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Accounting & Tax Committee  
Japan Foreign Trade Council, Inc.

To the International Accounting Standards Board 

Comments on Supplement “Financial Instruments: Impairment”

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) made in response to the solicitation of comments regarding the International Accounting Standards Board Supplement “Financial Instruments: Impairment”. JFTC is a trade-industry association with trading companies and trading organizations as its core members, while the principal function of its Accounting & Tax Committee is to respond to developments in domestic and international accounting standards. (Member companies of the Accounting & Tax Committee of JFTC are listed at the end of this document.)

I. General Comments

The intent of the proposals of the Supplement to the Exposure Draft is to revise the procedures contained in the original Exposure Draft for including expected credit losses in the computation of effective interest rate, which was considered to be impractical. We welcome this intent of the Supplement. However, we believe that some aspects of the proposals are not appropriate, such as the time-proportional approach to expected losses. Therefore, we request continued careful deliberations.

Given the different proposals that have been made by the IASB and the FASB concerning impairment of financial assets, we appreciate that the Supplement endeavors to promote convergence between IFRS and US GAAP by presenting a joint supplementary document proposing a common approach on impairment of open portfolios. However, we strongly request that the two boards continue their efforts toward convergence, not only in the area of impairment but also in other areas related to financial instruments, such as classification and measurement.

II. Specific Issues (Comments on Questions)

Question 1
We believe that the approach for recognition of impairment described in the Supplement deals effectively with the weakness in question (i.e., delayed recognition of expected credit losses). However, we believe that some approaches contained in the joint proposal are not necessarily appropriate, particularly with regard to time-proportional recognition of expected losses over the remaining life of the portfolios and with regard to portfolio categories.

- Delayed recognition of expected losses will be affected significantly by the rules adopted by entities regarding transfer from “good book” to “bad book.” Consequently, any delay in transfer to the bad book can be expected to result in delayed recognition of credit losses.

Question 2

If the assumption is that the proposed impairment model is practical for open portfolios, it is our belief that the model should be applied to all financial assets, including closed portfolios and individually managed assets.

- However, we believe that certain portions of the proposal are not practical, especially, but not limited to, requiring entities other than financial institutions to determine impairment allowances on a time-proportional basis (paragraph 2(a)(i)).

- The treatment of impairment of loans and other financial assets contained in open portfolios is an issue commonly faced by financial institutions. The Supplement limits its reconsideration to this single point because the proposal contained in the original Exposure Draft was deemed difficult to adopt for practical and administrative reasons. We, however, believe that loans and other financial assets contained in open portfolios are seldom of any material importance in the case of nonfinancial companies. Therefore, instead of identifying the development of a single impairment approach as the goal, we request that explicit guidance be given for choosing a simplified treatment in cases where such assets are immaterial.

- The separation of the computation of effective interest rate from the consideration of credit losses should be adopted as a unified approach applicable to all financial assets.

- Short-term trade receivables constitute an important financial asset for nonfinancial companies in general. The IASB Exposure Draft Revenue from Contracts with Customers proposes that credit risk be taken into account when measuring revenue. We request that short-term trade receivables be treated as a subject for consideration under financial instruments accounting and not as part of the Revenue Recognition Project.
Furthermore, we request the inclusion of simplified treatment of short-term trade receivables with no contractually determined rate of interest on the grounds that such items have no material impact on time value or credit risk.

- Nonfinancial entities are totally unfamiliar with the concepts of “open portfolio” and “closed portfolio.” The definition found in Appendix A of the Supplement or the definition and explanations given under paragraph B1 thereof do not provide sufficient guidance for judging whether a group of financial assets should be classified under “open portfolio” or “closed portfolio.” However, even if clear definitions of both types of portfolios were provided and entities were thereupon able to classify their financial assets, insofar as entities do not actually manage their receivables under these two categories, there is no reason to establish separate accounting treatments. Therefore, we believe it is not appropriate to include such concepts in accounting standards that are applicable to nonfinancial entities. Hence, the adoption of accounting standards based on the separation of “open portfolio” and “closed portfolio” should be avoided.

Question 3

We do not agree with this proposal.

- We support an approach that only allows onetime recognition of credit losses expected to occur within the foreseeable future (paragraph 2(a)(ii)). Because it is difficult for nonfinancial companies to estimate their final expected losses, it is not practical to at all times mandate a method requiring computation of impairment allowances on a time-proportional basis (paragraph 2(a)(i)). As for financial institutions, onetime recognition of expected losses is compatible with various existing regulations.

- It is unclear what is meant by foreseeable future. If losses can be rationally estimated for the period beyond the foreseeable future, should not this period also be included in the foreseeable future? Expected losses in an open portfolio would normally be computed using the cumulative default rate for each rating. It is unclear how the foreseeable future period and the remaining life of the receivable can be treated separately.

- In the event that the proposals of the Exposure Draft are adopted as they currently stand, we request that the use of simplified methods be allowed in cases where there is no material effect on financial statements.

Question 4
The proposed approach to determining the impairment allowance on a
time-proportional basis is impractical.

➤ Because it is difficult for nonfinancial companies to estimate their final
expected losses, it is not practical to at all times mandate a method
requiring computation of impairment allowances on a time-
proportional basis (paragraph 2(a)(i)).

Question 6

We find the proposal to be unclear.

➤ We anticipate considerable disparity and unevenness in application if
no additional guidance is provided beyond the content of paragraph 3.

➤ It is difficult to think that an entity would continue to manage an asset
in an open portfolio after recovery of principal has become its objective.
We request additional examples of bad book managed in an open
portfolio.

➤ As nonfinancial entities, we do not classify our receivables under open
portfolio and closed portfolio. Rather, the standard approach is to
determine allowances for individual problem receivables or to manage
receivables under some other classifications (a common method being
the use of a flat default rate for each group of similar receivables). We
find the accounting treatment of bad book proposed in the Supplement
to be appropriate for cases where allowances are determined for
individual receivables, and we find the accounting treatment of good
book proposed in the Supplement to be appropriate for all other cases.
Therefore, we submit the following proposal regarding classification by
good book and bad book. “Generally, any receivables for which
impairment losses are individually estimated due to problems with the
debtor’s credit or repayment conditions should be classified under bad
book, and all other receivables should be classified under good book.”
We believe the inclusion of such a statement will generate more
desirable results for the following reasons. This approach would clarify
the difference between good book and bad book, and would achieve
consistency between the receivable management methods of
nonfinancial entities and accounting standards.

Question 7

Although it is operational, the following concerns remain.

➤ Considerable disparity and unevenness will occur in application if no
further guidance is provided beyond the criteria set out in paragraph 3.
In such a case, entities can be expected to operate according to rules
that they themselves establish, and the preparers of financial statements and auditors will have no choice but to perform their accounting and auditing functions in accordance with these internal rules.

Question 8

We do not agree with this proposal.

➢ From an operational perspective, it will be simpler not to differentiate between financial assets but to recognize expected losses during the foreseeable future in bad debt allowances. Moreover, recognizing collectable assets in the statement of financial position is consistent with the Conceptual Framework for Financial Reporting and will prove useful to users of financial statements.

➢ Regarding classification under bad book, when an entity takes action toward recovery of its investment in a financial asset, we believe there is no difference between “total credit losses expected to occur over the life of financial assets” as required of bad book, and “total credit losses expected to occur over the foreseeable future” as required of good book.

➢ Classification of financial assets by similar levels of credit risk or some other form of rational method, and the establishment of methods for estimating expected losses in a manner that is consistent with actual practices are acceptable as management methods for internal control purposes. However, establishing separate accounting rules for each group of financial assets would create room for arbitrary judgment on the grouping and would also undermine comparability among entities.

➢ It is expected that the required procedures would entail considerable administrative burdens for nonfinancial companies. First, entities would be required to differentiate between good book and bad book. Second, computations would have to be done separately for the bad book. Third, time-proportional impairment allowances and minimum allowance amounts (floor) would have to be computed for the good book. Therefore, even if the two groups are differentiated, we request that consideration be given to allowing nonfinancial companies to apply simplified treatments.

Question 9

(a)

In cases where the floor amount is anticipated to exceed time-proportional expected credit losses, we understand that the application of the concept of floor will eliminate delayed recognition of expected credit
losses. However, we do not agree with the proposal for the following reasons.

➢ For nonfinancial entities, it is not practical to mandate a method requiring computation of impairment allowances on a time-proportional basis (paragraph 2(a)(i)). Therefore, we support an approach based only on paragraph 2(a)(ii).

➢ The proposal would require entities to constantly estimate two expected losses, which would entail heavy administrative burdens. Establishment of a floor means that losses are recognized at the time of initial recognition of the receivable, which lacks rationality. We believe that administrative procedures related to the good book should be simplified. For instance, portfolios for which a sharp increase in expected losses is estimated for the immediate future period of about twelve months (i.e., portfolios to which floor is applicable) should already at that point be removed from the good book and transferred to the bad book.

(b)

This approach is more practical than having to constantly compute the values of both paragraph 2(a)(i) and (ii).

(c)

We do not agree with the proposal.

There is no quantitative ground for establishing a bright line of at least twelve months. If this is proposed as an exceptional treatment of open portfolios limited to financial institutions only, this would be a practical approach for the preparation of financial statements. However, we oppose the proposal for establishing quantitative criteria predicated on the purpose of developing a single impairment model.

We believe it is not necessary to adopt a quantitative criterion for the length of period on the assumption that the level of precision in management and control systems varies among entities.

(d)

We believe this answer is "Yes".

(e)

Because the level of precision in management and control systems varies among entities, we feel it cannot be said that the foreseeable period will typically exceed twelve months.
Question 12

As indicated in our response to Question 13, we support the FASB approach. Between the IASB approach and the joint proposal, we feel that the joint proposal is more desirable. However, we do not agree with the determination of impairment allowances on a time-proportional basis.

Question 13

We support the FASB approach for immediate recognition in net income of expected credit losses expected to occur in the foreseeable future.

➢ As indicated in the FASB approach, for operational purposes, it is simpler and more convenient not to differentiate between financial assets but to recognize expected losses for the foreseeable future in bad debt allowances. Furthermore, recognizing collectable assets in the statement of financial position is consistent with the Conceptual Framework for Financial Reporting and will prove useful to users of financial statements as well. In the FASB approach, credit losses are not subject to time-proportional treatment, which is consistent with current practices. For this reason, we believe confusion associated with the introduction of a new approach would be minor. On the other hand, the IASB approach of time-proportional treatment of expected losses will defer losses, which will be complicated and troublesome in actual practice. Furthermore, if a variety of treatments were to be permitted as indicated in the Supplement, comparability would be undermined. We therefore believe that the expected benefits would not justify the costs associated with this treatment.

➢ The FASB approach could be applied not only to open portfolios but also to closed portfolios and individual financial assets.

➢ On the other hand, collectively recognizing losses upon initial recognition of acquired portfolios lacks rationality. For newer portfolios, one possibility would be, for example, to accumulate allowances on a time-proportional basis until the amount based on the FASB approach is reached.

Question 14Z

We agree with this proposal.

Question 17Z

We agree with this proposal.
Question 18Z

We do not agree with this proposal.

The scope of disclosure is significantly larger than the current IFRSs. From the perspective of entities, this means collecting and analyzing a larger body of data, which will require major changes in current computer systems. We request that the cost-benefit performance of this proposal be carefully examined with reference to usefulness to users of financial statements.

Paragraph Z8 requires disclosure of data from the previous four annual periods. This represents a serious imbalance with other presentations and disclosures that, for comparison purposes, require data from only one previous annual period. The proposal places an excessive burden on preparers of financial statements, and cannot be accepted.

Question 19Z

We do not agree with this proposal because we support the FASB approach as indicated in our response to Question 13.

III. Others

(Loss estimates)

Paragraph B5 states that estimation of losses should take into account future events that may occur after the measurement date. If adopted, this provision would make room for an excessive degree of arbitrariness in estimation. At the same time, this would raise doubts in explanations provided to auditors. For these reasons, we believe this proposal is impractical.
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