Accounting Standards Board of Japan
Kowa Building No.9,
1-8-10, Akasaka, Minato-ku, Tokyo
107-0052
Japan

Tel: +81-3-5561-8449
Fax: +81-3-5561-9624

http://www.asb.or.jp

CL 08

October 9, 2002

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

Dear Sirs,

Comments on the Exposure Draft of Proposed Amendments to IAS 32 and 39

The Accounting Standards Board of Japan (ASBJ) is pleased to comment on the Exposure Draft of Proposed "Amendments to IAS 32 and 39". The views expressed in this letter are those of International Issues Standing Committee of ASBJ.

Whilst we respect the effort made by IASB to improve the existing requirements in IAS 32 and 39, we express dissenting views on certain proposals in the Exposure Draft. The main reason is that certain proposals represent significant changes to fundamental approaches in IAS 39. In particular, we believe that proposals in Question 2 and Question 4 in Invitation to Comments on the proposed IAS 39 would go much beyond the scope of improvements.

We hope that our comments will contribute to the work of the IASB in arriving at its final decision.

Best Regards,

Ikuo Nishikawa

Chairman, International Issues Standing Committee
Vice Chairman, Accounting Standards Board of Japan

IAS 39: FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

Question 1 -- Scope: loan commitments (paragraph 1(i))
Do you agree that a loan commitment that cannot be settled net and the entity does not designate as held for trading should be excluded from the scope of IAS 39?

A. Agree.

Question 2 -- Derecognition: continuing involvement approach (paragraphs 35-57)
Do you agree that the proposed continuing involvement approach should be established as the principle for derecognition of financial assets under IAS 39? If not, what approach would you propose?

A. Disagree.
We believe that the financial component approach will be more appropriate than the proposed continuing involvement approach, because the former better reflects the economic consequence of securitisation.

The continuing involvement approach as proposed often leads to a result that an entity recognises transferred assets and the corresponding borrowings that do not meet the definition of assets and liabilities under the IASB framework. In particular, under the proposed approach, there can be a case that an entity is required to continue recognition of an asset that is already legally isolated and not controlled by the entity, or a liability for a mere contingent obligation.

The proposed continuing involvement approach also results in very different accounting consequences depending on the order of transactions. For instance, under the proposed approach, if an entity sells a loan to a third party and simultaneously provides a financial guarantee, the entity would be required to continue recognition of that loan because it has a continuing involvement with the loan. On the other hand, if an entity only provides a financial guarantee with a third party, it would not recognise any financial assets related to that guarantee, while the entity has same contractual rights and obligations as the former case. In Japan, many securitisation transactions are arranged in a form that a transferor provide credit enhancement instruments, which would not qualify for derecognition under the proposed approach. We believe that prohibition of derecognition for such transactions is inconsistent with the accounting treatment for guarantees and does not reflect economic consequences of transactions.

Question 3 -- Derecognition: pass-through arrangements (paragraph 41)
Do you agree that assets transferred under pass-through arrangements where the cash flows are passed through from one entity to another (such as from a special purpose entity to an investor) should qualify for derecognition based on the conditions set out in paragraph 41 of the Exposure Draft?

A. Disagree.
As mentioned in the answer to Question 2, we believe that the financial component approach will be more appropriate for derecognition of a financial asset. Therefore, we believe that the financial component approach is appropriate also in accounting for assets transferred under pass-through arrangements.

Question 4 -- Measurement: fair value designation (paragraph 10)
Do you agree that an entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss?

A. Disagree.
We do not believe that it is appropriate to permit to designate any financial instruments as an instrument that is measured at fair value with changes in fair value recognised in profit or loss. We do not consider it necessary to change the existing requirements of IAS 39 in this respect. The proposed revisions would permit designation obviously inconsistent with the entity's actual purpose of holding. We believe that such an amendment would depart from the fundamental notion of the existing IAS 39 that requires an entity to measure its financial instruments in accordance with their purposes of holding.

Question 5 -- Fair value measurement considerations (paragraphs 95-100D)
Do you agree with the requirements about how to determine fair values that have been included in paragraphs 95---100D of the Exposure Draft? Additional guidance is included in paragraphs A32---A42 of Appendix A. Do you have any suggestions for additional requirements or guidance?

A. Generally agree.
We have a comment on the proposed paragraph 100, which appears to mention that, in cases where there is no active market for a financial instrument, the prices in recent market transactions always should be given priority over the estimate using valuation techniques. We believe that an estimate using valuation techniques sometimes may be more appropriate in determining the fair value than a price based on reference to a recent market transaction that is infrequent and therefore not sufficiently reliable. We recommend that the standard should take into consideration a concern about use of a transaction price for which there is

doubt whether it is on an arm's length basis and practical difficulty in inquiring all the transaction prices including those in very infrequent trades.

Question 6 -- Collective evaluation of impairment (paragraphs 112 and 113A--113D)
Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment? Do you agree with the methodology for measuring such impairment in paragraphs 113A-113D?

A. Agree.
We believe that a loan asset or other financial asset that are not found to be impaired individually should be assessed again in a portfolio, because some of those loans as a whole is expected to become irrecoverable with certain probabilities.
With regard to the proposed paragraph B33 in Appendix B, the example of calculation provided there is theoretically accurate, but it should be noted that not all financial institutions at present keep sufficient data to follow the method shown in the example.

Question 7 -- Impairment of investments in available-for-sale financial assets (paragraphs 117--119)
Do you agree that impairment losses for investments in debt and equity instruments that are classified as available for sale should not be reversed?

A. Agree.

Question 8 -- Hedges of firm commitments (paragraphs 137 and 140)
Do you agree that a hedge of an unrecognised firm commitment (a fair value exposure) should be accounted for as a fair value hedge instead of a cash flow hedge as it is at present?

A. Agree.

Question 9 -- 'Basis adjustments' (paragraph 160)
Do you agree that when a hedged forecast transaction results in an asset or liability, the cumulative gain or loss that had previously been recognized directly in equity should remain in equity and be released from equity consistently with the reporting of gains or losses on the hedged asset or liability?

A. Disagree.
The proposed requirement would unnecessarily complicate the accounting treatment of the cases where an entity acquires depreciable assets as a result of hedged forecasted transactions. We believe that the existing treatment should not be changed at present, because this issue was already discussed when IAS 39 was first issued.

Question 10 -- Prior derecognition transactions (paragraph 171B)
Do you agree that a financial asset that was derecognised under the previous derecognition requirements in IAS 39 should be recognised as a financial asset on transition to the revised Standard if the asset would not have been derecognised under the revised derecognition requirements (ie that prior derecognition transactions should not be grandfathered)? Alternatively, should prior derecognition transactions be grandfathered and disclosure be required of the balances that would have been recognised had the new requirements been applied?

A. Disagree.
As mentioned in the answer to Question 2, we do not agree with the proposed continuing involvement approach. Even if the proposed continuing involvement approach were adopted, it would be appropriate to permit an entity to grandfather prior derecognition transactions because the continuing involvement approach is not theoretically superior to that of the existing standard. In addition, there may often be practical difficulty for an entity in reexamining all prior derecognition transactions.

Other: Initial recognition and measurement of financial guarantee contracts (paragraph 1 (f))
With regard to the proposed amendment that financial guarantee contracts should be initially recognised and measured at fair value, we have concerns about its practicability, because there are some obscure points in important respects, such as measurement method of fair value (whether it is same as measurement as a provision) and accounting treatment (e.g., whether an expense should be recognised if no guarantee fee is received).

IAS 32: FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION

Question 1 - Probabilities of different manners of settlement (paragraphs 19, 22, and 22A)

Do you agree that the classification of a financial instrument as a liability or as equity in accordance with the substance of the contractual arrangements should be made without regard to probabilities of different manners of settlement? The proposed amendments eliminate the notion in paragraph 22 that an instrument that the issuer is economically compelled to redeem because of a contractually accelerating dividend should be classified as a financial liability. In addition, the proposed amendments require a financial instrument that the issuer could be required to settle by delivering cash or other financial assets, depending on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder of the instrument, to be classified as a financial liability, irrespective of the probability of those events or circumstances occurring (paragraph 22A).

A. Disagree.

We do not agree with the proposal to disregard to probabilities of different manners of settlement. Where the occurrence of a future event that requires an issuer to settle in cash is extremely rare but the contractual arrangements requires the cash settlement, under the proposed requirements, the financial instrument should be classified as a liability by such nominal condition. We do not believe that such an accounting treatment appropriately reflects the substance of the transaction. We believe that the contingent settlement provision should be ignored when the possibility of the issuer being required to settle in cash or another financial asset is remote at the time of issuance, as prescribed in SIC-5.

Question 2 -- Separation of liability and equity elements (paragraphs 28 and 29)

Do you agree that the options in IAS 32 for an issuer to measure the liability element of a compound financial instrument initially either as a residual amount after separating the equity element or based on a relative-fair-value method should be eliminated and, instead, any asset and liability elements should be separated and measured first and then the residual assigned to the equity element?

A. Disagree.

We believe that a relative-fair-value-method should be retained as an option because there might be cases where it is more reliable or easier to apply than the proposed method.

Question 3 -- Classification of derivatives that relate to an entity's own shares (paragraphs 29C -- 29G)
Do you agree with the guidance proposed about the classification of derivatives that relate to an entity's own shares?

A. Disagree.

(1) Recognition of a purchase obligation as a liability
We do not agree with the proposed paragraph 29F, which requires an entity to recognise a forward repurchase contract and a written put option on the entity's own share with the settlement by the delivery of cash or other financial assets as liabilities. The proposed paragraph B26 in Basis for Conclusions states that the accounting for such financial instruments should be consistent with the treatment of shares that provides for mandatory redemption by the issuer. Although this rationale certainly applies to a forward repurchase contract, we believe that it does not apply to a written put option, because it is only a contingent obligation. In addition, with regard to the proposed paragraph 29F that requires the carrying amount of the financial liability recognised for a written option should be reclassified to equity if the derivative contract expires without the delivery of cash or other financial assets, we cannot find a clear reason why this case can be an exception to the general rule of derecognition of financial liabilities (the proposed paragraph 65A in IAS 39) and unclarity seems to be showing a flaw in recognition of a liability in this case. For these reasons, we believe at least that the written put option on the entity's own share should be accounted for in the same manner as other types of derivatives.

In addition, with regard to the case where the counterparty can choose the settlement method, we consider it is inconsistent that gross physical settlement is assumed for forward repurchase contracts and written put options whereas net cash settlement is assumed for other types of derivatives on entity's own shares.

(2) Treatment of the case where an issuer can choose the settlement method
The proposed paragraph 29E requires that a derivative contract on an entity's own share that has more than one settlement alternative for the entity should be accounted for as a derivative asset or liability unless the entity has an established practice of gross physical settlement. However, we cannot find a clear reason why net settlements should be always assumed when the entity has no established practice of gross physical settlements.