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European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels
Belgium

Re: Comments on the Discussion Paper
Equity Instruments - Impairment and Recycling

1. The Accounting Standards Board of Japan ("we") welcome the opportunity to provide our comments on the European Financial Reporting Advisory Group's ("EFRAG") Discussion Paper *Equity Instruments - Impairment and Recycling* (the "DP"), issued in March 2018.

2. Recycling of other comprehensive income ("OCI") items is one of the areas which we have continuously supported and asked for in our discussions with the IASB. In this context, we highly commend and strongly support EFRAG's initiative to consider the recycling and impairment of equity instruments designated at fair value through other comprehensive income ("FVOCI").

3. Unlike the requirements under IFRS 9 *Financial Instruments*, we think that it would be ideal to develop definitions or criteria to determine the scope of equity instruments to be carried at FVOCI, rather than to permit an option, in order to enhance the relevance of profit or loss. Nevertheless, we understand that the scope of equity instruments to be carried at FVOCI is not the main issue in the DP and, accordingly, our comments on the specific questions in the DP assume that the scope of equity instruments to be carried at FVOCI will not be changed from that in the existing IFRS 9.

4. Our comments on the specific questions in the DP are provided in the Appendix of this letter.

5. We hope that our comments on EFRAG's DP eventually contribute to improvements in global accounting standards. If you have any questions, please feel free to contact us.

Yours sincerely,

Yukio Ono

Chairman

Accounting Standards Board of Japan

1. Unlike the requirements under IFRS 9, we think that it would be ideal to develop definitions or criteria to determine the scope of equity instruments to be carried at FVOCI, rather than to permit an option, in order to enhance the relevance of profit or loss. Nevertheless, we understand that the scope of equity instruments to be carried at FVOCI is not the main issue in the DP and, accordingly, our comments on the specific questions in the DP assume that the scope of equity instruments to be carried at FVOCI will not be changed from that in the existing IFRS 9.

Question 1
Q1.1 What are your views on the arguments presented in paragraphs 2.3 - 2.10? Do you consider that the reintroduction of recycling would improve the depiction of the financial performance of long-term investors? Alternatively, do you consider that the existing requirements of IFRS 9 provide an adequate depiction? Please explain.

2. We think that the any item that is included in OCI should subsequently be recycled to profit or loss, because this enables profit or loss to have the following features, which would ensure the relevance of profit or loss as a measure of performance of an entity:

   (a) Profit or loss depicts the return when the uncertainty about the expected return in the light of the objective of the investments has been sufficiently reduced.

   (b) Profit or loss becomes "all-inclusive" so that the accumulated amount of profit or loss over all accounting periods equals that of the cash flows over all accounting periods.

   In this context, we agree with the analyses in the DP, which support the recycling of accumulated OCI to profit or loss for equity instruments designated at FVOCI when such equity instruments are sold or impaired.

3. The DP notes that the performance of entities that operate in a long-term investment business model would be better reflected in the financial statements by recycling. However, we are not convinced that recycling should be limited to equity instruments that an entity holds as part of its long-term investments, based on the view stated in the preceding paragraph.

4. In addition, the DP notes that some argue that recycling of accumulated OCI to profit or loss when equity instruments are sold does not properly reflect the performance in the period of disposal, because the accumulated gain or loss would relate to performance over the entire holding period. While we agree that the profit or loss recognised in the period of disposal may not have predictive value, we are nevertheless convinced that recycling of accumulated OCI to profit or loss when equity instruments are sold is relevant for the following reasons:

   (a) Paragraph 2.7 of the IASB's *Conceptual Framework for Financial Reporting* ("the IASB's *Conceptual Framework*") states that "financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both". Profit or loss recognised on disposal has confirmatory value because it reflects the fact that the equity instrument has been sold. We think that information which reflects the fact that the equity instrument has been sold has more confirmatory value and thus would be more useful than information which merely reflects the fact that the fair value of the equity instrument has changed during the period by holding the equity instrument.

   (b) Because disclosures regarding the amounts which are reclassified from OCI to profit or loss (in accordance with paragraph 92 of IAS 1 *Presentation of Financial Statements*) are provided, users should be able to assess the so-called "quality of earnings" by comparing the total profit or loss amount and the amount that was recycled from accumulated OCI to profit or loss.

Question 2
Q2.1 What are your views on the arguments presented in paragraphs 2.11 - 2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.

5. We think that recycling relating to equity instruments designated as FVOCI should be accompanied by the recognition of impairment losses through profit or loss.

6. We view the accounting for equity instruments carried at FVOCI as a typical example of dual measurement, that is, different measurement bases are selected for the statement of financial position and the statement of profit or loss, as stated in paragraph 6.85 of the IASB's *Conceptual Framework*. Our understanding is that

the measurement basis selected for the statement of financial position would be fair value and the measurement basis selected for the statement of profit or loss would be historical cost.

7. It is established practice to recognise impairment losses through profit or loss when the historical cost of an asset is no longer recoverable, under the assumption that it provides more relevant information. We note that this view is acknowledged in paragraph 6.7(c) of the IASB's *Conceptual Framework*.

Question 4
Q4.1 What should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability…)? Q4.2 Which, if either, of the two models do you prefer? Please explain. Q4.3 Do you have suggestions for a model other than those presented in the DP? If so, please describe it and explain why it would meet characteristics such as relevance, reliability and comparability.

8. We note that IAS 39 *Financial Instruments: Recognition and Measurement,* which required recycling when equity instruments classified as available-for-sale ("AFS") financial assets were impaired, did not specifically prescribe the objective of recognising impairment losses in profit or loss.

9. If impairment losses were to be recognised in profit or loss under IFRS 9 for equity instruments carried at FVOCI, we think the objective of such recognition would be similar to the view presented in paragraph 2.14 of the DP, that is, to reflect the expected overall return from the investment in equity instruments in profit or loss, by recognising the effects of identifiable adverse changes in the issuer's economic conditions.

10. In the light of the objective discussed in the preceding paragraph, we think that the two models discussed in the DP can be analysed as follows:

    (a) The "revaluation model" is unlikely to meet the objective stated in the preceding paragraph because any decline in fair value below the original acquisition cost would be recognised in profit or loss immediately, regardless of whether such decline in fair value has been caused by identifiable adverse changes in the issuer's economic conditions.

(b) The impairment model which requires considering a threshold such as a "significant or prolonged" decline in fair value is more likely to meet the objective stated in the preceding paragraph, although a "significant or prolonged" decline in fair value may not necessarily depict the effects of identifiable adverse changes in the issuer's economic conditions.

11. Regarding the trigger for recognising impairment losses, we think a threshold that would result in providing relevant information to users, in the light of the objective discussed in paragraph 9 of this letter, needs to be determined.

12. Historically, accounting standards in our jurisdiction have set the threshold for recognising impairment losses at a level where it is considered that the uncertainty of incurring losses has been sufficiently reduced, that is, it is irreversible, and have not permitted the reversal of impairment losses.

13. Recognising impairment losses based on this relatively high threshold is more likely to result in meeting the objective discussed in paragraph 9 of this letter. Nevertheless, we acknowledge that some may view that this approach results in recognising impairment losses too late. On the other hand, if a relatively lower threshold were to be used as the trigger for recognising impairment losses, we think the resulting impairment losses may include losses that are not necessarily consistent with the objective discussed in paragraph 9 of this letter.

Question 5
Q5.1 Do you support the inclusion of quantitative impairment triggers in an impairment model? If so, should an IFRS Standard specify the triggers, or should management determine them? Q5.2 If you do not support quantitative impairment triggers, how would you ensure comparability across entities and over time?

14. We acknowledge that there had been practical problems regarding the implementation of the "significant or prolonged" criterion included in IAS 39 for the impairment of equity instruments classified as AFS financial assets. Accordingly,

we agree that improvements are needed if an impairment model based on the “significant or prolonged” criterion were to be re-introduced.

15. We think that introducing a quantitative threshold regarding the significance or the length of the decline in fair value in the IFRS Standard may reduce the burden of entities making judgements and thus may make the impairment model more operational. At the same time, uniform judgements based on a quantitative threshold may not result in a faithful representation because it may prevent entities from reflecting the economic substance of the specific situation.

16. We think that it is important to consider the trade-off between uniformity and flexibility discussed in the preceding paragraph. Specifically, if a quantitative threshold were to be introduced, we think a rebuttable presumption should be introduced to ensure that entities will and can provide financial information that is useful.

Question 6
Q6.1 How should subsequent recoveries in fair values be accounted for? Please explain. Q6.2 If subsequent recoveries in fair values are recognised in profit or loss, which of the approaches in paragraphs 5.2 - 5.10 do you support and why?

17. We think that issues regarding the accounting for subsequent recoveries in fair values should be addressed together with the impairment model.

18. As discussed in paragraph 12 of this letter, if we set the threshold for recognising impairment losses at a level where it is considered that the uncertainty of incurring losses has been sufficiently reduced, we do not think that subsequent recoveries should be recognised.

19. On the other hand, as discussed in paragraph 13 of this letter, if we set the threshold for recognising impairment losses at a relatively lower level, we think the objective of recognising impairment losses becomes less clear and, accordingly, it would be difficult to determine whether and when the reversal of impairment losses should be recognised.