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Technical Director
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Financial Accounting Standards Board
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Comment on Invitation to Comment *Disclosure Framework*

We welcome the opportunity to provide our comments on the Invitation to Comment (ITC) *Disclosure Framework*.

We appreciate the efforts of the FASB (the Board) to improve the effectiveness of disclosures in the notes to financial statements. We support the development of a disclosure framework because we share the Board's view that excessive disclosure is burdensome to reporting entities and can overwhelm users or lead them to overlook important information. We believe standard setting based on an appropriate disclosure framework would enhance the users' ability to find and understand relevant information.

Our key comments are summarized below.

Cost-benefit considerations

We agree with the Board's view that this paper would not be complete without the discussion of associated costs. We are concerned that the costs might exceed the benefits if the scope of the notes to financial statements and disclosure requirements are determined merely from a theoretical standpoint. Although disclosure costs are discussed in Chapter 7, we think further discussion from the perspective of the current practices is necessary and the results of such discussion should be reflected thoroughly in the final paper of the disclosure framework.

Scope of the notes to financial statements

In our view, some questions identify pieces of information that are inappropriate for inclusion in the notes to financial statements although such information may contribute to assessing the prospects for future cash flows.

We will describe our views on the scope of the notes to financial statements in our comments to Question 3 in Appendix A and in the matrix in Appendix B. The major differences between the Board's proposal and our view are as follows;

- ✓ Information related to transactions, events and conditions which have not occurred before year end generally would not be included in the notes to financial statements except for nonrecognized subsequent events. (Please refer to Questions O3, O4, O5, O6 and O7)
- ✓ Information which is prepared using alternative methods that are different from those used when recognized on the face of financial statements, such as pro forma information and sensitivity analysis, would be included in the notes to financial statements only when there is virtually no continuity in the reporting entity due to business combinations and the estimate involves a high degree of uncertainty. (Please refer to Questions G2, L5, L8 and L13)
- ✓ In principle, descriptions of the plans or strategies regarding the risk exposure of items would not be included in the notes to financial statements. (Please refer to Questions G3, O3, O5 and O6)

In addition, the auditability of disclosures needs to be considered when developing disclosure requirements because users expect that audited information included in the financial statements is highly reliable.

Approaches to make disclosure requirements flexible

We agree with the view that disclosure requirements should be flexible.

In order to make disclosure requirements flexible, we recommend the Board apply (a) the approach to establish three or more tiers of information items, which is described in paragraph 3.11d, and (b) the approach to change the way in which the Board words its disclosure requirements to be less prescriptive, which is described in paragraph 3.11a. We think the combination of these two approaches would address issues regarding the number of items to be disclosed and the depth of the disclosures.

Interim financial statements

We think that an approach that is different from the approach based on the baseline assessment of annual financial reporting should be developed to meet the objectives of interim financial reporting because we believe the extent of disclosures in interim financial statements should be determined in the light of the objectives of interim financial reporting.

Appendix A contains our responses to the Questions for Respondents and Appendix B illustrates our view regarding the scope of the notes to financial statements.

We hope our comments will contribute to the forthcoming deliberations of the Board.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Ikuo Nishikawa". The signature is fluid and cursive, with the first name "Ikuo" and last name "Nishikawa" clearly distinguishable.

Ikuo Nishikawa

Chairman of the Accounting Standards Board of Japan

Appendix A
Responses to Questions for Respondents

Question 2: Do the decision questions in this chapter and the related indicated disclosures encompass all of the information appropriate for notes to financial statements that is necessary to assess entities' prospects for future cash flows?

We think the decision questions in this chapter and the related indicated disclosures do not include the following disclosures explicitly and thus we suggest the Board add these items.

- a. Nonrecognized subsequent events
- b. Supplemental pro forma information related to business combinations

We explain our rationale for our view in Question 3.

Question 3: Do any of the decision questions or the related indicated disclosures identify information that is not appropriate for notes to financial statements or not necessary to assess entities' prospects for future cash flows?

In our view, some questions identify information that is inappropriate for inclusion in the notes to financial statements, even though they may contribute to assessing the prospects for future cash flows.

We focused on the nature of the items to be included in the notes to financial statements. When developing disclosure requirements, whether the benefits exceed the costs and whether such disclosures can be audited need to be considered. Therefore, it is not our intention to include all items that we analyzed eventually be disclosed and included in the notes to financial statements.

At first, we reviewed the group of questions related to the information about a reporting entity in general. Our findings are summarized below.

- a. Question G2b

It was unclear to us whether the question included supplementary pro forma information related to business combinations. We think the Board should explicitly describe that such supplementary pro forma information would be included in the notes to financial statements because such disclosure is important from the perspective of comparability and usefulness to assess the entities' prospects for future cash flows when there is virtually no continuity in the reporting entity due to business combinations.

- b. Question G2c

We think the description regarding the elimination of intercompany transactions and balances is unuseful to assess the entities' prospects for future cash flows because such disclosure would not

provide incremental information when users are expected to be knowledgeable of U.S. GAAP.

c. Question G3c

We think the description of plans or strategy to deal with any concerns about the shortfall should not be included in the notes to financial statements but rather be reported outside of the financial statements such as risk information or the MD&A. This is because such information may contain descriptions that reflect management biases and thus there is a possibility that such information cannot be represented faithfully nor be verified.

Secondly, we reviewed the group of questions related to the information about line items and other events and conditions that can affect an entity's prospects for future cash flows.

We considered the scope of the notes to financial statements categorizing the information as described in Appendix B. Our thoughts for each category are summarized below.

- Category A

- Category A represents disclosures with regard to the items which are related to the transactions, events or conditions that occurred before year end and are recognized on the face of financial statements and are measured by not using estimates¹.
- For items in Category A, quantitative and qualitative information should be included in the notes to financial statements. Quantitative information should contain disaggregated information such as the breakdown of the item, maturity analysis, a reconciliation of the carrying amount from the beginning to the end of the period, and segment information. Qualitative information should contain explanatory descriptions related to facts², explanations of factors and circumstances that might affect the quality and nature of items.
- In principle, the description of the plans or strategies regarding the risk exposure of the items would be inappropriate for inclusion in the notes to financial statements. This is because such information may contain descriptions that reflect management biases and thus there is a possibility that such information cannot be represented faithfully nor be verified. For example, some may describe an overly optimistic plan whereas others may describe an overly pessimistic plan. Such information should be reported outside of the financial statements such as risk information or the MD&A.
- Information which is prepared using alternative methods that are different from those used when recognized on the face of financial statements, such as sensitivity analysis and pro forma information, generally should not be included in the notes to financial statements.

¹ In this comment letter, the term 'estimates' include fair value estimates.

² Including a description of the nature of the item, a description of what the numerical description represents, explanation of significant facts about the quality and nature of the item and the process used to determine the numerical depiction.

This is because, in many cases, explanatory descriptions related to facts provide sufficient information.

- Category B
 - Category B represents disclosures with regard to items which are related to the transactions, events or conditions that occurred before year end and are recognized on the face of financial statements and are measured by using estimates.
 - For items with high uncertainty in the estimates and belonging to Category B, information which is prepared using alternative methods that are different from those used when recognized on the face of financial statements, such as sensitivity analysis and pro forma information, generally should be included in the notes to financial statements. This is due to the concerns that explanatory descriptions related to facts cannot provide sufficient information to assess the entities' prospects for future cash flows when there is high uncertainty in the estimates.
 - The scope of the notes to financial statements would be the same as category A except for the information described above.
- Category C
 - Category C represents disclosures with regard to the items which are related to the transactions, events or conditions that occurred before year end but are not recognized on the face of financial statements. An example in this category is contingencies which exist at year end but are not recognized on the face of the financial statements.
 - With regards to the items in Category C, the scope of the notes to financial statements would be the same as Category A. However, the volume and depths of the disclosures required are usually less than those required for the items in Category A. For example, quantitative information may only contain the breakdown of the item and further disclosures may not be required.
- Category D
 - Category D represents disclosures with regard to nonrecognized subsequent events which are related to the transactions, events or conditions which have not occurred before year end and are not recognized on the face of financial statements.
 - With regards to the items in Category D, quantitative and qualitative information should be included in the notes to financial statements. However, qualitative information would be limited to explanatory descriptions related to facts. Explanations of factors and circumstances that might affect the quality and nature of the items would not be included.
 - We think that only the information related to the financial position at year end and the financial performance for the years presented generally should be included in the financial statements. However, nonrecognized subsequent events are included in the notes to

financial statements as an exception. This is because disclosing nonrecognized subsequent events in advance to next fiscal year's financial statements is expected to contribute to assessing the entities' prospects for future cash flows. To achieve this purpose, disclosing only the quantitative information and information regarding explanatory descriptions related to facts should be sufficient.

- Category E
 - Category E represents disclosures with regard to the items other than nonrecognized subsequent events which are related to the transactions, events or conditions which have not occurred before year end and are not recognized on the face of financial statements.
 - Items in this category include the risks which do not exist at year end but may exist in the future.
 - Items in this category generally should not be included in the notes to financial statements but should be reported outside of the financial statements such as risk information or the MD&A. This is because such information is unrelated to the financial position at year end and the financial performance for the years presented and there is a possibility that such information cannot be represented faithfully and be verified.

Based on the analysis explained above, we think the following questions contain those that are inappropriate for inclusion in the notes to financial statements:

a. Questions L5bcd and L6bcd

These decision questions require disclosing the information such as the indication of how changes in factors would affect the prospects for future cash flows arising from the line item, a general description of the policies, practices, and strategies that could mitigate the effect of the changes in conditions or factors. We think such information should be provided only when there is high uncertainty in the estimation.

Additional information regarding the line items in Category B under our classification, which involve high uncertainty in the estimates, should be included in the notes to financial statements in order to provide supplemental information to faithfully represent the underlying uncertainty.

On the other hand, we think additional information regarding the line items in Category A such as revenue are inappropriate for inclusion in the notes to financial statements because it is expected that the explanatory descriptions related to facts provide sufficient information.

b. Question L8

We think this decision question is inappropriate for inclusion in the notes to financial statements. Under our classification, this item is classified as information which is prepared using alternative methods that are different from those used when recognized on the face of financial statements in

Category A.

The carrying amount of a depreciated asset may differ from the value of the asset when the market value of the asset changes or the value in use of the asset changes.

For business investments, the change in the market value of the asset has no meaning except when recognizing an impairment loss.

Disclosing the value in use for productive assets or intellectual properties may lead to disclosing the value of internally generated goodwill related to the asset group. It is the users who are responsible for evaluating the value of the company. We are concerned that, if such disclosures are provided by preparers, they may mislead users and impair neutrality.

c. Question L13c

We think the pro forma effects on the current-year financial statements are inappropriate for inclusion in the notes to financial statements.

Under our classification, this item would be classified as information which is prepared using alternative methods that are different from those used when recognized on the face of financial statements in Category A or B. In our view, such information in Category A is inappropriate for inclusion in the notes to financial statements. Even though the new accounting standards may include accounting estimates and the information is classified in Category B, it is unnecessary to include the information in the notes to financial statements because it does not provide additional information regarding the uncertainty in estimates.

In addition, we are concerned that the disclosure requirements may cause burdens for preparers such as the discussion about the method of the calculations, gathering related information, and designing the process for such calculation.

d. Questions O3bc, O4, O5, O6 and O7

Under our classification, these decision questions would be classified in category E. We think they are inappropriate for inclusion in the notes to financial statements because such information does not relate to the financial position at year end and the financial performance for the years presented and there is a possibility that such information cannot be represented faithfully and be verified.

Question 4: Would these decision questions be better applied by reporting entities instead of the Board? In other words, should the Board change its practice of establishing detailed requirements in each project and, instead, establish a single overall requirement similar to the questions in this chapter?

We think it is appropriate that the Board applies the decision questions as the basis for the development of disclosure requirements and the reporting entities prepare the notes to financial statements in accordance with the requirements. This is due to concerns regarding the burdens on reporting entities to disclose relevant information when applying those questions. In addition, we

are concerned about the diversity in practice because those questions are not detailed enough.

Question 5: Do you think that this decision process would be successful in helping the Board to set more effective disclosure requirements? If not, what would be a better approach?

We agree that the decision process would be successful in helping to set more effective disclosure requirements. However, we think some elements such as stewardship, faithful representation and verifiability are not necessarily taken into account because relevance to assessing the prospects for future cash flows is the main focus in the ITC. We recommend that these elements be considered. In addition, sufficient considerations regarding the cost-benefit analysis and auditability are critical.

Question 6: Would any of the possibilities in this chapter (see paragraphs 3.8 and 3.11) be a practical and effective way to establish flexible disclosure requirements?

Question 7: If more than one approach would be practical and effective, which would work best?

Question 8: Are there other possibilities that would work better than any of the ones discussed in this chapter?

(General comments on Questions 6 through 8)

One view is that standard-setters do not need to set disclosure requirements because management has the incentive to voluntarily disclose internal information in order to minimize its capital costs. Users are likely to evaluate the company conservatively when management has information but does not disclose them. In order to avoid such situation, it is expected that management would voluntarily disclose such information without any disclosure requirement and that capital markets function efficiently.

However, in reality, management has the tendency not to disclose negative information sufficiently and it would be necessary to set mandatory disclosure requirements.

Considering these factors, the extent of disclosure would depend on the view on how much information should be disclosed mandatorily, and that view is likely to change over time.

Furthermore, this view may depend on how stringent capital markets are regulated in each jurisdiction. In some jurisdictions, discussions with regulators may be necessary in addition to the discussions among preparers, users and standard-setters although it may not apply to the circumstance in the U.S.

(Specific comment on Question 7)

We recommend combining the approaches described in paragraphs 3.11a and 3.11d.

Currently, we face two types of issues. One issue relates to the number of items to be disclosed. Another issue is that the disclosure requirements are too detailed. We think the issue related to the numbers of items could be addressed using the approach described in paragraph 3.11d. The other

issue could be addressed using the approach described in paragraph 3.11a.

The approach to establish three or more tiers of information items, which is described in paragraph 3.11d, would be practicable and easily accepted by reporting entities. Using this approach would enable reporting entities to find that disclosure requirements are consistent with their circumstances and may result in the reduction of the volume of the notes to financial statements.

Sometimes we find that accounting standards require too much disaggregated information, beyond the needs of management. In order to address this issue, the approach to change the way in which it words disclosures to be less prescriptive, which is described in paragraph 3.11a, would work and, accordingly, we can expect efficient and effective disclosures.

We think the combination of the approaches described in paragraphs 3.11a and 3.11d do not contradict with each other and would be the most effective way to resolve the issues we are currently facing.

Question 9: This chapter attempts to provide a benchmark for judgments about disclosure relevance by clarifying the objective for the judgments. Is the description of the approach clear enough to be understandable? If not, what points are unclear?

We think that from a conceptual standpoint, the description of the approach is understandable.

However, the difficulty we may face in the approach is that reporting entities judge relevance from the perspective of sophisticated users. It may not be easy for reporting entities to judge whether a note to financial statements would be expected to change users' assessment of prospects for future cash flows by a material amount when the assumed users in this chapter are highly sophisticated. Therefore, we think additional guidance is necessary to make the approach more practicable. We recommend the Board develop the guidance based on outreach activities researching how users are developing the baseline assessment and which kind of information can be incremental to that baseline assessment.

In addition, as the Board is aware, influences by auditors and regulators are important elements to consider. We think it is critical to undertake initiatives to obtain mutual consensuses from auditors and regulators with regards to the proposed approach.

Question 10: Can this approach (or any approach that involves describing the objective for the judgments) help identify relevant disclosures? If so, what can be done to improve it? If not, is there a better alternative? What obstacles do you see, if any, to the approach described?

We agree that the proposed approach can help identify relevant disclosures. We think the approach based on the baseline assessment can improve current practice in which reporting entities are judging relevance without a specific benchmark and it might result in diversities among the notes to financial statements, even in the annual report.

We expect more appropriate disclosures by combining the approach bases on the baseline assessment and other elements such as cost-benefit considerations and reliability of information.

Question 12: Would any of the suggestions for format improve the effectiveness of disclosures in notes? If so, which ones? If not, why not?

We emphasize the importance of tables and cross references to improve the effectiveness of disclosures.

Historically, disclosures using uniform tables have been frequently used under Japanese GAAP and such disclosures are considered to be highly useful by users.

Although cross references are currently used, the extent of cross references should be expanded.

This is due to the concern that users may miss the related information when it is disclosed in other notes.

Question 14: Do any of the suggested methods of organizing notes to financial statements improve the effectiveness of disclosure?

We disagree with ordering grouped information according to their relevance to users.

Ordering of items relying on the managements' view of relevance may result in focusing too heavily on the items which management wants to emphasize and, therefore, may mislead users. In addition, disclosures in such orders may make it difficult for users to find the relevant information when users compare companies because as the information would be disclosed in different orders for each entity.

Question 15: Are there different ways in which information should be organized in notes to financial statements?

One idea to improve the organization of notes to financial statements is to include accounting policies and related disclosures in the same note.

Because entities are encouraged to provide their accounting policies should be described in the first note, most reporting entities describe their accounting policies first and then go on to provide notes about the assets and liabilities in the order the items are presented on the balance sheet. As a result, accounting policies and related disclosures are described in different notes and, therefore, makes it difficult for users to understand the relationships between the notes. Furthermore, reporting entities are sometimes required to split the information between accounting policies and other notes to financial statements.

We expect that including accounting policies and related disclosures in the same note would enhance the understandability of financial statements from the users' point of view.

Question 16: Do you think that any of the possibilities in this chapter would improve the effectiveness of disclosures for interim financial statements?

Question 17: If you think that a framework for the **Board's** use in deciding on disclosure requirements for interim financial statements would improve the effectiveness of interim reporting, what factors should the Board consider when setting disclosure requirements for interim financial statements?

Question 18: If you think that a framework for **reporting entities'** use in deciding on disclosures for interim financial statements would improve the effectiveness of interim reporting, what factors should reporting entities consider when providing disclosures for interim financial statements?

Question 19: What impediments do you see regarding the development of a framework for the Board, reporting entities, or both that addresses disclosures for interim financial statements?

(Comment on Questions 16 through 19)

We think that an approach that is different from the approach based on the baseline assessment for annual financial reporting should be developed to meet the objectives of interim financial reporting because we believe the extent of disclosures in the interim financial statements should be determined in the light of the objectives of interim financial reporting.

Although the baseline assessment for interim financial reporting would be based on previous annual financial statements and notes, adjusted for consideration of condensed interim financial statements, such adjusted baseline assessment may not always meet the objectives of interim financial reporting. For example, if the objectives of interim financial reporting focused on timeliness, the approach based on the adjusted baseline assessment may result in excessive disclosures where the costs exceed the benefits. In addition, it may be difficult for reporting entities to prepare and publish interim financial statements in a timely manner.

Question 20: Would the change to the requirements described in paragraph 7.8 for disclosure of the summary of accounting policies improve the effectiveness of disclosure?

We agree with the change to the requirements described in paragraph 7.8.

When users are expected to be knowledgeable of accounting standards and related reporting requirements, we think the summary of accounting policies in current practice includes unnecessary descriptions.

We expect that this change would not only result in the reduction of the volume of the notes to financial statements, but also improve understandability. We also recommend the Board include accounting policies and related disclosures in the same note as we have discussed earlier in our comments to Question 15.

Question 21: Should the summary of accounting policies include information about industry-specific accounting policies?

We think the summary of accounting policies should include information about industry-specific accounting policies.

It would be difficult to assume that users have sufficient knowledge about industry-specific accounting policies even when it is assumed that users are expected to be knowledgeable of accounting standards and related reporting requirements.

Question 22: Are there other required disclosures that could be modified or eliminated in the short term that would result in a significant reduction in the volume of notes to financial statements?

We do not find any disclosures that could be modified or eliminated in the short term that would result in a significant reduction in the volume of the notes to financial statements.

We suggest the Board focus on the development of the disclosure framework in the near future.

We expect setting disclosure requirements based on the appropriate disclosure framework would eventually lead to the reduction in the volume of the notes to financial statements.

Appendix B Scope of the notes to financial statements

			Transactions, events and conditions that occurred before year end (including related estimates)		Transactions, events and conditions that have not occurred before year end				
			Recognized on the face of financial statements		Not recognized on the face of financial statements				
			Items measured by not using estimates *6	Items measured by using estimates *6	Unrecognized items	Nonrecognized subsequent events	Other than nonrecognized subsequent events		
Category			A	B	C	D	E		
Factual information	Quantitative information	Numerical depiction *1	○	○	○	○	×		
	Qualitative information	Explanatory description related to fact *2	○	○	○	○	×		
		Explanation of factors and circumstances that might affect the items' quality and nature *3	○	○	○	×	×		
		Description of the plans or strategies regarding the risk exposure of the item	×	×	×	×	×		
Information which is prepared using alternative methods that are different from those used when recognized on the face of financial statements	Quantitative information	Numerical depiction *4	×	○	×	×	×		
	Qualitative information	Related explanatory description *5	×	○	×	×	×		

- Generally included in notes to financial statements
 × Generally not included in notes to financial statements

- *1 Including disaggregated information such as the breakdown of the item, maturity analysis, a reconciliation of the carrying amount from the beginning to the end of the period, segment information.
 *2 Including a description of the nature of the item, a description of what the numerical description represents, explanation of significant facts about the quality and nature of the item, the process used to determine the numerical depiction.
 *3 Including a description of risk exposure, measurement uncertainty.
 *4 Including the amounts calculated using pro forma calculation, sensitivity analysis.
 *5 Including an explanation of input and models used.
 *6 The term 'estimates' include fair value estimates.