equally divided between the IASB supporters (39%) and the FASB supporters (37%), with 25% undecided.

The CAC feels, in the first place, asking questions like 12 and 13 above, which is self-denial of the common proposal in the supplement, is evidence that the supplement was published without full deliberation between the two boards. As mentioned in the General Comments above, the CAC thinks the supplement is an improvement over the exposure draft, but that there is still room for further improvement.

The FASB supporters in our survey think the FASB approach would bring forth conservative and adequate provisions. This suggests clearer guidance and enhanced comparability are necessary for the IASB approach to gain further support. One CAC member opined that the definition of ‘foreseeable period’ in the FASB approach is obscure, and thus it should be defined, taking the business cycle into consideration, as ‘(expected losses) during the coming 4 to 5 years’.

Question 18Z

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

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

The CAC’s opinion was divided in regard to the disclosure requirements proposed in

the supplement. In our survey, we asked, ‘*Do you think disclosure requirements in the supplement offer enough information to understand the new approach and to utilize in corporate analysis?*’ (Question 5) to which only 28% answered ‘Yes’, 37% ‘Cannot judge at this moment’, and 35% ‘No’.

Some believed that the proposed disclosure would provide useful information regarding the accuracy of loss estimates by an entity in comparing expected losses and actual realized losses. One CAC member requested the disclosure of the names and outstanding amounts of major borrowers in the good book (no further disclosure is necessary for the bad book as all expected losses are already provisioned for). Some others do not support the disclosure requirements because they are against the new approach proposed in the supplement in the first place.

Lastly, the CAC would like to express its serious concern over significant differences of opinions between the IASB and the FASB at a moment when the June deadline for the MoU and December deadline for the SEC decision on possibly adopting IFRS are rapidly approaching. The CAC hopes its comments will be of some help for the two boards in reaching a consensus.

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 the Supplement to ED “Financial Instruments: Impairment”

Background and methodology

The Securities Analysts Association of Japan (SAAJ) sponsored a study session on the supplement to the exposure draft “Financial Instruments: Impairment”, inviting an ASBJ (the Accounting Standards Board of Japan) staff member as a lecturer. Some 118 of our certified members participated in the session held on March 1st. A questionnaire was subsequently sent to each participant and 57 responded, making for a 48% 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 supplement proposes a new approach for impairment. Do you think this approach, by dealing with delayed recognition of expected credit losses, offers useful information for corporate analysis?

A1:

Yes.	49.1%
No.	17.5%
Cannot judge at this moment.	33.3%

Q2: The supplement proposes methods to differentiate the good and bad books. Do you think the method will differentiate the books properly and operationally to offer useful information for corporate analysis?

A2:

Yes.	35.1%
No.	45.6%
Cannot judge at this moment.	19.3%

Q3: The supplement proposes, as the first step in the ‘higher of test’, to calculate time-proportional expected credit losses using a straight-line approach or an annuity approach. Do you think the proposal will be operational in offering useful information for corporate analysis?

A3:

Yes.	21.0%
No.	54.4%
Cannot judge at this moment.	24.6%

Q4: The supplement proposes to use minimum allowance amount (floor) for ‘higher of test’. Do you think this approach is an improvement in impairment accounting?

A4:

Yes.	31.5%
No.	38.6%
Cannot judge at this moment.	29.8%

Q5: Do you think disclosure requirements in the supplement offer enough information to understand the new approach and to utilize in corporate analysis?

A5:

Yes.	28.1%
No.	35.1%
Cannot judge at this moment.	36.8%

Q6: Which one of the original approaches, by the IASB and the FASB, do you think will offer more useful information for corporate analysis?

A6:

The IASB approach.	38.6%
The FASB approach.	36.8%
Cannot judge at this moment.	24.6%