Accounting Standards Board of Japan (ASBJ)

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International Accounting Standards Boards
30 Cannon Street
London EC4M 6XH
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Dear Sir or Madame,

Comments on Discussion Paper "Preliminary Views on Financial Statement Presentation"

We appreciate many years of efforts by IASB and FASB on the project on Financial Statement Presentation and welcome the opportunity to comment on the Discussion Paper "Preliminary Views on Financial Statement Presentation" (hereinafter referred to as "the DP"). The views mentioned below are those of the Technical Committee for Financial Statement Presentation, which has been set up in the Accounting Standards Board of Japan (ASBJ) and is composed of the members from preparers, users, auditors, academics and staff of ASBJ.

I. OVERALL COMMENTS

1) Overall direction of the DP

1. We welcome the retention of the presentation of "net income" and the recycling mechanism in the DP. It is evident that the presentation of net income as an overall measure of performance in combination with recycling of income is meaningful to and demanded by many users. It should be maintained for the future unless those needs by users change significantly. In addition, it should be taken into consideration that management of entities also makes use of a measure of net income as information for management control.

2. The proposals by the DP should be considered from the viewpoint of feasibility and of costs and benefits. Results of field tests performed during the comment period should be adequately analyzed and reflected in the development of the standard, taking particular care of the reason for the participating companies failing to meet the proposed requirements, considering the possibility of a selection bias in the field tests. In addition, with regard to the increase of the costs for preparers, the effects of other MOU items which are likely to be implemented around the same time should be taken into consideration.

3. Regarding the cohesiveness, which is positioned as one of the basic objectives of financial

statement presentation in the DP, we do not deny it as far as it helps achieving the objectives of financial reporting. However, each statement has different contents of information to convey (i.e., financial position, performance and cash flows) and accordingly has different roles. What is essential is whether the objectives of financial reporting are best achieved by financial statements. Absolutization of and excessive emphasis on cohesiveness might prevent each statement from best fulfillment of its functions.

2) The proposal to mandate the use of the direct method in preparing the statement of cash flows

4. We disagree with the proposal to mandate the use of the direct method in preparing statement of cash flows, from the viewpoint of the roles of the statement of cash flows and cost and benefits (including timely disclosures). Reconciliation between profit or loss and operating cash flows, which the statement of cash flows using the indirect method provides, is considered to be useful by many users for the purpose of the analysis between profit and cash flows. From that perspective, we also disagree with the proposal to replace the statement of cash flows using the indirect method with the reconciliation schedule between the statement of cash flows using the direct method and the statement of comprehensive income. The choice of the indirect method should be permitted as with the existing rule.

3) Presentation of net income and total comprehensive income attributable to non-controlling interests and owners of the parent

5. The issue of how net income and total comprehensive income attributable to non-controlling interests should be presented in the consolidated statement of comprehensive income is, in our understanding, out of the scope of the DP. However, this issue should be clearly prescribed in the final standard (including illustrative examples), since the requirement of paragraph 83 of the existing IAS 1 (i.e., profit or loss and total comprehensive income for the period attributable to non-controlling interests and owners of the parent should be separately disclosed) is not explicitly reflected in the DP. We consider this issue as an important one that may affect the determination of the appropriateness and feasibility of the proposals of the DP.

6. Presentation of net income attributable to owners of the parent is necessary, because it would correspond to the shares of the parent traded in the market and earnings per share is determined based on profit or loss attributable to owners of the parent[1].

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1 Effects of any transactions with non-controlling interests should be reflected in the numerator of earning per share.

4) Relationship with other projects

7. The proposals of the DP need to assess the relationship with other projects as below. Those issues should be addressed from the viewpoint of achieving the objectives of financial reporting. Absolutization of cohesiveness which is just a means might result in undermining the objectives of financial reporting.

8. According to the DP, postretirement benefit obligation is considered to be an operating liability and all of post-employment benefits expenses would be classified as operating expenses by pursuit of cohesiveness. On the other hand, disaggregation of post-employment benefits expenses is considered in the project on post-employment benefits. Considering such situation, too much pursuit of cohesiveness should be avoided because it might overly restrict the alternative approaches in other projects.

9. IASB's Discussion Paper "Preliminary View on Amendment of IAS 19 *Employees Benefits*" shows several alternatives, including that of presenting all changes in the defined benefit obligation and in the value of plan assets in profit or loss and that of presenting part of actuarial gains or losses in comprehensive income. In our view, the adoption of the recycling mechanism should be considered in the project on post-employment benefits[2], considering the retention of the net income with recycling in the DP on financial statement presentation and the viewpoint of convergence with US GAAP[3].

10. Although we agree with the idea of presenting the net amount of assets and liabilities for the business section and the financing section (see paragraph 15 of this paper), the idea of linked presentation considered in the project on derecognition should be addressed in line with the stance of the financial statement presentation project (presentation consistent with the basic concept of corporate valuation models). In addition, in the project on segment reporting, effects of the proposals of the ED should be fully considered.

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[2] ASBJ' s comment letter on the post-employment benefits DP (dated September 26, 2008) does not support any of the alternative approaches of income statement presentation shown in that DP. We suggested that actuarial gains or losses should be recognized in other comprehensive income and subsequently recycled into profit or loss. The IASB tentatively decided that all changes in plan assets and defined benefit obligations should be presented in profit or loss, but we disagree with that form the above viewpoints.

[3] Furthermore, adoption of the recycling mechanism should be also considered in the remeasurement model for plant, property and equipment (IAS 16) and intangible assets (IAS 38).

II. RESPONCES TO SPECIFIED QUESTIONS IN THE DP

$\boxed{\text{Question 1}}$ Objective of presentation of financial statements

(Doubts about positioning the cohesiveness as an objective)

11. We have doubts about the adequacy of the proposal by the DP to position cohesiveness as one of three objectives of presentation of financial statements, because cohesiveness is just a means for useful presentation and not appropriate as an objective. It is not self-evident that the more cohesiveness is strengthened the better the objectives of financial reporting are achieved. It is necessary to consider how best the objectives of financial reporting can be achieved by presentation of financial position, performance and cash flows in each statement.

12. We do not believe it is appropriate to always prioritize cohesiveness, although we do not deny that there would be aspects where strengthening of cohesiveness can enhance the usefulness of financial reporting. Cohesiveness should be positioned as a means rather than an objective of financial statement presentation. The following points need be reconsidered:
    (a) Since the contents that each statement attempts to report (financial position, performance and cash flows) is not same, alignment at the level of subtotals and line items would not always ensure enhancement of the usefulness.
    (b) Although the design based on the cohesiveness objective would change the contents of each statement, there may be some aspects that are less useful under the revised format. For example, when plant, property and equipment and equity investments (such as investments in associates or business partners) are classified as operating assets in the statement of financial position, acquisition and sales of them would be also classified as operating in the statement of cash flows. This would result in the operating cash flows being mixture of those from the ordinary business activities and those from the long-term strategy. Such consequence would undermine the merit of the statement of cash flows that the relationship between operating results on an accrual basis and those on a cash basis, and therefore it is doubtful that usefulness to users would be enhanced.

13. There may be situations where it is not reasonable that all statements have apparently corresponding subtotals in accordance with paragraph 2.23 of the ED. For example, considering the abovementioned change in the contents of the operating cash flows, for the purpose of facilitating the comparison between expenditures on long-term operating assets (included in the investing cash flows under the existing rule) and recurring cash inflow as its source (included in the operating cash flows under the existing rule), a subtotal within the operating category that represents the total before deducting expenditures on long-term

operating assets may be useful. However, the apparently corresponding subtotal in the statement of financial position would be net operating assets and liabilities less long-term operating assets, which is obviously meaningless for comparison with the operating cash flow before deducting capital expenditure that reflects contributions of long-term assets. We do not believe that it is adequate to deny the presentation of the subtotal in the statement of statement of cash flows merely because the apparently corresponding subtotal in the statement of financial position would be meaningless and misleading.

(Role of the statement of cash flows)

14. We believe that, in the statement of cash flows, emphasis should be placed on the mutually complementary relationship with the statement of comprehensive income. As referred to in paragraph 4.26 of the DP, academic research demonstrates that accrual accounting produces income numbers that are more highly associated with stock returns than are cash flows from operations or the change in cash during the period. This seems to indicate that income figures have a primary role in predicting future cash flows and the statement of cash flows complements them. From such viewpoint, the statement of cash flows is primarily expected to help analysis of profit by providing the reconciliation between profit and cash flows.

Question 2 Separation of business activities from financing activities

15. We regard the idea of separating business activities and financing activities in the three statements as a reasonable clue to designing the basic structure of financial statements. However, the DP does not clearly explain what use of the separated financial data is expected by separation of financing activities (e.g., which key financial ratios are supposed for financial activities).

16. In our view, separation of business activities and financing activities is consistent with the basic concept of corporate valuation models that the value created by business activities is distributed to claimholders comprising financing and equity. And it reflects the difference between business activities directly associated with value-creating activities and financing activities as capital-raising for business.

Question 3 Equity

17. We believe that equity should be presented separately from the financing section so as to distinguish capital-raising activities with owners and financing activities resulted from non-owner transactions. An alternative view that equity should be included in the financial section (paragraph 2.53) is inconsistent with the principle that the statement of comprehensive

income includes only non-owner transactions.

18. Separation of equity from the financing section in the statement of cash flows would be also adequate because it would make clear the repayment of debts and facilitate the calculation of the ratios representing the entity's ability of repayment for debts, such as the debt service coverage ratio (DSCR).

19. According to the proposals of the DP, the financing section of the statement of cash flows would include payment of dividends as well as interests paid (paragraph 2.48). However, we believe that dividends paid should be included in the equity section rather than the financing section because it is economically identical to the repayment to owners through acquisition of treasury stocks, unlike repayment of debts. As mentioned in the response to Question 1, classification should be based on the viewpoint of achieving the objectives of financial reporting and roles of each statement, rather than on mere pursuit of cohesiveness.

Question 4 Discontinued operations

20. As described in paragraph 2.71, users are likely to treat information about the results of discontinued operations differently from the continuing operations because they have different implications for future cash flows, in assessing the amount, timing and uncertainty of future cash flows. We agree that discontinued operations should be presented in a separate section because it is useful to separate discontinued operations from continuing operations

Question 5 Management approach

21. We basically agree with the adoption of a management approach which emphasizes the views of management in separating sections and categories. This would be also useful from the viewpoint of enhancing the communications between management and users. However, some argue that classification in the statement of financial position involves essential difficulty and there may be a significant concern about comparability.

Question 6 Would the proposed change in presentation make it easier to calculate some key financial ratios?

22. Depending on how sections are actually separated, ratios based on inaccurate correspondence could be derived. In addition, some argue that the proposed change could cause inconvenience for the use other than profitability analysis such as safety analysis.

Question 7 Classification at the reportable segment level

23. To classify assets and liabilities (and related changes) at the reportable segment level is consistent with the management approach and better than a uniform classification at the entity level.

Question 8 Consequential amendments to existing segment disclosure requirements

24. To make disclosure of assets by segment too detail should be avoided from the viewpoint of costs and benefits. We believe that disclosure of total assets by segment, as prescribed in the existing rule, is sufficient. However, when financing expenses are included in the measure of segment profit or loss, disclosure of total segment assets and liabilities by sections (business and financing) may be necessary.

Question 9 Definitions of the business section and the operating and investing categories within that section

25. As mentioned in the response to Question 2, we agree with the proposal that the items relating to value-creating activities should be included in the business section and the items relating to capital-raising activities should be included in the financing section.

(Problems with the use of the core/non-core concept)

26. We agree that classifying the business section into the operating category and the investing category is in itself useful, by an understanding that they are classified according to the degree of relationship with value-creating activity. However, we do not support the categorization based on the concept of "core/non-core" or central or not (paragraph 2.64), from the following viewpoints:
    (a) In the early stage of the performance reporting project, the IASB discussed that categorization using the concept of core/non-core was not practical or meaningful.
    (b) The abuse of pro forma income based on the core/non-core concept has been severely criticized and it was one of the starting points of the FASB's project on this subject. We have a concern that the distinction by the core/non-core concept could be abused to exclude unprofitable segments from the operating category so as to manipulate the operating profit.
    (c) The range of the investing category could become too wide by arbitrary interpretations.
    (d) The DP states that the investing category may have line items for revenues, cost of goods sold, advertising, general and administrative expenses, and other expenses (paragraph 2.66). Such presentation in the statement of comprehensive income could reduce clarity of financial statements. It would be enough that such information is provided by segment reporting.

(Our suggestion about the definitions)

27. As an alternative to avoid the abovementioned problem, we suggest the definitions of the operating and investing categories should be established so that the range of the assets and liabilities included in the investing category is restrictive. There will be the following approaches. In either approach, it is envisaged that the investing category under such definition would mainly comprise some of investments in equity or properties.
    (a) Define the operating category as below, after the definition of 'revenue' in the Revenue Recognition project, and the remaining would be included in the investment category;
    "The operating category within the business section should include assets and liabilities that management views as related to manufacturing of goods or rendering of services in the process of ordinary activities of the business."
    (b) Define the investing category in the very restrictive manner such as "strategic investments" and the remaining would be included in the operating category.

(Composition of the statement of cash flows)

28. As mentioned in the response to Question 1, according to the proposal of the DP, acquisitions and sales of plant, property and equipment and some of investments in associates would be included in the operating category in the statement of cash flows. Such presentation would cause a problem that it would not provide a clear comparison between expenditures on long-term operating assets (included in the investing cash flows under the existing rule) and recurring cash inflow as its source (included in the operating cash flows under the existing rule). Considering that many users regard the net operating cash flows before deducting expenditures on long-term operating assets as important, we suggest that a subtotal showing that amount should be presented within the operating category in the statement of cash flows.

Question 10 Definition of financing section

29. We agree that treasury assets should be presented in the financing section, because they are evaluated alongside an entity's debt as a part of 'net debt' and could be used to retire its existing debt immediately, as described in paragraph 2.61. By nature, from the viewpoint of consistency with the management approach, there could be items other than financial instruments to be included in the financing section. However, in actuality, it is considered to be infrequent that assets or liabilities other than financial instruments are managed as part of financing activities. We agree that management should be given flexibility in judgment of which items of financial assets and liabilities should be included in the financing section, provided that they are related to financing activities.

Question 12 **Cash equivalents**

30. We basically agree that cash should be distinguished from short-term investments.

Question 13 **Assets and liabilities that are measured on different bases**

31. We consider that it would be useful to present on separate lines in the statement of financial position assets and liabilities which are similar in form but measured on different bases because of different natures. However, it would be inappropriate to subdivide line items too much. In our understanding, specific application of this proposal under the existing measurement requirements would be limited to the cases such as disaggregation of investments in securities into held-to-maturity, at fair value through profit or loss, available-for-sale and investments accounted for by the equity method. Further disaggregation, such as impaired items within assets measured at cost or classification by the level of input within the financial instruments measured at fair value, should be provided in the notes, not in the statement of financial position.

Question 14 **A single statement of comprehensive income**

32. We believe that choice between the one-statement approach and the two-statement approach should be permitted. Given the recycling of items of other comprehensive income is maintained, the financial statements can be considered a "dual presentation system", which presents both net income and total comprehensive income which have clean surplus relationship with equity. Because net income and total comprehensive income are separately determined in this system, the two-statement approach which clearly distinguishes them should be allowed as an alternative. BC50 of IAS 1 (as revised in 2007) states that most respondents preferred the two-statement approach because it distinguishes profit or loss and total comprehensive income. We believe that this rationale for the two-statement approach is still valid, considering that net income has been maintained in the DP as a result of the deliberation in the Segment B of the project, and therefore the two-statement approach should not be eliminated.

33. In the statement of changes in equity, it should be made clear that the accumulated other comprehensive income and retained earnings should be separately presented as components of equity attributable to the owners of the parent, to clearly indicate the clean surplus relationship with equity.

Question 15 **Other comprehensive income**

34. We agree with the proposal that the category to which items of other comprehensive income (except some foreign currency translation adjustments) should be indicated.

Question 16 **Disaggregation of income and expenses by their nature**

35. The proposed disaggregation in the statement of comprehensive income would be too detail, although we agree that disaggregation of income and expenses by their function and by their nature would generally enhance the usefulness of information. Japanese users say that their primary uses of the information about income and expenses by nature are added-value analysis and break-even analysis. Those needs would be sufficiently satisfied by disclosing the total of major expense items including depreciation and amortization expense and employee benefit expense (as required in paragraph 104 of IAS 1).

36. Disaggregation of cost of goods sold by nature on the consolidated basis would require adjustments of components of manufacturing costs for transactions within the group with regard to offset of transactions and elimination of unrealized profits. Since the existing accounting systems of entities are not generally designed taking the collection of such data into consideration, such requirement could impose significant burdens on preparers, including revision of accounting systems and increases of works of subsidiaries.

Question 17 **Allocation of income taxes**

37. We agree with the DP's conclusion that income taxes should be allocated to the discontinued operations section and the other comprehensive income section, in addition to the income taxes section, and presented within the statement of comprehensive income in accordance with existing requirements, because it would ensure the retention of the presentation of net income as is today.

Question 18 **Foreign currency transaction gains and losses**

38. Strict application of the proposed approach could be significantly burdensome in some cases. We believe that the approach similar to that to basket transactions would be sufficient, rather than pursuing cohesiveness strictly.

Question 19 **A direct method of presenting operating cash flows**

39. We disagree with the proposal of the ED to eliminate the indirect method mandate the direct method of presenting operating cash flows in the statement of cash flows.

（Advantage of the indirect method）

40. As stated in paragraph 3.79, the principal advantage of the indirect method of presenting cash flows is that reconciles profit or loss or net income to net operating cash flows, and many users

have asked for that type of reconciling information and there are users who prefer an indirect method to a direct method. Management of entities also makes use of the statement of cash flows prepared using the indirect method as information for management controls and finds it useful.

41. Information about profit represents a measure of the results of operations by allocating cash flows to relevant periods and the statement of cash flows by the indirect method plays a role of a tool for verifying such allocation process. As mentioned in the response to Question 1, we believe that, in the statement of cash flows, emphasis should be placed on the mutually complementary relationship with the statement of comprehensive income and that the statement of cash flows prepared using the indirect method, which provides the information about reconciliation between profit and cash flows, sufficiently fulfils that objective.

(Doubt about benefits of requiring the direct method)

42. On the other hand, it is not clear the presentation of what items in the direct method are considered to enhance the decision usefulness. If it would be argued that the benefits of requiring the direct method would exceed the costs mentioned below, the specific contents of the benefits should be explained.

Question 20 Costs related to using the direct method

43. If the use of the direct method are mandated, the cost for meeting that requirement would be significant because:
    (a) Preparing the statement of cash flows by the direct method would be highly difficult under the existing systems of bookkeeping and accounting and require a fundamental restructuring of those systems.
    (b) In particular, when an entity having a number of subsidiaries attempts to directly prepare the consolidated statement of cash flows by the direct method, it needs to collect detailed data from subsidiaries and introduce an integrated accounting system or develop an accounting system ready for the preparation of the statement of cash flows using the direct method. Considering the need for offsetting cash flows within the group, initial costs for preparers would be significant and ongoing costs for preparing the information would largely increase.
    (c) Therefore, if the direct method would be mandated, most of entities are expected to use the indirect direct method (determining the amounts of the items of the operating cash flows by adjusting the related revenues and expenses for the change during the period in the amounts of the related asset and liability). Nevertheless it would require remarkable workloads.

(d) If an entity has material overseas subsidiaries, adjustments for the translation difference would be much complicated. When an "indirect direct method" is used, the amount of cash flow would be calculated as follows:

Transaction during the period (translated at the average rate)

+) Opening balance (translated at the opening rate)

--) Closing balance (translated at the closing rate)

This total could significantly differ from the actual total amount of the cash flows translated at the average rate. To derive more precise amounts, exchange differences arising on translation of the financial statements of overseas subsidiaries should be analyzed into line items of assets and liabilities to adjust the total above. Such adjustments for each of many subsidiaries could be troublesome works.

(e) It should be also noted that the more line items are required, the larger the cost for preparation would be. For example, if the proposal to require disaggregation of expenses both by function and by nature is adopted, disaggregation by nature, including materials and labor, would require remarkable workloads for preparers even when it uses the indirect direct method, as mentioned in paragraph 3.82.

44. With respect to the question about how to reduce the costs without reducing the benefits, it is difficult to find an answer because it is unclear the presentation of what items users would find large benefits, as mentioned in paragraph 41 above. It would not be appropriate to mandate the direct method, unless the users' specific needs are persuasively demonstrated and an adequate guidance is established on the method of preparation to reasonably resolve the preparers' concerns about costs.

Question 21 Effects of basket transactions

45. In our view, allocation of profit or loss and cash flows relating to a business combination is unnecessary, because a business combination is acquisition of an entity or a business as a whole. We believe that determination of a category in which a basket transaction should be included should be based on the nature of that transaction itself, rather than linking each asset and liability with a category it relates to.

46. For example, for a business combination in which the fair value of the net asset acquired exceeds the cost of the acquisition (a negative goodwill arises), we do not consider it appropriate to allocate the excess to more than one category. According to IFRS 3, the excess is recognized as a gain because the reason for arising is not identified. Thus, allocating it would be inconsistent with such rationale for the treatment under IFRS 3.

47. Since we believe that it is appropriate to determine the category in which effects of a basket transaction should be included by looking to the nature of that transaction itself, we support the alternative B (present in the category that reflects the activity that was the predominant source of those effects) in principle. However, if the relevant category cannot be clearly identified, we suggest the presentation in the operating category, pursuant to paragraph 2.35.

Question 23 Reconciliation schedule

48. As mentioned in the response to Question 19, we disagree with mandating the use of the direct method and believe that use of the indirect method should be permitted. We do not consider that the proposed reconciling schedule is necessary for companies using an indirect method. In our view, a large part of the needs for the information provided by the proposed reconciliation schedule would be satisfied by the statement of cash flows using the indirect method. And for companies using a direct method, preparation of the proposed reconciliation schedule would be an excessive demand from the viewpoint of costs and benefits and it would be sufficient to disclose major reconciling items pursuant to the indirect method.

49. The proposal of the ED is not clear about which of many figures presented in the reconciling schedule are supposed to be primarily needed by users. If the preparation of the reconciling schedule is to be required, information to be presented should be narrowed down. Furthermore, as mentioned in paragraph 43 of this letter, it is necessary to establish adequate guidance on the method of preparation to reasonably resolve the preparers' concerns about costs.

Question 24 Disaggregation of changes in fair value

50. Needs for further disaggregation of changes in fair value should be fully considered in the project on financial instruments.[4]

Question 25 Alternative reconciling formats

51. We do not believe that consideration of alternative reconciling formats is necessary, because the statement of cash flows using the indirect method is sufficient for analysis of profit and operating cash flows.

Other Elimination of a current or non-current distinction based on operating cycle

52. The DP proposed to require only a one-year distinction and to eliminate a current or non-current

[4] We consider that the situation where there is a need to disaggregate changes in fair value into those attributable to changes in interest rate and others often indicates the problems with measurement at fair value itself.

distinction based on operating cycle in the statement of financial position. However, the reasons that a one-year distinction is simpler and easier to understand (paragraph 3.8) does not seem to be sufficiently persuasive to justify a significant change in the approach to presentation for entities with an operating cycle longer than one year.

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We hope that our comments will contribute to the IASB's future deliberation in this project.

Sincerely yours,

Take Arai

Takehiro Arai
Chairman, the Technical Committee for Financial Statement Presentation
Board Member (full-time), Accounting Standards Board of Japan