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November 29, 2006

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

Dear Sir/Madam,

Comments on Discussion Paper "Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information"

Accounting Standards Board of Japan (ASBJ) is pleased to comment on the Discussion Paper "Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information" (hereinafter referred to as "the Preliminary Views"). The views expressed in this letter were deliberated in the International Issues Standing Committee and the Technical Committee for the Conceptual Framework of the ASBJ.

First of all, we appreciate IASB having issued this document as a discussion paper rather than an exposure draft, because it would ensure constituents more opportunities for expression of opinions.

The comments below are based on the Series of Discussion Papers "Conceptual Framework of Financial Accounting" issued by the ASBJ, as an outcome of the consideration by the Working Group on Fundamental Concepts of the ASBJ in September 2004 (hereinafter referred to as "the Series of Discussion Papers issued by the ASBJ").

1. Financial performance measured by changes in its resources and the claims on them

OB23 of the Preliminary Views describes about a financial performance, as follows;

> Information about an entity's financial performance during a period measured by changes in

its resources and the claims on them other than claims resulting from transactions with owners as owners, as well as the components of the total change, is critical in assessing the entity's ability to generate net cash inflows.

If this text means that financial performance is measured only by changes in assets and liabilities, we believe that it is questionable for the following reason;

The objective of financial reporting is to provide information to help investors and others to assess the entity's future cash flows (OB3). We can understand that investors and other users estimate future results of the entity, and revise continuously their estimation of future results by comparing the actual results with their ex ante expectation.

Information of assets and liabilities and net assets, which is difference between them, is not sufficient for investors and other users to estimate the future results of the entity. Information of mere changes in assets and liabilities during the period is also insufficient, because such information has no additional value that exceeds that of the balances of assets and liabilities. Therefore, we need prepare the information of the actual results which helps to estimate the future results, by further modifying and aggregating the information of changes in assets and liabilities.

At present, net income and earnings described in FASB's Concept Statement No.5, which are derived from adjustment of timing, are used as the aggregated results as mentioned above and many empirical researches have suggested usefulness of these information for estimating the future results. Abolition of disclosure of net income or earnings that is widely accepted would need evidence that information replacing it is more useful.

As stated above, we believe that the profit information such as net income or earnings is necessary as the actual results to be compared with the ex ante expectation, in achieving the objective of financial reporting.

2. The parent company concept and the economic unit concept

OB10 of the Preliminary Views explains that the Preliminary Views adopts the entity perspective as the basic perspective underlying financial reporting for the following reasons;

- The information provided by general purpose external financial reporting is directed to the needs of a wide range of users rather than only to the needs of a single group.
- Financial reports reflect the perspective of the entity rather than only the perspective of the entity's owners or any other single group of users.
- Information that is primarily directed to the entity's owners or to another group of users is in addition to—not a replacement for—information prepared in accordance with the entity perspective.

This appears to suggest the adoption of the economic unit concept in preparation of consolidated financial statements. However, we believe that the parent company concept should be adopted as a primary view for the following reasons:

- The primary objective of financial reporting is to provide investors and other users with information that is useful in predicting future cash flows so that they can estimate the value of the entity.
- The primary users and beneficiaries of financial information are the present and future owners of the entity who are most interested in the value of the reporting entity.
- Owners of the parent entity have interests in the entire group, whereas minority shareholders have only interests in a particular subsidiary.

In addition, we have a doubt whether the rationales for adoption of the entity perspectives stated in the Preliminary Views can be sufficient reasons for adoption of the economic unit concept in consolidation. The Preliminary Views states that "it (focus on a wide range of users) is more consistent with the objective of providing information that is useful for resource allocation decisions by investors, creditors, and other users than a narrower focus on existing ordinary shareholders would be"(BC1.10) and "the entity perspective is consistent with the focus on a wide range of users" (BC1.11). However, the parent company concept focuses on not only the existing ordinary shareholders but also potential investors. Furthermore, OB12 states "information that meets the needs of investors and creditors is likely to be useful to members of other groups who are interested in an entity's ability to generate net cash inflows" and we believe that the parent company concept is consistent with such a view, whereas it is unclear which groups of users would find the economic unit concept more useful than the parent company concept.

We believe that the information prepared in accordance with the economic unit concept can be added to the information prepared in accordance with the parent company concept, where appropriate.

3. Reliability vs. Faithful presentation

The Preliminary Views would replace the qualitative characteristic of reliability that appears in the boards' existing frameworks with the qualitative characteristic of faithful representation that is the sub-characteristic of reliability. However, it is doubtful whether faithful representation can perfectly replace reliability.

In our understanding, there have been checks and balances between reliability and relevance and determination of desirable trade-off between them has been considered as one of the most important issues in setting accounting standards. Therefore, we have concern about whether the trade-off between relevance and faithful representation would adequately work and faithful representation would function as check on relevance, if reliability would be replaced by faithful representation.

The reason of our concern as above is that faithful representation does not seem to be fully independent from relevance. More specifically, how facts are transformed into accounting data is also considered as an issue of relevance, i.e., the value of accounting information.

4. Faithful presentation and Measurement attributes

QC18 of the Preliminary Views mentions faithful representation in connection with measurement attributes using an example of a stamping machine.

This example of a stamping machine explains that the selection of measurement attributes is an issue for standard-setters to resolve. However, we are concerned that the example seems to imply that current market-based value, such as replacement cost and fair value, is preferable to cost-based measures (depreciated cost).

In addition, when deliberating measurement attributes in later phases of the project, we believe that the IASB and the FASB should take into consideration the effect on profit information which is essential to assess the entity's future cash flows, not focusing only on measurement of individual assets and liabilities.

5. Internal consistency

In BC2.52 to BC2.54, the Preliminary Views discusses internal consistency which is one of qualitative characteristics in the Series of Discussion Papers issued by the ASBJ and concludes that internal consistency is not included in qualitative characteristics. BC2.54 states the following reason;

> To add internal consistency could impede evolution in the body of financial reporting standards to improve the relevance, faithful representation, comparability, or understandability of financial reports on the grounds that adopting new standards would not result in internal consistency.

We believe that the view above in BC2.54 includes misunderstanding, in the light of the following explanation in the Series of Discussion Papers issued by the ASBJ.

> When developing new accounting standards, it is difficult to judge in advance whether accounting information satisfies the qualitative characteristic of relevance and reliability. Therefore, satisfying the qualitative characteristic of relevance and reliability is judged through the judgment whether (individual accounting standards which generates) this accounting information is internally consistent with the current system of accounting standards. However, such inference process functions effectively only when it is agreed that the current system of accounting standards provides useful accounting information. When environmental conditions or paradigm of accounting theories have changed and it is judged that the consensus above is no longer achieved, we cannot infer relevance and reliability by the internal consistency of the current system of accounting standards. Internal consistency is not intended to maintain or continue practices.

We hope our comments will contribute to the discussion in the IASB and the FASB.

Best Regards,

Shizuki Saito
Chairman, Accounting Standards Board of Japan
Chairman, Technical Committee for the Conceptual Framework