Accounting Standards Board of Japan (ASBJ)
Fukoku Seimei Building 20F, 2-2, Uchisaiwaicho 2-chome, Chiyoda-ku, Tokyo 100-0011, Japan
Phone +81-3-5510-2737 Facsimile +81-3-5510-2717 URL http://www.asb.or.jp/

ASBJ FASF

July 28, 2009

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

Dear Sir or Madame,

Comments on the Exposure Draft "Derecognition"

We appreciate the efforts of the International Accounting Standards Board (IASB) on the derecognition project and welcome the opportunity to comment on the Exposure Draft "Derecognition" (hereinafter referred to as "the DP"). The views described below are those of the Technical Committee for Special Purpose Entities (SPEs), which has been set up within the Accounting Standards Board of Japan (ASBJ)[1].

Summary

(1) We agree with the basic idea of approach in the ED which determines derecognition based on whether the entity controls the right to the cash flows underlying the financial asset.

(2) However, we do not agree with all aspects of the proposed approach in the ED because we do not always consider the proposed approach to be an improvement that better achieves the objective of financial reporting, which is to assist financial statements users in predicting future cash flows (see paragraph 11 for our comment on Question 7).

(3) In particular, we disagree with the implications of the ED, where most sale and repurchase agreements (repo transactions) and securities lending agreements will be treated as a sale of the transferred assets, thereby resulting in a fundamental change in accounting (paragraphs BC58 to BC60 of the ED). We think these transactions should be accounted for as financing transactions, in the same way it is accounted for currently, so that it could faithfully represent the substance of the transaction (see paragraph 6(c)for our comment on Question 3)

(4) Also, we are of the view that the alternative approach should not be adopted, and that the proposed approach, amended by reflecting our comments set out in this comment letter, should be adopted (see paragraph 12 for our comment on Question 7)

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[1] The Technical Committee for SPEs, which has deliberated mainly the scope of consolidation that is related to issues of derecognition, elaborates this comment.

(5) This project is one of the items in the MOU with the US Financial Accounting Standards Board (FASB). We expect that the project is undertaken so that it promotes global convergence, which would include addressing the issues we raise in this comment letter.

Comments on Questions

Our comments on the questions which are set out in the DP are provided below. We hope that these help the IASB in its forthcoming deliberations in this project.

Question 1—Assessment of 'the Asset' and 'continuing involvement' at reporting entity level

Do you agree that the determination of the item (ie the Asset) to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity (see paragraphs 15A, AG37A and AG47A)? If not, why? What would you propose instead, and why?

1. We agree with the approach proposed in the ED on this matter. This is because, in the context of consolidated financial statements, whether the transfer meets the criteria for derecognition would ultimately be assessed based on whether the transfer is to someone outside the reporting entity as a group.
2. We also agree with the proposal that the determination of the Asset to be evaluated for derecognition is made on the basis of the transferor's remaining interest in the financial asset that was the subject of the transfer at the level of the reporting entity (see our comment to Q6 in paragraph 10).

Question 2—Determination of 'the Asset' to be assessed for derecognition

Do you agree with the criteria proposed in paragraph 16A for what qualifies as the item (ie the Asset) to be assessed for derecognition? If not, why? What criteria would you propose instead, and why?

(Note: The criteria proposed in paragraph 16A are the same as those in IAS 39.)

3. We disagree with the proposal in paragraph 16A for the following reasons.
   (a) In determining 'the Asset' to be assessed for derecognition, the ED proposes a different treatment between a transfer of the right to the *first* 90 % of the cash flows of a financial asset and a transfer of the right to a proportionate 90 % share of its cash flows. However, this is inconsistent with the basic principle adopted in the ED, which determines derecognition based on whether the entity controls the right to the cash flows underlying

the financial asset (paragraphs BC9 to BC12 and paragraph BC14 of the ED). A similar view on this matter is expressed in the alternative views (paragraphs AV3 and AV5 of the ED).

(b) It is unclear what is meant by 'specifically identified cash flows' of a financial asset that is the Asset to be assessed for derecognition proposed in paragraphs 16A and AG39A. Although this proposed criterion is the same as that in the existing IAS 39, there is no example in the ED such as interest rate strips described in paragraph 16(a)(i) of the existing IAS 39.

(c) Paragraph BC23 of the ED states that a transferor might be required to continue to recognise the transferred asset in its entirety under the proposed approach (as if it controlled the entire asset), even though it might be exposed to only some of the risk and rewards associated with that asset after transfer. However, the ED supports the approach in paragraph 16A because it (1) provides fewer opportunities for structuring and (2) is less complex to apply than the current requirements in the existing IAS 39 (paragraph BC23 of the ED). We do not think such accounting leads to improvement in financial reporting. The proposed approach may lead to continuing recognition of the 'transferred' asset in its entirety by the transferor[2], and this does not reflect the fact, including a case that almost part of the financial asset is actually transferred and the transferor no longer retains substantially all of the rights to the cash flows of the transferred financial asset (paragraph AG39A). This occurs because the transferor is required to apply the 'continuing involvement' filter and 'practical ability to transfer for own benefit' test to the asset in its entirety as the Asset under the proposed approach.

4. In addition, paragraph BC35 of the ED states that if 'the Asset' to be assessed for derecognition had been defined as a right to *any* cash flows of a financial asset, it would have allowed an entity to achieve derecognition of a transferred part of a financial asset even though (1) the part transferred included some or all of the risks or rewards of the part retained or (2) the performance of one part was dependent on that of the other part. Accordingly, the ED proposes that the Asset to be assessed for derecognition be restricted. We understand the concerns regarding derecognition of a financial asset in its entirety in this context. However, we do not think that these concerns are convincing enough to deny derecognition of the actually transferred part of a financial asset.

5. Indeed, we disagree with the alternative approach that would allow derecognition of a financial asset in its entirety and the retention of the rights to the remaining cash flows of that asset to be treated as a new asset if an entity transferred a right to *any* cash flows of a financial

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[2] In addition, under the proposed approach, there is no provision that would result in the transferor recognising the asset to the extent of its continuing involvement in the asset in the current version of IAS 39 (paragraph BC23 of the ED).

asset (paragraphs BC69, AV19 and AV24). On the other hand, under the proposed approach, if a part of the financial asset is transferred and the transferor surrenders its control, only that transferred part is derecognised and the retention of the rights to the remaining cash flows of that asset is treated as a retained interest, not as a new asset (paragraphs 21A and 22A). Thus, a transfer of a part of a financial asset would not lead to derecognition of the entire asset under the proposed approach as often as it would under the alternative approach and, therefore, we think it is unnecessary to restrict unduly the Asset to be assessed for derecognition under the proposed approach.

Question 3—Definition of 'transfer'

Do you agree with the definition of a transfer proposed in paragraph 9? If not, why? How would you propose to amend the definition instead, and why?

6. We generally agree with the direction of the definition of 'transfer' as proposed in paragraph 9 of the ED but also think that some specifics and criteria for derecognition need to be reconsidered.
   (a) We think that a 'transfer' generally should be a legal exchange between a financial asset and cash and/or a noncash financial asset, such as in the case of a legal sale of a financial asset. However, although a transaction that would transfer all of the cash flows from the financial asset held by the transferor is not a legal exchange, in cases where the transferor has no continuing involvement and does not enjoy economic benefits or suffer losses from that asset, it is in substance an outright sale of the financial asset by the transferor. Accordingly, we do not disagree with a 'transfer' definition that includes transactions that are not legal sales.
   (b) Even though lending or pledging the financial asset could qualify as a 'transfer' (paragraphs B29 and BC60 of the ED), we believe that they are substantially the same as continuing to hold such assets if, after the completion of the transaction, the contractual requirement and the transferor's behavior lead that the asset certainly exist in the form it had existed before the transaction, which should be continuously stated. Accordingly, we think the final standard should say, as in paragraph AG40 of the existing IAS 39, that the lending or pledging of a financial asset should not qualify for derecognition.
   (c) In this connection, paragraphs BC58 to BC60 of the ED indicates that most sale and repurchase agreements (repo transactions) and securities lending agreements would be treated as a sale of the transferred assets, thereby resulting in a fundamental change in accounting. We disagree with the proposals that lead to this outcome. A sale and repurchase with fixed price agreements that will be physically settled should be treated as a

single transaction that has the substance of the borrowing with collateral. As such, even if a transferee is free and able to transfer the financial asset that is the subject of the transfer, such transaction should be accounted for as a financing transaction in the same way as it is accounted for currently, so that the substance of the transaction is faithfully represented[3]. We note that, in such transaction, (1) parties of the transaction consider the difference between the initial sales amount and repurchase amount (or lending fee, if it is a lending transaction) to be an interest payment and (2) the transferor has a certain obligation to pay the amount for re-acquisition if the repurchase agreement or lending agreement is not expected to be settled on a net basis before the agreement term ends.

7. As another issue, we think when exactly the transfer should be accounted for is questionable. We think that the transfer of the right to the cash flows underlying the financial asset should be accounting for on the settlement date. Also, we observe that a regular way sale of financial assets would be derecognised, as applicable, using trade date accounting or settlement accounting under paragraphs 38 and AG53 to AG56 of the existing IAS39, provided that it is used consistently. We think those paragraphs should be maintained.

Question 4— Determination of 'continuing involvement'

Do you agree with the 'continuing involvement' filter proposed in paragraph 17A(b), and also the exceptions made to 'continuing involvement' in paragraph 18A? If not, why? What would you propose instead, and why?

8. We agree with the 'continuing involvement' filter proposed in the ED because whether the asset should be derecognized is debatable only when there is continuing involvement. However, certain continuing involvement should not prevent derecognition, and thus we think it is necessary provide exceptions to 'continuing involvement' as in paragraph 18A.

Question 5—'Practical ability to transfer for own benefit' test

Do you agree with the proposed 'practical ability to transfer' derecognition test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

(Note: Other than the 'for the transferee's own benefit' supplement, the 'practical ability to transfer' test proposed in paragraph 17A(c) is the same as the control test in IAS 39.)

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[3] In FASB Statement No.166, *Accounting for the Transfer of Financial assets - an amendment of FASB Statement No.140,* a transfer of a financial asset shall not be accounted for as a sale if the transferor maintains effective control over the transferred financial assets that include an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity.

9. We think the arguments and guidance in the ED are inappropriate and thus should be revised.
   (a) We think that, normally, derecognition of a financial asset should be assessed from the transferor's perspective. However, we agree that derecognition may be assessed from the perspective of the transferee in order to apply the assessment easier (paragraphs BC16 and BC17 of the ED), provided that such assessment faithfully represents the transactions[4].
   (b) Based on the reasons mentioned in paragraph BC21, the ED limits the transferee's 'practical ability to transfer' to situations where the transferee obtains the practical ability to transfer[5] to a third party. However, we do not think that such restriction reflects the nature of financial assets because a transferee can obtain the economic benefits of a financial asset in ways other than through the transfer of the asset to a third party, such as holding the financial asset and receiving all of the cash flows that the underlying financial asset generates[6]. In addition, if such restriction exists primarily to benefit the transferee (see ED of SFAS140, paragraph 54A) or each third-party holder of beneficial interests issued by the SPE as a transferee has the right to pledge or exchange the beneficial interests it received without any condition (see SFAS166, paragraph 9b), it should not preclude the transferee's ability to control the transferred financial asset.
   (c) The ED sets out some factors to consider in determining whether a transferee has the practical ability to transfer the Asset. This includes *economic constraints*, that is, for example, the transferor's guarantee if it is sufficiently valuable. According to paragraph AG52E(e) of the ED, this is because a transferee incurs losses on a transfer of the Asset in isolation to a third party, and thus the transfer may be economically constrained to transfer the Asset in isolation (paragraph AG52L(e) of the ED). However, the guarantee is principally transferred together with the transferred financial asset and thus this substance would be a transfer of both the guarantee and the assets deemed as a single transaction in the same way as a convertible bond. Also, as noted in (b) above, we do not think that the transferor's guarantee precludes the transferee's control of economic benefit on the transferred asset because a transferee can obtain the economic benefits of a financial asset in ways other than through the transfer of the Asset to a third party.
   (d) Furthermore, even on the premise that *economic constraints* preclude the practical ability to transfer the Asset to a third party as noted in the ED, we do not understand why the mere fact that transferor retains subordinated interest in the transferee (e.g., special purpose

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[4] We believe that criteria whether assessment faithfully represents the transactions should include a perspective recognising gain or loss on transfer, in addition to a perspective removing merely an asset from a statement of financial position.

[5] In relation to this 'transfer', the ED such as paragraphs AG52A and AG52B uses it as disposal and it is unclear whether that term in the phrase of 'practical ability to transfer' is same as a definition of 'transfer' proposed in paragraph 9 of the ED. If it is not same, that term should be amended as appropriately.

[6] This would be same as the alternative view (paragraph BC20 of the ED).

entity) precludes the practical ability, that is, the transferee being in a position to transfer the Asset to an unrelated third party unilaterally and without having to impose additional restrictions on that transfer (paragraph AG52L (d) of the ED). In our understanding, there is no such example in the existing IAS 39.

(e) Although the 'practical ability to transfer' test proposed in paragraph 17A(c) of the ED is the same as the control test in the existing IAS 39 (except for the 'for the transferee's own benefit' supplement), we note that the accounting consequences proposed in the ED are different from those in the existing IAS 39. Based on paragraph 20(c) of the existing IAS 39, the transferor continues to recognise the transferred financial asset to the extent of its continuing involvement in the asset, even if the transferor has retained control of the asset when the transferee does not have a practical ability to transfer the asset, which is same wording as the ED. Accordingly, the existing IAS 39 somewhat considers economic characteristics that the financial asset is dividable and securitization makes an unbundling of the assets, but the ED does not.

Question 6—Accounting for retained interests

Do you agree with the proposed accounting (both recognition and measurement) for an interest retained in a financial asset or a group of financial assets in a transfer that qualifies for derecognition (for a retained interest in a financial asset or group of financial assets, see paragraph 21A; for an interest in a financial asset or group of financial assets retained indirectly through an entity, see paragraph 22A)? If not, why? What would you propose instead, and why?

(Note: The accounting for a retained interest in a financial asset or group of financial assets that is proposed in paragraph 21A is not a change from IAS 39. However, the guidance for an interest in a financial asset or group of financial assets retained indirectly through an entity as proposed in paragraph 22A is new.)

10. We support the proposal in paragraph 21A because the following reasons.

(a) An interest retained in a financial asset in a transfer (e.g., remaining 20 per cent interest in a loan portfolio of which a proportionate 80 per cent interest in that portfolio is transferred) is continuously stated as an investment made by the transferor after the transfer and should be as part of the financial asset that the transferor previously recognized. In addition, because the example illustrated in paragraph AG37A of the ED is the same transaction from the transferor's perspective, it would be appropriate to treat the transaction as a partial transfer (or partial retention) of the financial asset that was the subject of the transfer at the level of the reporting entity.

(b) In our understanding, the alternative approach would view a transfer transaction as

unbundling and rebundling of the financial asset (paragraph AV11) and, therefore, would treat a partial transfer such as a proportionate 80 per cent interest in a loan portfolio (as illustrated in paragraph AG37A) as if 100 per cent was transferred and 20 percent was newly purchased. Both the proposed approach in the ED and the alternative approach share the view that transactions that are equivalent from the transferor's perspective should be treated in the same manner. However, we think that the economic benefits embodied in a financial asset are the rights to future cash flows and, compared to non-financial assets, those rights are easier to divide. Thus, the transferor is able to transfer a portion of those rights and retain the remaining portion of those rights, and we are of the view that a partial transfer (or partial retention) is not necessarily deemed to be a combination of transfer of an entire asset and purchase of a new asset in the alternative approach.

(c) We think that the proposal in paragraph 21A of the ED is appropriate[7]. However, as pointed out in the alternative view (paragraph AV14 of the ED), paragraph 22A of the ED may not be always operational in a case where the transferee is a business entity, not an SPE. Rather, we are of the view that it would be more feasible to treat the part retained as a new asset if the transferor cannot determine whether an asset is a retained interest that continues to be held by the transferor or a proceed as a new asset from a transfer (see paragraphs 58 and 272 of SFAS140)[8].

Question 7—Approach to derecognition of financial assets

Having gone through the steps/tests of the proposed approach to derecognition of financial assets (Questions 1–6), do you agree that the proposed approach as a whole should be established as the new approach for determining the derecognition of financial assets? If not, why? Do you believe that the alternative approach set out in the alternative views should be established as the new derecognition approach instead, and, if so, why? If not, why? What alternative approach would you propose instead, and why?

11. We do not accept all aspects of the proposed approach in the ED because in parts we do not view the proposed approach as an improvement in achieving the objective of financial

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7 This is an approach to allocate the carrying amount of the financial asset previously recognised between the part retained and the part transferred (and derecognised) on the basis of the relative fair values of those parts on the date of transfer. Because the costs of those parts are not separately identifiable, they are allocated between those on a rational basis as in the case when joint products are produced (see paragraph 14 of IAS2 'Inventory').

8 In paragraph IG E.3.1 of the existing IAS 39, when equity shares classified in available for sale securities are exchanged for equity shares issued by the acquirer because the investee is acquired and the transaction qualifies for derecognition, the holder of the acquiree's equity shares disposes of the shares and received the acquirer's equity shares at the faire value (the difference is recognised in profit or loss).

reporting, which is to assist financial statement users in predicting future cash flows.

(a) The future economic benefits embodied in a financial asset are the rights to future cash flows. Considering the economic characteristics of financial assets that they are flexibly dividable, when a party sells a preferred portion of the financial asset and retains only its subordinated portion, the transferred preferred portion should be accounted for as a sale and retained subordinated portion should be accounted for as part of the financial asset recognized before the transfer, so as to faithfully represent the substance of the transaction (see paragraphs 3 to 5 for our comment on Question 2).

(b) We generally agree with the direction of the proposed definition of 'transfer' but also think that some specifics and criteria for derecognition need to be reconsidered (see paragraph 6 for our comment on Question 3).

(c) We think the arguments and guidance in the ED regarding 'practical ability to transfer' test are inappropriate and thus should be revised (see paragraph 9 for our comment on Question 5).

(d) We disagree with the proposals in paragraphs BC58 to BC60 of the ED, which lead to the conclusion that most sale and repurchase agreements (repo transactions) and securities lending agreements will be treated as a sale of the transferred assets, and thus resulting in a fundamental change in accounting (see paragraph 6(c) for our comment on Question 3).

12. As mentioned in paragraphs 5 and 10(b) of this comment letter, we are of the view that the alternative approach should not be adopted. We think that the proposed approach, amended by reflecting our comments set out in this comment letter, should be adopted.

Question 8—Interaction between consolidation and derecognition

In December 2008, the Board issued an exposure draft ED 10 *Consolidated Financial Statements*. As noted in paragraphs BC28 and BC29, the Board believes that its proposed approach to derecognition of financial assets in this exposure draft is similar to the approach proposed in ED 10 (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level). Do you agree that the proposed derecognition and consolidation approaches are compatible? If not, why? Should the Board consider any other aspects of the proposed approaches to derecognition and consolidation before it finalises the exposure drafts? If so, which ones, and why? If the Board were to consider adopting the alternative approach, do you believe that that approach would be compatible with the proposed consolidation approach?

13. It is unclear how meaningful it is to compare the proposed derecognition approach in this ED with the consolidation approach proposed in ED 10.

(a) The proposed approach to derecognise financial assets is similar to the proposed

consolidation approach because both approaches are based upon the control concept that requires the ability to obtain the underlying future economic benefits and the ability to access the benefits for one's own benefit (or the ability to restrict others' access to those benefits).

(b) However, those are different proposals because derecognition is applied at the level of assets and liabilities whereas consolidation is assessed at the entity level. In particular, considering that financial reporting may have different boundaries (i.e., parent-only or consolidated), it seems to be meaningless to discuss whether the proposed derecognition and consolidation approaches are compatible. Rather, the focus should be placed on whether the accounting consequences provide a faithful representation when both approaches are applied.

14. We think that comparison between derecognition of financial assets and non-financial assets would be more beneficial.

(a) Based on the definition of the assets set out in paragraphs BC2 to BC14 of the ED, derecognition of all of the assets is uniformly determined by whether (1) the future economic benefits underlying an asset cease to exist or (2) control over the future economic benefits of an asset is relinquished.

(b) However, the nature of the assets vary, and therefore, factors to consider in making the determination of whether control over the future economic benefits of an asset has relinquished would differ depending on its nature:

- derecognition of financial assets is assessed based on whether the entity has relinquished control over unbundled cash flows because the economic benefits embodied in a financial asset are the rights to future cash flows that can be flexibly divided,
- derecognition of non-financial assets (such as inventory or tangible fixed assets) is assessed based on whether the entity has relinquished control over the asset itself (the whole asset).

(c) In this context, there would be more situations where financial assets would be derecognised than situations where non-financial assets would be derecognised. However, it is anticipated in the Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers' that control of inventory could be surrendered even if product warranties or the customer's rights to return the goods are provided. Also, a sale treatment as well as financing treatment under the sale and leaseback transaction is deliberated in the Discussion Paper 'Leases.' On the other hand, the ED proposes that a sale treatment is precluded in a transfer of a financial asset generally if the transferor makes a guarantee to the transferee or retains subordinated interest in the transferee and, thus, situations where financial assets are derecognized seem to be more narrower than situations

where non-financial assets are derecognised.

(d) In the above analysis, for both financial assets and non-financial assets, whether the transferor has relinquished control is assessed based on the transferee's ability to freely dispose of the assets. However, the following factors seem to restrict an entity from derecognising the financial asset and thus should be reconsidered:
   - Determination of 'the Asset' to be assessed for derecognition is restricted (See paragraph 3 of our comment on Question 2)
   - Economic constraint is considered in determining whether a transferee has the practical ability to transfer the Asset (See paragraph 9 of our comment on Question 5).

Question 9—Derecognition of financial liabilities

Do you agree with the proposed amendments to the principle for derecognition of financial liabilities in paragraph 39A? If not, why? How would you propose to amend that principle instead, and why?

15. We agree with the proposal for derecognition of financial liabilities, except how 'modifications' are treated in proposed paragraph 40A of the ED below.

(a) 'Modification' is simply changes in the terms of the original debt instrument, which is different from 'novation' which replaces the original contract with a new contract. Even when the terms of the contract are modified substantially, the original financial liability still exists and a new financial liability does not incur in its place. Accordingly, we are of the view that 'modifications' should be treated as a remeasurement issue such as in FASB Statement No. 15, *Accounting for Debtors and Creditors for Troubled Debt Restructurings,* rather than a derecognition issue.

(b) In connection with when the term of a financial liability is considered to be substantially different (see paragraph 40A of the ED), the description in paragraph AG62 of the ED that 'if the discounted present value is at least 10 per cent different' should be removed, even though it is the same as the existing paragraph AG62 of the existing IAS39, because there is no reasonable justification and it is a rule-based requirement.

Question 11— Disclosures

Do you agree with the proposed amendments to IFRS 7? If not, why? How would you propose to amend those requirements instead, and why?

16. We think that the proposed disclosure amendments should be improved as follows:

(a) Non-recourse debt that has recourse only to specified assets are different in character from other debt that has recourse to any assets. Instead of disclosing the net position as proposed in paragraph 42B (e) of the ED, we think that indirect net presentation (gross non-recourse liabilities less gross related assets that do not qualify for derecognition) in the statement of financial position provides a presentation that is representationally faithful.
In this connection, the Discussion Paper 'Preliminary Views on Financial Statement Presentation' proposes that an entity should classify its assets and liabilities into categories. Under the proposal, an entity would classify related assets and liabilities in the same category and present subtotals for each category. If management decides to present non-recourse liabilities in investing liabilities and related assets in investing assets, those are presented in the same category and a subtotal presented for investing assets and liabilities, which is essentially an indirect net presentation. In light of such the objective of this DP, the indirect net presentation of non-recourse liabilities and related assets should substantially improve the usefulness of users.

(b) ED 10 *Consolidated Financial Statements* proposes disclosures about the reporting entity's involvement with structured entities that it does not control. With regard to disclosures about continuing involvement in financial assets that an entity derecognises, we think that disclosures should be combined so that they provide more useful information to users of financial statements.

(c) Paragraph 42E(c) of the ED proposes that an entity shall disclose relevant information in the period that has the greatest transfer activity if the total amount of transfer activity is not evenly distributed throughout the reporting period. However, we do not understand the purpose of this disclosure (i.e., when and why it is required) and suggest that it be reviewed.

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We expect that our comments contribute to the forthcoming deliberations in the project.

Yours sincerely,

Takehiro Arai
Chairman of the Technical Committee for SPEs
Board member of the Accounting Standards Board of Japan