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17 January 2014

International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
United Kingdom

Dear Sir or Madam,

Comments on the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*

The Accounting Standards Board of Japan (the "ASBJ" or we) appreciates the intensive efforts made by the International Accounting Standards Board (IASB) in relation to the Conceptual Framework project and welcomes the IASB's decision to expose the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (hereinafter referred to as the "DP") to solicit public comments from a wide range of constituents.

Overall comments

1. We welcome the IASB's decision to review the *Conceptual Framework for Financial Reporting* (hereinafter referred to as the "*Conceptual Framework*") in response to the feedback received from respondents regarding the Request for Views *Agenda Consultation 2011*. The *Conceptual Framework* identifies concepts that are to be applied consistently when newly developing and revising accounting standards and a robust conceptual framework is necessary to ensure consistency within IFRSs. Accordingly, we support the IASB's decision to undertake the Conceptual Framework project with high priority.

2. In addition, considering that the existing *Conceptual Framework* does not fully address some important areas, such as measurement and the concept of performance, we appreciate the IASB's decision to focus on these areas in the Conceptual Framework project based on the feedback received from constituents.

3. However, we believe that there are a number of areas where the discussion in the DP should be improved. For the IASB's preliminary views stated in Sections 6 and 8 of the DP, we believe that the major points that need improvement are as follows:
   (a) We believe that the measurement basis that is relevant from the perspective of reporting the entity's financial position should be appropriately discerned from the measurement basis that

is relevant from the perspective of reporting the entity's financial performance. In this respect, we propose extending the discussion stated in the measurement section of the DP. (Please refer to paragraphs 77-95 of this comment letter.)

(b) We believe that the term "profit or loss" should be defined as an element of financial statements that is directly derived from the objective of financial reporting. We attempt to define profit or loss, by proposing that profit or loss is the change in net assets during a period using measurement bases that are relevant from the perspective of reporting an entity's financial performance. We also propose that profit or loss represents an all-inclusive measure of irreversible outcomes of an entity's business activities in a certain period. We believe that the amount once presented in other comprehensive income (OCI) should be subsequently recycled with no exceptions. (Please refer to paragraphs 134-169 of this comment letter.)

4. Our responses to the questions in Sections 6 and 8 of the DP are based on our paper *Profit or Loss/OCI and Measurement* that was discussed at the December 2013 ASAF meeting. This paper explained our view on profit or loss/ OCI, their relationships with measurement and the applications of these concepts to specific examples. We recommend the IASB to refer to this paper for a better understanding of this comment letter.

5. For the IASB's preliminary views stated in Sections other than Sections 6 and 8 of the DP, we believe that the major points that need improvement are as follows:

Section 4

(a) We disagree with the IASB's preliminary view stated in paragraph 4.24 of the DP that, in principle, an entity should recognise all of its assets and liabilities, because, in principle, we believe that the recognition criteria should include the probability criterion. (Please refer to paragraphs 45-50 of this comment letter.)

Section 5

(b) Unlike the IASB's preliminary views stated in the DP, we recommend that a mezzanine section be provided between liabilities and equity in order to improve the presentation of the claims against the entity in the statement of financial position. (Please refer to paragraphs 60-68 of this comment letter.) In addition, we do not support the IASB's preliminary view that measure of each class of equity claim should be updated at the end of each reporting period. (Please refer to paragraphs 69- 72 of this comment letter.)

Section 7

(c) In our understanding, disclosure requirements under existing IFRSs have not been developed based on a consistent policy and, accordingly, some standards require disclosure of information that is not necessarily relevant. We think that the revised *Conceptual Framework* should specify the situations when disclosure requirements would be provided. Based on such discussion, we think that the existing disclosure requirements should be revisited together with the outcomes of the Disclosure Initiative. (Please refer to paragraphs 100-128 of this comment letter.)

Section 9

(d) We are of the view that the unit of account is extremely important for the development of accounting standards. Accordingly, even when the IASB decides not to fully deliberate this issue in this revision of the *Conceptual Framework*, we encourage the IASB to separately consider this issue at the conceptual level. (Please refer to paragraphs 185 and 186 of this comment letter.)

6. In addition, we would like to stress that the review of the *Conceptual Framework* should not be used to justify existing IFRSs or recent deliberations by the IASB, because otherwise it would be difficult for the IASB to provide a sound basis for newly developing and revising accounting standards in order to address a broad range of financial reporting issues.

7. Our comments on specific questions in the DP are provided under the heading “Responses to the specific questions in the DP.” Further, in addition to our normal deliberation process, we solicited public comments from constituents in Japan, taking into account the significance of the discussions in the DP on global financial reporting. The purpose of this procedure was to identify at an early stage the aspects of the discussions on which we need to ask for improvements from the Japanese point of view. Accordingly, this comment letter has been prepared considering the responses received from this procedure and includes the views of a wide range of constituents in Japan. We also have attached an Appendix A to describe the major views that are not necessarily consistent with the views of the ASBJ but those we believe would be useful for the IASB to consider in its future deliberations.

<u>Responses to the specific questions in the DP</u>

Our responses to the specific questions in the DP are provided below.

Section 1 - Introduction

Question 1
Paragraphs 1.25–1.33 set out the proposed purpose and status of the *Conceptual Framework*. The IASB's preliminary views are that: (a) the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and (b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the *Conceptual Framework*. If this happens the IASB would describe the departure from the *Conceptual Framework*, and the reasons for that departure, in the Basis for Conclusions on that Standard. Do you agree with these preliminary views? Why or why not?

8. We basically agree with the IASB's preliminary views. This is because the role of the *Conceptual Framework* to identify the concepts that the IASB will use consistently when newly developing and revising IFRSs is more important than any other role. Moreover, by identifying departures from the *Conceptual Framework*, it is expected that such departures would be limited, which would result in standard setting that is more consistent with the *Conceptual Framework*.

9. Paragraph 1.33 of the DP states that the IASB will review the *Conceptual Framework* from time to time in the light of the IASB's experience of working with it. We recommend that the IASB retain this statement. We think that the *Conceptual Framework* is a living document that may change in the long-term through interactive feedback from the standard-setting process.

10. Notwithstanding the above, we think that the following three points need to be improved or reconsidered:

<u>The IASB' preliminary view (a) stated in Question 1</u>

We think that the *Conceptual Framework* not only assists the IASB but also parties other than the IASB who contribute to the process of newly developing and revising accounting standards. Accordingly, the phrase "to assist the IASB" should be replaced with "to assist the IASB and those who contribute to newly developing and revising IFRSs."

<u>The IASB's preliminary view (b) stated in Question 1</u>

It is unclear as to what qualifies as a "departure." Situations where individual standards may be in conflict with certain aspects of the *Conceptual Framework* include, for example, when a change to accounting standards better reflects the economics of the transaction and thus achieves the overall objective of the financial reporting, when cost-benefit considerations are needed, or when the existing *Conceptual Framework* does not reflect the current thinking of the IASB. It is unclear as to whether all of these circumstances would be viewed as departures, and accordingly, we think clarification is needed. Moreover, in relation to paragraph 9 of this comment letter, the *Conceptual Framework* should clearly state that departures may, in some cases, trigger changes in the IASB's thinking and ultimately result in revisions of the *Conceptual Framework* itself.

Other comments

We think that the role of the *Conceptual Framework* to assist parties other than the IASB as described in paragraphs 1.27(b) and 1.28(b) of the DP should be reconsidered. These paragraphs state that the *Conceptual Framework* is useful for developing accounting policies when no accounting standard specifically applies to a particular transaction or event (Paragraph 1.27(b) refers to the existing requirement in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). However, it is unclear as to whether this role continues to be necessary even when existing IFRSs cover a wide range of transactions and events, unlike the days when the *Conceptual Framework* was originally published in 1989. Accordingly, the IASB should consider whether the revised *Conceptual Framework* should clearly state this supplementary role.

Section 2 - Elements of financial statements

Question 2
The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions: (a) an asset is a present economic resource controlled by the entity as a result of past events. (b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events. (c) an economic resource is a right, or other source of value, that is capable of producing economic benefits. Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

11. For the definitions of assets and liabilities, we agree with the general direction in the DP that the existing definitions should be further clarified. However, we disagree with the preliminary view in the DP that equity should be defined as the residual in the assets of the entity after deducting all its liabilities. As described later in our comments to Question 10, we propose that equity be classified as the most residual claim (that is, usually the common stock of the parent entity). (For further details, please refer to our comments to Questions 10.)

12. Our views on the definitions of assets and liabilities proposed in the DP are as follows.

Past events

13. In the IASB's discussions that led to the issuance of the DP, many constituents were concerned with removing the reference to "past events" in the definitions of assets and liabilities because it may mean something different from the existing definitions. Based on such concerns, we agree with retaining the phrase "as a result of past events" in the definitions.

Economic resources

14. Paragraph 3.7 of the DP states that the guidance would clarify that, for a physical object, such as an item of property, plant and equipment, the economic resource is not the underlying object but a right (or a set of rights) to obtain the economic benefits generated by the physical object. However, we are concerned with describing this notion in the *Conceptual Framework* without sufficiently addressing the unit of account issue.

15. We are of the view that the unit of account is extremely important for the development of accounting standards. (Please refer to our comment to Question 24.) Unless the notion of unit of account is explicitly explained in the *Conceptual Framework*, it would be difficult to consistently explain, for a single asset comprising several rights, whether a single asset should be recognised as

a whole or some of those rights should be recognised separately.

Question 3
Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that: (a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources. (b) the *Conceptual Framework* should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability. (c) the recognition criteria should not retain the existing reference to probability. Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

The IASB's preliminary view (a) stated in Question 3

16. As described later in our comments to Questions 3(c) and 8, in principle, we believe that the recognition criteria should include the probability criterion. Nevertheless, we do not think that a probability criterion is necessary in the definitions.

17. As stated in paragraph 2.18 of the DP, it is not necessarily clear whether the term "expected" in the existing definitions is intended to convey a requirement that the probability of an inflow or outflow of economic benefits must meet some minimum threshold.

18. Accordingly, for the purpose of clarifying that the definitions do not include a probability criterion, we agree with the preliminary view in the DP that the definitions of assets and liabilities should not retain the notion that an inflow or outflow is "expected."

The IASB's preliminary view (b) stated in Question 3

19. Regarding existence uncertainty, we think there are some cases where it would be difficult to discern existence uncertainty from outcome uncertainty. For example, for certain litigations, the fact that the probability for which economic benefits would flow from the entity is very low may be due to the fact that there is high existence uncertainty regarding the cause of the litigation.

20. Accordingly, we think that it is not necessary to set a probability criterion for existence uncertainty separately from outcome uncertainty. We think this issue should be addressed by setting a

probability criterion in the recognition criteria in the *Conceptual Framework* and providing specific guidance in individual standards.

<u>The IASB's preliminary view (c) stated in Question 3</u>

21. As described later in our comment to Question 8, we disagree with the IASB's preliminary view because ,in principle, we believe that the recognition criteria should include the probability criterion. (For further details, please refer to our comments to Question 8.)

Question 4
Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52. Do you have any comments on these items? Would it be helpful for the *Conceptual Framework* to identify them as elements of financial statements?

<u>Determination of elements</u>

22. We disagree with the IASB's preliminary view stated in the DP regarding the elements for the statement of financial position and the statement of profit or loss and OCI. We think that "assets," "liabilities," "equity," "profit or loss," "comprehensive income" and "OCI" should all be treated as elements of financial statements[1]. We think that the elements of financial statements should be determined in light of the objective of financial reporting. In particular, we think that the following paragraphs in the *Conceptual Framework* should be considered when determining the elements of financial statements:

    (a) General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity. (Paragraph OB12)

    (b) Changes in a reporting entity's economic resources and claims result from that entity's financial performance and from other events or transactions such as issuing debt or equity instruments. (Paragraph OB15)

    (c) Information about a reporting entity's financial performance helps users to understand the return that the entity has produced on its economic resources. (Paragraph OB16)

23. In addition to the elements of financial statements that are determined directly in light of the

[1] We think that income and expense may not necessarily need to be treated as elements of financial statements if "profit or loss," "comprehensive income" and "OCI" are elements and presented in the financial statements.

objective of financial reporting, we think other elements of financial statements should be determined by considering the interrelation between the elements of financial statements (hereinafter referred to as "articulation").

24. First, we think that "assets," "liabilities," "equity" and "profit or loss" should be treated as elements of financial statements that are derived directly from the objective of financial reporting. We think that the totals of assets, liabilities and equity provide the most relevant information from the perspective of reporting an entity's *financial position* and thus should be treated as elements of financial statements. In addition, we think that profit or loss provides the most relevant information to report an entity's *financial performance*[2].

25. Second, we think that "comprehensive income" and "OCI" should be treated as elements of financial statements in order to represent the interrelation between the elements of financial statements[3]. When equity is treated as an element of financial statements, comprehensive income also needs to be treated as an element of financial statements due to articulation[4]. OCI also needs to be defined as an element of financial statements due to articulation when profit or loss and comprehensive income are treated as elements of financial statements[5].

<u>Elements for the statements of changes in equity</u>

26. Paragraph 2.52 of the DP states that the following items would be defined as elements for the statement of changes in equity. However, from the perspective of presenting the interrelation between the elements of financial statements, we do not think that the following terms should be treated as an element.
    i. Contribution to equity;
    ii. Distribution of equity; and
    iii. Transfers between classes of equity.

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[2] The reason why profit or loss provides more relevant information than comprehensive income is described in our comment to Question 19 (paragraph 151) of this comment letter.

[3] Further, as described later in our comments to Question 10, we think that the IASB should consider a three-category approach which provides a mezzanine category between liabilities and equity. Under this approach, this mezzanine would also be treated as an element.

[4] Investments by and distributions to owners also should be treated as elements of financial statements. The interrelation between the elements of financial statements can be illustrated as follows:

Equity at beginning of the period + Comprehensive income + Investments by and distributions to owners = Equity at end of the period.

[5] The interrelation between the elements of financial statements can be illustrated as follows:

Comprehensive income – Profit or loss = OCI

Section 3 - Additional guidance to support the asset and liability definitions

Question 5
Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50. Do you agree with this preliminary view? Why or why not?

Encompassing constructive obligations in the definition of liabilities

27. The IASB has a preliminary view that it will retain both legal and constructive obligations in the definition of liabilities and to add more guidance to help distinguish constructive obligations from economic compulsion. We agree with this preliminary view, as far as, in principle, the recognition criteria encompass the probability criterion. (Please refer to our comments on Questions 3 (c) and 8 in the DP.) Limiting liabilities to legal obligations and enforceable obligations may result in concluding that an item is not a liability even if an entity has little discretion to avoid the outflow of economic resources to others. Such a conclusion result would not provide users with useful information to assess the prospects for future net cash inflows to the entity.

Relationship between constructive obligations and "present" obligations

28. We are concerned that the DP is unclear as to when a constructive obligation becomes a "present" obligation that meets the definition of a liability.

29. Paragraphs 3.72 to 3.97 of the DP discuss three views regarding when a 'present' obligation arises using seven scenarios as examples. We note that every scenario in the DP addresses conditional legal obligations (that is, obligations arising from laws and regulations or contracts).

30. However, we think there may be cases where an entity has conditional constructive obligations. For example, even though an entity does not have a contractual obligation, it may have a constructive obligation to pay bonuses to its employees if those employees meet a certain condition (for example, five years' services). Until the condition of five years' service is met, the entity's obligation is conditional.

31. Accordingly, we think the revised *Conceptual Framework* should clarify that the discussion on "present" obligations in the DP would have similar implications for constructive obligations as well as legal obligations.

Question 6
The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the *Conceptual Framework* are put forward: (a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions. (b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions. (c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions. The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3. Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

View 1

32. We support the IASB's preliminary view to reject View 1. This view would have some advantages from the viewpoint of enhancing comparability. However, we are concerned that View 1 may fail to faithfully represent the economics of an event or transaction by excluding all conditional obligations from the scope of present obligations. In addition, under View 1, an entity may have too much discretion to manage the timing of recognising a liability by refraining from meeting a minor requirement in a contract.

View 3

33. View 3 focuses only on the occurrence of past events (that is, whether the amount of the liability will be determined by reference to benefits received, or activities conducted, by the end of the reporting period) for determining whether there is a "present" obligation (see paragraph 3.66 of the DP.) Under View 3, we are concerned that the scope of liabilities may be extended to any items

for which an entity has discretion to avoid by its future activities. Moreover, we are concerned that the accounting outcome may become highly subjective.

<u>View 2</u>

34. Based on the above discussions, we think that, if the IASB were to specifically choose from one of the three views in the DP for inclusion in the revised *Conceptual Framework*, View 2 would be the most reasonable candidate. For the purpose of faithfully representing the substance of the economic event or transaction, a "present" obligation should be identified before the obligation finally becomes unconditional.

35. However, we have the following concerns with the descriptions of View 2.

36. We are concerned that, based on the description in paragraph 3.79 of the DP, situations where "the entity has no practical ability to avoid through its future action" (see paragraph 3.78 of the DP) may be interpreted too broadly.

> *3.79 The assessment of whether an entity has the practical ability to avoid any remaining conditions would require judgement. Guidance might be needed (possibly in individual Standards) to identify the types of condition that an entity might not have the practical ability to avoid. Arguably, these conditions might include, for example, conditions that the entity could avoid only by ceasing to operate as a going concern, significantly curtailing operations or leaving specific markets.*

37. First, the going concern assumption is the assumption on which financial statements are prepared and, therefore, we do not think it should be used to determine whether an entity has a present obligation.

38. Second, we do not think that the guidance should include the phrase 'the conditions that the entity could avoid only by leaving specific market' because some may interpret it as meaning that an entity is merely under economic compulsion to remain in the market (that is, it is economically advantageous for the entity to continue to operate in the market). Even if the entity is under such economic compulsion to remain in the market, it may have the discretion to avoid the remaining condition by its future actions.

Question 7
Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

39. The treatment for executory contracts should be discussed in the *Conceptual Framework* with the focus given to what should be the unit of account. We are of the view that the unit of account is

extremely important for the development of accounting standards. (Please refer to our comments to Question 24.)

40. Paragraph 3.110 of the DP states that, in principle, a net asset or net liability arises under an executory contract and the initial measurement of that contract would typically be zero. Our understanding is that the DP treats an executory contact as a single unit of account. Based on this understanding, we agree with the IASB's preliminary view in the DP for the following reasons.

41. When a contract is executory, even when it is enforceable, there is more uncertainty regarding whether the contract will be executed in the future by either of the parties when compared with situations where at least one party has fully or partially performed. This is because many contracts could be cancelled more easily by either party when they are executory. The party who offers to cancel the contract may be required to compensate the other. However, in general, the amount of the compensation would be significantly smaller than the entire contract amount.

42. When a contract is executory, there is uncertainty regarding whether future cash inflows or outflows based on the contract amount would arise in the future. Accordingly, recognising the asset and the liability on a gross basis would not necessarily provide relevant information.

43. However, even if a net asset or net liability for an executory contract is recognised in principle as proposed in the DP, further discussion regarding when an executory contract should be recognised on a gross basis is needed.

44. For example, for certain long-term firm commitments, the uncertainty regarding whether it will be executed is reduced to a certain extent by prescribing a non-cancellable clause or by establishing a disincentive for the party to compensate an amount that is close to the contractual amount when the contract is breached. We think that further discussion regarding whether the related assets and liabilities should be recognised on a gross basis in these situations is needed.

Section 4 - Recognition and derecognition

Question 8
Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because: (a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or (b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed. Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Probability Criterion

45. We disagree with the IASB's preliminary view in paragraph 4.24 of the DP which states that, in principle, an entity should recognise all of its assets and liabilities, because we believe that the recognition criteria should ,in principle, include the probability criterion[6]. This is because that when an item has uncertainty regarding the inflows or outflows of future economic benefits and its probability does not exceed a certain threshold, recognising such item as an asset or a liability is likely to result in recognising gains or losses due to reversals in subsequent periods. Gains or losses in the period when the asset or liability is recognised or in subsequent periods are often less relevant compared with the case where an asset or liability is not recognised.

46. Specifically, we think that the revised Conceptual Framework should prescribe a minimum threshold for the probability criterion (for example, "probable"[7]) should be defined in the revised Conceptual Framework. In addition to the prescription in the revised Conceptual Framework, an appropriate threshold for the probability criterion should be determined in the accounting standards to make the information relevant, as necessary, considering the nature of the transactions or events in the scope of those standards. (Please refer to paragraph 50 regarding the possible asymmetry between the threshold for the probability criterion relating to the recognition of assets and that relating to the recognition of liabilities at the standards level.) We note that there may be cases where the probability criterion will not be prescribed at the standards level, that is, when the IASB assumes that the probability criterion is always met regarding the transactions or events in the scope of the standards under development or revision, and decides that it is not necessary to require

[6] The probability criterion refers to a requirement where a certain probability of inflows or outflows of future economic benefits is required in order to recognise an asset or a liability.
[7] The term "probable" means 'more likely than not' in US GAAP.

preparers of financial statements to determine whether the probability criterion is met.

47. We also note that the probability criterion may be applied to single transaction or event as the unit of account, whereas in other cases, the probability criterion may be applied to a group of homogeneous transactions or events as the unit of account (for example, in the case of reserves for sales returns where the portfolio of the goods is treated as the unit of account).

48. Notwithstanding the above, we think that instruments that meet the definition of "derivatives" under IFRSs should be treated as an exception and the probability criterion should not be required. Having considered the characteristics of derivatives, we think that it is relevant to recognise and measure at the current market price such instruments regardless of their probabilities.

49. This discussion reminds us of the past discussions relating to the proposed amendments to IAS 37 *Provisions Contingent Liabilities and Contingent Assets*. In June 2005, the IASB published for public comment an Exposure Draft of Proposed Amendments to IAS 37 which proposed to delete the probability criterion, but many respondents noted that the recognition criteria should include the probability criterion. We think that the situation has not changed from that time. Many of the Japanese constituents think that the recognition criteria should include the probability criterion, and we also think that the probability criterion should be included in the revised Conceptual Framework.

<u>Threshold for the Probability Criterion</u>

50. We think that the IASB should consider whether, at the standard level, the threshold for the probability criterion relating to the recognition of assets should be symmetrical to that relating to the recognition of liabilities. For example, under IAS 37 the threshold relating to contingent liabilities is "probable," whereas the threshold relating to contingent assets is "virtually certain." However, the DP lacks consideration in this regard. We think that it is necessary to confirm whether the existing treatments should be justified with the concept of "prudence", and the IASB should consider whether the threshold for the probability criterion at the standards level relating to the recognition of assets should be symmetrical to that relating to the recognition of liabilities. (Regarding the concept of "prudence", please refer to our comments to Question 22.)

Question 9
In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria. (This is the control approach described in paragraph 4.36(a)). However, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction.

Possible approaches include:

(a) enhanced disclosure;

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or

(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

Relationship between the Control Approach and the Risk and Rewards Approach

51. We disagree with the DP which proposes the control approach as the basic approach because we think the relationship between the control approach and the risk and rewards approach should be addressed at the conceptual level.

52. Traditionally, the control approach and the risk and rewards approach have been viewed as different accounting concepts which may lead to very different conclusions. Accordingly, IFRS 9 *Financial Instruments*, for example, seeks to avoid the potential conflict between those accounting models by considering the risk and rewards approach first and then considering the control approach.

53. However, in recent discussions, the two approaches are not necessarily viewed as conflicting with each other. For example, whether the customer has the significant risks and rewards of ownership of the asset is considered to be one of the indicators of the transfer of control in paragraph 37(d) of the IASB's revised Exposure Draft *Revenue from Contracts with Customers* issued in November 2011.

54. We are of the view that the proposed derecognition criteria does not describe the relationship between the control approach and the risk and rewards approach and the situations where it is appropriate to apply the risk and rewards approach. As a result, the proposed derecognition criteria would rely too much on the decisions made at the standards level. Accordingly, we think the relationship between the control approach and the risk and rewards approach should be dealt with at the conceptual level.

Relationship with the Unit of Account

55. Before discussing when applying the risk and rewards approach is appropriate, we think that the concept of the unit of account should be discussed (or at least, they should be discussed concurrently), because the concept of the unit of account would significantly affect the derecognition criteria.

56. In a very simple case, when all risks and rewards are transferred, the concept of the unit of account would not matter in determining whether an asset or a liability should be derecognised. However, the conclusion may be different depending on the unit of account when a portion of the risks or rewards are retained.

57. For example, in the case of a sale of receivables with recourse, the credit risk does not change before and after the transaction because of the recourse. If the unit of account is the financial asset as a whole, the asset should not be derecognised under the risk and rewards approach because a substantial risk is retained. Conversely, the asset should be derecognised under the control approach because the present ability to direct the use of the asset so as to obtain the economic benefits that flow from the asset has been transferred.

58. If there are multiple units of account and the recourse is treated as a unit to be accounted for separately and if all risks and rewards relating to the remaining portion are transferred, the transferred portion should be derecognised not only under the control approach but also under the risk and rewards approach. The entity would continue to recognise the recourse portion under both approaches.

59. As discussed above, the accounting treatment can be different depending on the unit of account, even when the fact pattern is the same. Although we understand the discussion relating to the concept of unit of account is difficult, in case the IASB decides not to fully deliberate this issue in this revision of the *Conceptual Framework*, we encourage the IASB to separately consider this issue at the conceptual level.

Section 5 - Definition of equity and distinction between liabilities and equity instruments

Question 10
The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view: (a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities. (b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are: (i) obligations to issue equity instruments are not liabilities; and (ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)). (c) an entity should: (i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity. (ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim. (d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards. Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

<u>Views on the preliminary views in the DP</u>

60. We disagree with the strict obligation approach proposed in the DP. Instead, we recommend the IASB consider a three-category approach which provides a mezzanine section between liabilities and equity in order to improve the presentation of the creditor's side of the statement of financial position.

61. Distinctions in the creditor's side of the statement of financial position is said to have two roles:
    (a) to distinguish transactions or events that give rise to income/expense from transactions with owners in their capacity as owners (contributions from or distributions to equity participants); and

    (b) to provide information about solvency of an entity.

We believe that the former role is more important. The most residual claim is usually the common stock of the parent entity and we believe that relevant information is provided through clear presentation of income/expense which changes the interests of the holders of that claim (separately from those changes arising from transactions with owners in their capacity as owners). Information centered on the most residual claim is generally consistent with the information needs of the users of financial reporting, indicated by the current per share information such as EPS (currently, EPS information is provided from the perspective of common stock holders of the parent entity). In addition, this line distinguishes transactions with owners in their capacity as owners from other transactions or events and, accordingly, the linkage between the statement of financial position, the statement of comprehensive income and the statement of changes in equity would be made clear.

62. On the other hand, providing information useful for assessing solvency is an additionally important role of the distinction between liabilities and equity. It provides a measure that indicates the stability or viability of the entity by displaying the extent of claims the entity assumes that it cannot avoid to pay.

63. Under the strict obligation approach, which is the preliminary view of the DP, income would include changes in the interests of multiple equity claims and would not clearly display the changes in the interests in the most residual claim. However, this approach would provide useful information for assessing an entity's solvency as a result of distinguishing liabilities and equity based on the existence of the obligations to deliver economic resources.

64. On the other hand, under the narrow equity approach, equity would be the most residual claim and other claims would be liabilities. Income provides information about the changes in the interests of the equity participants (holders of the most residual claim) except for changes arising from transactions with such participants in their capacity as equity holders. Accordingly, the relationship between income and the most residual claim would be clear. In addition, as explained in paragraph 61 of this comment letter, this is consistent with the information needs from the perspective of the holders of common stock of the parent entity. However, under this approach, information about the solvency of the entity would not be displayed clearly in the statement of financial position because the creditor's side is not separated based on the obligation to deliver economic resources[8]. Moreover, liabilities would be the residual of assets and equity and, therefore, its characteristics would not be clear.

65. As pointed out in paragraphs 63 and 64 of this comment letter, both the strict obligation approach

[8] As stated in paragraph 5.32 of the DP, the same information can be provided by clearly distinguishing claims without obligations to deliver economic resources. However, the distinction would be clearer if the creditor's side included a mezzanine category as mentioned in paragraph 65 of this comment letter.

and the narrow equity approach have strengths and weaknesses in achieving the two roles expected in the distinction of the creditor's side of the statement of financial position. Accordingly, one solution might be using both approaches to achieve both roles. First, the most residual claim (usually the common stock of the parent entity) would be classified as equity[9] similar to the narrow equity approach. Second, liabilities would be separated from other items by the existence of obligations to deliver economic resources. Finally, items which are neither equity nor liabilities would be included in the mezzanine category (the three category approach). The mezzanine category would include, for example, warrants, preferred shares, and non-controlling interests.

66. The three category approach takes advantage of both the narrow equity approach and the strict obligation approach and, therefore, the approach would clarify the line of whether a transaction is that with owners in their capacity as owners and provide information that is useful for assessing the solvency of the entity.
    (a) Income/expense is the change in net assets except for those related to the contributions from (distributions to) the equity participants. Accordingly, consistent with the narrow equity approach, the definition of equity which identifies equity participants first is consistent with the definition of income/expense, and it would be made clear that income/expense is a change in interests from the perspective of the equity participants.
    (b) The distinction based on the obligation to deliver economic resources provides information useful for assessing solvency by displaying the extent of claims the entity cannot avoid to pay.

67. Some may be concerned that the three category approach may be more complex than the two category approach[10]. However, the characteristics of information provided through the three category approach would be clearer. Moreover, the mezzanine category would be useful in providing information regarding ambiguous claims the entity assumes that are neither classified as a liability nor as equity.

68. As suggested in paragraph 65 of this comment letter, the distinction between items of equity and items other than equity should be determined first. This is because the order would be important

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[9] Equity includes contribution from equity participants, retained earnings (accumulated balance of profit or loss), and accumulated other comprehensive income (AOCI). We believe that retained earnings and AOCI should be separately presented in the equity category as mentioned in paragraph 73 of this comment letter.

[10] Even when the creditor's side of the statement of financial position has two categories, we still believe that it is more appropriate to classify the most residual claim as equity and the other claims as liabilities as is the case with the narrow equity approach. We believe that distinguishing transactions or events that give rise to income/expense from those with owners in their capacity as owners is more important as mentioned in paragraphs 61 and 65 of this comment letter and accordingly, we expect that this would ensure the linkage between the statement of financial position and the statement of comprehensive income. We note, however, that it is possible to provide the line in the liability category that distinguishes claims with obligations to deliver economic resources in order to supplement the information about solvency as mentioned in footnote 8 of this comment letter.

for distinguishing the most residual claim when the claim also obligates an entity to deliver economic resources. Even if the most residual claim obligates an entity to deliver economic resources, it bears the risks of the businesses of the entity first and, accordingly, it would be appropriate to classify the most residual claim as equity in the statement of financial position if it has the same characteristics of common stock in other entities. The DP states that the narrow equity approach might make it unnecessary to create an exception for puttable instruments in the most subordinated class of instruments. We think that our suggested approach has the same effect.

Views on updating measurement

69. We disagree with the IASB's preliminary view of updating measurement as stated in (c) of Question 10.

70. Paragraph 5.17 of the DP states that updating measurement would provide a clearer and more systematic view of how an equity claim would affect another equity claim and that it would provide a way to resolve some liability/equity classification issues that have proved problematic over the years. It may be true that updating measurement would provide useful information to estimate future cash flows of each equity claim by displaying the interaction between equity claims. It may also be true that the tension of classification between liabilities and equity would be mitigated by updating measurement if the line between liabilities and equity are understood as the boundary between an item to be remeasured and an item not to be remeasured.

71. However, we do not support updating measurement under the strict obligation approach for the following reasons:
    (a) It is unclear as to what the updated measure of the most residual equity claim represents. Paragraph 6.12 of the DP states that it is criticised that the amount presented as total net assets has little meaning because it is an aggregation of items measured using various different measurements. The updating of measurement is likely to exacerbate the situation because the amount of the most residual equity claim would be calculated after deducting the economic value of some equity claims from total net assets, and the resulting amount would be even less meaningful.

    (b) The transfer of wealth between equity claims would not be appropriately displayed if the measurement of certain equity claims is updated with their fair values and the most residual equity claim absorbs this effect. Consider a situation where an entity has issued only two classes of equity claims: a common stock and a written call option on the entity's common stock (an obligation to issue the entity's common stock). The economic value of the common stock, which is the most residual equity claim, and that of the option generally move in the same direction to the extent that market price of the common stock is higher than the strike price of the option. However, because net assets are allocated with the constraint that total equity is fixed, the book value of the common stock would be determined as the residual after deducting the fair value of the option and, therefore, the book value of the common stock and that of the option move in the opposite direction. Thus, updating measurement of claims with similar characteristics might result in a counterintuitive outcome. One way to address this problem may be to update the measure the most residual equity claim with fair value, but this would be inconsistent with the objective of financial reporting which states that financial reporting is not designed to show the value of a reporting entity. (Please refer to paragraph OB7 of the *Conceptual Framework* and paragraph 4.9(c) of the DP.) Some may argue that updating measurement of the option with its economic value would appropriately display the transfer of wealth between existing and future shareholders (in the examples mentioned above, holders of entity's common stock and those of a call option on entity's common stock respectively), but we disagree because the value of common stock and that of the option would not be compared on the same basis and it would not display the dilution of interests of the existing shareholders through updating measurement.

(c) Sometimes it may not be clear from legal requirements or explicit provisions of the contract how to allocate retained earnings to each equity claim in situations where measurement is updated by allocating the underlying net assets. (Please refer to paragraph 5.18 of the DP.)

72. The approach suggested in paragraph 65 of this comment letter may raise the question of whether the measurement of items in the mezzanine section should be updated. However, we think that the measurement of those items should not be updated other than situations where items are remeasured through the allocation of underlying net assets, which is the case for non-controlling interests. As pointed out in paragraph 71(b) of this comment letter, if the measurement of an item is to be updated with its fair value, the measurement of the most residual equity claim should also be updated with its fair value in order to achieve the appropriate presentation of the interactions between items. However, that would contradict with the objective of financial reporting, which states that financial reporting is not designed to show the value of a reporting entity. (Please refer to paragraph OB7 of the *Conceptual Framework* and paragraph 4.9(c) of the DP.)

Presentation of retained earnings and accumulated other comprehensive income in the equity section

73. The *Conceptual Framework* should provide a clear distinction between retained earnings and accumulated other comprehensive income (AOCI) in the equity section of the statement of financial position. Retained earnings are the accumulation of profit or loss, which is the

irreversible outcome of the business[11]. Its characteristics are different from those of AOCI in that AOCI has not become an irreversible outcome yet. Retained earnings and AOCI need to be separately displayed considering their differences in the hardness of the information, the way the information is used, and clear presentation of the relationship between the elements of the statement of profit or loss and OCI proposed in our response to Question 4 and the items presented in the statement of financial position.

<u>Other items</u>

74. Section 5 of the DP deals with part of the discussion relating to elements of financial statements in Section 2 of the DP and deals with part of the discussion relating to measurement in Section 6 of the DP. Decisions in Section 5 of the DP may influence the discussions in other sections, so these issues should be discussed consistently.

75. The DP points out the exceptions to the basic principle in existing IAS 32 *Financial Instruments: Presentation* which give rise to inconsistencies between standards and complexity of requirements (Paragraph 5.23-24 of the DP). Accordingly, the IASB should consider reviewing the IAS 32, which is criticised as being complex, in the future based on the outcome of this project.

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[11] Please refer to paragraph 141 of this comment letter.

Section 6 - Measurement

Question 11
How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that: (a) the objective of measurement is to contribute to the faithful representation of relevant information about: (i) the resources of the entity, claims against the entity and changes in resources and claims; and (ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. (b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements; (c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI; (d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement: (i) for a particular asset should depend on how that asset contributes to future cash flows; and (ii) for a particular liability should depend on how the entity will settle or fulfil that liability. (e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and (f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost. Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

76. Our views on the IASB's preliminary views relating to measurement are as follows. We note that most of the Japanese constituents agree with our views.

(a) Regarding Question 11(a), although the proposed objective of measurement is consistent with the objectives of financial reporting and the qualitative characteristics in the existing

Conceptual Framework, we do not agree with the IASB's preliminary view because we think it is insufficient to develop individual accounting standards. We think that the proposed objective should be modified to focus more on measurement.

(b) Regarding Question 11(b), we agree with the IASB's preliminary view. We think that a mixed attribute model, in which measurement bases are determined based on the nature of the investments or how the entity will settle or fulfil the liabilities, should be adopted.

Some may argue that the aggregated amounts are not meaningful if a single measurement basis is not adopted. However, we think that individual measurements may not be relevant if a uniform measurement basis is adopted regardless of the specific situations relating to the transactions or events. In such case, we believe that the aggregated amounts are not relevant.

(c) Regarding Question 11(c), we agree with the IASB's preliminary view. In particular, we strongly agree with paragraph 6.76 of the DP which states that one possible way of dealing with uncertainty about how an asset will contribute to future cash flows would be using one measure in the statement of financial position and using a different measure to determine the amounts recognised in profit or loss. In this regard, we think that measurement bases which are relevant from the perspective of reporting an entity's *financial position* and measurement bases which are relevant from the perspective of reporting an entity's *financial performance*, respectively, should be discerned appropriately.

(d) Regarding Question 11(d), we generally agree with the IASB's preliminary view, but we have some different opinions in specific areas. Our views are provided in our responses to Questions 12 and 13.

(e) Regarding Question 11(e), we think that it is important to use the appropriate measurement basis and the number of measurement bases in itself is not the problem. We disagree with the IASB's preliminary view if the "smallest number" means one because it would contradict with the IASB's preliminary view relating to Question 11(b).

(f) Regarding Question 11(f), we agree with the IASB's preliminary view.

Question 12
The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that: (a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide

information that is more relevant and understandable than current market prices.

(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

77. We agree with the view that the measurement basis used for a particular asset should depend on how the asset would contribute to future cash flows. However, the DP does not discuss the measurement bases that are relevant from the perspective of reporting an entity's financial position and the measurement bases that are relevant from the perspective of reporting an entity's financial performance separately.

78. We think that the measurement bases that are relevant from the perspective of reporting an entity's *financial position* and the measurement bases that are relevant from the perspective of reporting an entity's *financial performance* should be considered separately. Therefore, we discuss such measurement bases for each category proposed in the DP. We note that many of the Japanese constituents agree that the measurement bases that are relevant from the perspective of reporting an entity's *financial position* and the measurement bases that are relevant from the perspective of reporting an entity's *financial performance* should be considered separately.

79. In addition, we think that Sections 6 and 8 of the DP are closely related. Accordingly, we expect that our comments to Question 12 are read together with our comments to Question 19 through 21.

Using an asset in business operations to generate revenues or income

80. We think that cost-based measurement is relevant from the perspectives of reporting both an entity's *financial position* and *financial performance* because the changes in current market prices do not have any relationship to the future cash flows that will be generated from using the assets in business activities.

81. It can be argued that management always has the option to sell the assets or continue to use them in order to generate revenues or income in business operations and whether assets should be measured at current market prices in order to report the basis for the management's decisions to continue to use the assets should be considered from the perspective of reporting an entity's

financial position. Although the current market price or cash-based measurement may be relevant from the perspective of reporting an entity's *financial position,* it is difficult to uniquely determine the current market price or cash-flow-based measurement because such measurement can vary depending on the other assets to be combined with when an asset is used together with other assets to generate cash flows. Accordingly, cost-based measurements would be the only feasible option for these types of assets.

Selling an asset (held for trading)

82. We think that the current market price is relevant for an asset held for sale, provided that the assets classified in this category are limited to those investments held for trading.

83. In this case, we think that the current market price is relevant from the perspective of reporting an entity's *financial position* because the entity can generate cash flows that are equivalent to the current market price. Furthermore, we think that the current market price is relevant from the perspective of reporting an entity's *financial performance* because the outcomes of the entity's business activities are deemed irreversible and the changes between cost and current market price represent the outcomes of the investment in light of the purpose of the transactions.

84. In addition, we believe that financial instruments whose future cash flows are expected to change significantly in response to the changes in the underlying and require no or very little initial net investment (that is, the instruments meeting the definition of "derivatives" under IFRSs) should be classified in this category[12]. In our view, having considered the characteristics, a current market price is considered to be relevant for such instruments from the perspectives of reporting both an entity's *financial position* and *financial performance*.

Holding an asset for collection according to terms

85. We agree with the IASB's preliminary view in the DP that cost-based interest income, along with bad debt expenses as estimated by management, is likely to provide relevant information. We think that this is applicable from the perspectives of reporting both an entity's *financial position* and *financial performance.*

86. However, there may be cases where management intends either (a) to hold an asset for collection according to terms or (b) to sell the asset where an entity has the practical ability to do so. In this case, we think that the current market price is relevant from the perspective of reporting an entity's *financial position* because the entity can generate cash flows equivalent to the current market price if it wishes to do so. From the perspective of reporting an entity's *financial performance,*

[12] When such instruments are used for hedging transactions and accounted for under the cash flow hedge accounting requirements, the relevant measurement basis for such instruments (from the perspective of reporting an entity's *financial performance*) would be determined differently, to be consistent with the accounting for the hedged items.

cost-based measurement is relevant because the uncertainty regarding whether the cash flows will actually occur at current market price has not been reduced to the point where the outcomes are irreversible or deemed irreversible.

Charging others for rights to use an asset

87. We think that cost-based measurement is relevant from the perspective of reporting an entity's *financial position* when management primarily intends to earn rental income. This is because the current market price does not have any relationship with future cash flows that will generated from charging others for rights to use the assets.

88. However, there may be cases where management intends either (a) to earn rental income or (b) to sell the asset where an entity has the practical ability to do so. In this case, we think that the current market price is relevant from the perspective of reporting an entity's *financial position* because the entity can generate cash flows equivalent to the current market price if it wishes to do so. From the perspective of reporting an entity's *financial performance*, we think that cost-based measurement is relevant because the uncertainty regarding the outcomes of the entity's business activities is not reduced to the point where the outcomes are irreversible or deemed irreversible when the entity bears the risk relating to any fluctuations in the residual value of the assets.

Assets: Summary

89. The following table summarises our views discussed above.[13]

[13] Although it is not included in the table, it is necessary to determine whether impairment has occurred in order to ensure that an entity's assets are carried at no more than their recoverable amount. When impairment losses are recognised, the current market price or cash-flow-based measurement will be used from the perspectives of reporting an entity's *financial position* and *financial performance*.

How the asset contributes to future cash flows	Likely measurement basis	
	From the perspective of reporting an entity's *financial position*	From the perspective of reporting an entity's *financial performance*
Using an asset in business operations to generate revenues or income	Cost-based measurement	Cost-based measurement
Selling an asset (held for trading)	Current market price	Current market price
Holding an asset for collection according to terms	Cost-based measurement	Cost-based measurement
Either holding an asset for collection according to terms or selling it	Current market price	Cost-based measurement
Charging others for rights to use an asset	Cost-based measurement	Cost-based measurement
Either charging others for rights to use an asset or selling it	Current market price	Cost-based measurement

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(b) a cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would

support.

90. We generally agree with the IASB's preliminary views stated in the DP. We think that the current market price would not be relevant unless the liability can be transferred because the current market price has no relationship with actual cash flows. Therefore, for liabilities other than derivatives, a cost-based measurement or cash-flow-based measurement should be used, depending on the terms of the liability.

91. We think that although a single measurement basis should be used for most liabilities, two different measurements can be used for liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined.

Liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined

92. When a liability has stated terms but a highly uncertain settlement amount that has not yet been determined is remeasured by using a cash-flow-based measurement, it may be relevant to use inputs that are updated at the reporting date from the perspective of reporting an entity's *financial position*. For example, in the case of remeasuring insurance liabilities, using the discount rate at the reporting date may more faithfully represent insurance liabilities than using the discount rate at initial recognition.

93. However, from the perspective of reporting an entity's *financial performance*, it may not be relevant to recognise gains or losses using inputs that are updated at the reporting date. For example, in the case of remeasuring insurance liabilities, recognising gains or losses due to changes in discount rates may not be relevant because the effects of discounting do not have any relationship with actual cash flows. In this case, using the inputs applied at initial recognition can be relevant.

94. Based on the discussions above, two different measurements can be used when remeasuring liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined due to different inputs.

Liabilities: Summary

95. The table below summarises our views that are discussed above.

How the liability is settled or fulfilled	Likely measurement basis	
	From the perspective of reporting an entity's *financial position*	From the perspective of reporting an entity's *financial performance*
Liabilities without stated terms	Cash-flow-based measurement	Cash-flow-based measurement
Liabilities which have stated terms but highly uncertain settlement amounts that have not yet been determined	Cash-flow-based measurement *1	Cash-flow-based measurement *1
Paying cash or delivering other assets according to the stated terms	Cost-based measurement (but not for derivatives)	Cost-based measurement (but not for derivatives)
Being released by the creditor on transferring the obligation to another party	Current market price	Current market price
Performing services or paying others to perform services	Cost-based measurement	Cost-based measurement

*1 Inputs used from the perspective of reporting an entity's *financial position* may be the same as or may be different from those used from the perspective of reporting an entity's *financial performance.* When they are different, OCI would be used.

Question 14
Paragraph 6.19 states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities

that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows: (a) if the ultimate cash flows are not closely linked to the original cost; (b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or (c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or the liability is highly leveraged). Do you agree with this preliminary view? Why or why not?

96. We agree that cost-based measurement is not relevant for items that meet the definition of derivatives, and a current market price is relevant for such items. However, the rationale is different from that provided in the DP. Our view on derivatives is described in paragraph 84 of this comment letter.

Question 15
Do you have any further comments on the discussion of measurement in this section?

97. We think that measurement can be affected by the unit of account. Regarding our comment on the concept of the unit of account, please refer to our comments to Question 24.

Section 7 - Presentation and disclosure

Question 16
This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the *Conceptual Framework*. In developing its preliminary views, the IASB has been influenced by two main factors: (a) the primary purpose of the *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and (b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including: (i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project; (ii) amendments to IAS 1; and (iii) additional guidance or education material on materiality. Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the *Conceptual Framework* on: (a) presentation in the primary financial statements, including: (i) what the primary financial statements are; (ii) the objective of primary financial statements; (iii) classification and aggregation; (iv) offsetting; and (v) the relationship between primary financial statements. (b) disclosure in the notes to the financial statements, including: (i) the objective of the notes to the financial statements; and (ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information. Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the *Conceptual Framework*.

Relationship between primary financial statements

98. Paragraph 7.31 of the DP states that no primary financial statement has primacy over other primary statements, but we think that the statement of cash flows should have less primacy than the statement of financial position and the statement of profit or loss and other comprehensive income due to the reason described in the following paragraph.

99. Paragraph OB17 of the existing *Conceptual Framework* states that accrual accounting provides a better basis for assessing the entity's past and future performance than information solely about

cash receipt and payments during that period. This implies that the statement of financial position and the statement of profit or loss and other comprehensive income, that are prepared based on accrual accounting, provides better information than the statement of cash flows, that are prepared based on cash-based accounting. Accordingly, the statement of cash flows should be treated as supplementary information to profit or loss which is prepared based on accrual accounting.

<u>Scope of the notes to financial statements</u>

100. Disclosure requirements under existing IFRSs were not developed based on a consistent policy and, accordingly, some requirements require disclosure of information that is not necessarily relevant. We think that the revised *Conceptual Framework* should specify when disclosures would be required. Based on such discussion, we think that the existing disclosure requirements should be revisited together with the outcomes of the Disclosure Initiative.

101. We agree with the IASB’s preliminary views stated in the DP relating to the notes to financial statements in many respects. However, we think that a mere listing of items to be disclosed in the notes to financial statements such as one provided in Table 7.1 of the DP may be misleading and, accordingly, it is necessary to discuss when disclosure requirements are needed. Specifically, we think that the scope of the notes to financial statements related to line items should be determined based on the timing of the underlying transactions and events and the description of completeness in paragraph QC13 of the *Conceptual Framework*.

102. Our following analysis focuses on the nature of the items that are to be included in the notes to financial statements. Needless to say, when developing disclosure requirements, standard-setters should consider whether the benefits overweigh the costs and whether such disclosures can be audited. Therefore, we do not intend that all items that we analyse below would eventually be disclosed in the notes to financial statements.

103. In the following analysis, we specifically focus on the following issues:
   (a) Treatment of forward-looking information

   (b) Specifying when alternative measurements would be disclosed

   (c) Treatment of the description of the plans or strategies regarding the risk exposure of items

104. Our thinking on the scope of the notes to financial statements is based on the categorisation described in Appendix B. Our views on those categories are summarised below.

Category A

105. Category A represents disclosures of items that are recognized on the face of the financial

statements and are measured without using estimates[14], relating to transactions, events or conditions that occurred before year-end.

106. For items in Category A, quantitative and qualitative information would be included in the notes to financial statements. Quantitative information would 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 would contain a description of the nature of the item, a description of what the numerical description represents, an explanation of significant facts about the quality and nature of the item and the process used to determine the numerical depiction, explanations of factors and circumstances that might affect the quality and nature of the items.

107. In principle, it is inappropriate to include in the notes to financial statements the description of the plans or strategies regarding the risk exposure of the items. This is because there is a possibility that such information cannot be represented faithfully nor be verified. Such information would be reported outside of the financial statements such as in the management commentary.

108. Information relating to alternative measurements can be grouped into the following categories:

(a) Information relating to measurements using alternative measurement bases (for example, fair value information for items which were measured and recognised on the face of financial statements at cost)

(b) Information relating to measurements using alternative inputs (for example, sensitivity analysis)

(c) Information relating to measurements using alternative accounting policies (for example, the effects of changes in a certain accounting policy)

109. Information relating to measurements using alternative measurement bases may be included in the notes to financial statements in very limited circumstances. If the measurement bases were selected appropriately from the perspective of the statement of financial position and the statement of comprehensive income, such disclosure would not be necessary. However, when newly developing or revising accounting standards, the IASB may decide to use one measurement basis, even when it is relevant to use two measurement bases from the perspectives of reporting an entity's *financial position* and *financial performanc*e. In such case, it may be appropriate to disclose information relating to measurements using an alternative measurement basis.

110. Information relating to measurements using alternative inputs generally would not be included in

[14] In this comment letter, the term 'estimates' include fair value estimates.

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

111. Information relating to measurements using alternative accounting policies would be included in the notes to financial statements because such disclosure would be important from the perspective of comparability.

Category B

112. Category B represents disclosures of items that are recognised on the face of the financial statements and measured using estimates, relating to transactions, events or conditions that occurred before year–end.

113. Information relating to measurements using alternative measurement bases would not be included in the notes to financial statements. Generally, fair value measurements or cash-flow-based measurements would be selected as the measurement basis for the items in Category B. In this case, cost would generally be the alternative measurement basis. However, information based on cost would not be relevant and, therefore, such information would be inappropriate for inclusion in the notes to financial statements.

114. For items in Category B with high uncertainty in the estimates, information relating to measurements using alternative inputs generally would be included in the notes to financial statements. This is due to the concerns that explanatory descriptions related to facts do not provide sufficient information to assess the entity's prospects for future cash flows when there is high uncertainty in the estimates.

115. The scope of the notes to financial statements would be the same as category A except for the information described above.

Category C

116. Category C represents disclosures of items that are not recognised on the face of the financial statements, relating to transactions, events or conditions that occurred before year-end. An example of an item in this category is a contingency that exists at year-end but is not recognised on the face of the financial statements.

117. With regard to items in Category C, the scope of the notes to financial statements would be the same as Category A, except for information measured by alternative measurement bases and alternative accounting policies which would not be included in the notes to financial statements. However, the volume and depth of the disclosures would usually be less than those required for items in Category A. For example, quantitative information may only contain the breakdown of

an item and further disclosures may not be required.

Category D

118. Category D represents disclosures of items that are not recognised on the face of the financial statements, relating to non-adjusting events after the reporting period (transactions, events or conditions which have not occurred before year-end).

119. With regard to items in Category D, quantitative and qualitative information would be included in the notes to financial statements. However, qualitative information would be limited to explanatory descriptions related to facts.

120. We think that information related to the financial position at year-end and the financial performance for the years presented generally would be the only information included in the financial statements. However, we think non-adjusting events after the reporting period should be included in the notes to financial statements as an exception. This is because disclosing non-adjusting events after the reporting period in advance to next fiscal year's financial statements is likely to contribute to assessing the entity's prospects for future cash flows. In order to achieve this objective, disclosing only the quantitative information and explanatory descriptions related to facts should be sufficient.

Category E

121. Category E represents disclosures of items that are not recognised on the face of the financial statements, relating to items other than non-adjusting events after the reporting period (transactions, events or conditions which have not occurred before year-end).

122. Items in this Category E include information regarding the risks which do not exist at year-end but may exist in the future.

123. Items in Category E generally should not be included in the notes to financial statements but should be reported outside of the financial statements such as in the management commentary. 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 nor be verified.

Cost-benefit Considerations

124. We think that the section which deals with presentation and disclosure in the revised *Conceptual Framework* should include the descriptions about cost-benefit considerations.

125. The IASB's preliminary views regarding the recognition criteria described in Section 4 of the DP and measurement described in Section 6 of the DP include the consideration whether the benefits

justify the costs, but such considerations are not described in Section 7 of the DP.

126. There are various kinds of notes to financial statements. Certain notes to financial statements simply require the disclosure of the processes or the figures used for recognition and measurement. However, other notes require an entity to undertake additional processes to gather information to provide the disclosures. We think that when newly developing or revising accounting standards, the IASB should consider whether the benefits justify the costs, in particular, for those disclosure requirements which require an entity to undertake additional processes to gather information to provide such disclosures. For example, disclosures regarding the quantification of the sensitivity of recognised or disclosed measurements described in Table 7.1 of the DP should be limited only to situations where the uncertainty of measurement is very high.

127. In addition, there may be cases where disclosing information results in competitive harm. Such harm can be viewed as a cost and, accordingly, should be taken into consideration when developing disclosure requirements.

128. Descriptions of the cost constraint on useful financial reporting described in QC35 through QC39 of the existing *Conceptual Framework* should also be applied to the notes to financial statements. We suggest that cost-benefit considerations should be described in the section which deals with presentation and disclosure in the revised *Conceptual Framework*

Question 17
Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing *Conceptual Framework*. Consequently, the IASB does not propose to amend, or add to, the guidance in the *Conceptual Framework* on materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the *Conceptual Framework* project. Do you agree with this approach? Why or why not?

129. We think that emphasising the appropriate application of materiality relating to the notes to financial statements in the *Conceptual Framework* would be meaningful, even though the existing *Conceptual Framework* already contains a description of materiality.

130. Notes to financial statement often include qualitative disclosures and, in this case, materiality should be determined based on the nature of the notes to financial statements. In addition, the materiality threshold relating to primary statements and the materiality threshold relating to the notes to financial statements should be different. However, in some situations, they are mistakenly considered to be the same. We think that the *Conceptual Framework* should clearly

state the importance of materiality relating to the notes to financial statements in order to address the disclosure overload issue.

131. In addition, we agree with the development of additional guidance or educational material on materiality, but we believe that implementation of such guidance or educational material is critical. In this regard, we support the IASB's intention to collaborate with International Auditing and Assurance Standards Board (IAASB) and International Organization of Securities Commission (IOCSO).

Question 18
The form of disclosure requirements, including the IASB’s preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52. Do you agree that communication principles should be part of the *Conceptual Framework*? Why or why not? If you agree they should be included, do you agree with the communication principles proposed? Why or why not?

132. We think that the proposed communication principles are highly beneficial. However, we think that some of those principles do not assist the IASB in newly developing or revising accounting standards.

133. As described paragraph 1.26 of the DP, if the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when newly developing or revising accounting standards, the proposed communication principles should be classified into two groups - that is, those described in the revised *Conceptual Framework* and those described in accounting standards.

Section 8 - Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

Question 19
The IASB's preliminary view that the *Conceptual Framework* should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22. Do you agree? Why or why not? If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

<u>Definition as an element of financial statements</u>

134. We agree with the IASB's preliminary view stated in the DP in that profit or loss should be required. However, we disagree with the IASB's preliminary view stated in the DP that it considers the profit or loss issue as a presentation issue, because we believe that profit or loss should be treated as an element of financial statements. Regarding our view on the elements of financial statements, please refer to our comments to Question 4. We note that many of the Japanese constituents, including preparers and users of financial statements, support our view that profit or loss should be treated as an element of financial statements.

135. We suggest defining comprehensive income and profit or loss as separate elements of financial statements in the following manner[15]:

    Comprehensive income is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting an entity's *financial position*.

    Profit or loss is the change in net assets during a period except those changes resulting from transactions with owners in their capacity as owners, whereby the recognised assets and liabilities comprising the net assets are measured using measurement bases that are relevant from the perspective of reporting an entity's *financial performance*.

136. The definitions in the preceding paragraph are suggested under the premise that two measurements would be used for certain assets and liabilities, although a single measurement would be used for most assets and liabilities. Measurements of assets and liabilities that are relevant from the perspective of reporting an entity's *financial position* (and are used to determine comprehensive income) are presented in the statement of financial position. Measurements of assets and

[15] As stated in paragraph 22 of this comment letter, our comments to Question 4 recommend that profit or loss, comprehensive income and other comprehensive income (OCI) be treated as elements of financial statements. On that premise, we suggest the definitions of these terms in our response to Question 19. However, these definitions mainly focus on when profit or loss, comprehensive income or OCI of an item should be recognised (that is, the timing of recognition).

liabilities that are relevant from the perspective of reporting an entity's *financial performance* (and are used to determine profit or loss) can be different from the measurements presented in the statement of financial position.

137. When comprehensive income is different from profit or loss, OCI is used as "the linkage factor." We suggest that OCI be defined as an element of financial statements in the following manner:

OCI is "the linkage factor" that is used when the measurements that are relevant from the perspective of reporting an entity's *financial position* differ from the measurements that are relevant from the perspective of reporting an entity's *financial performance*.

138. We think that the view that two different measurement bases can be used for certain assets and liabilities is consistent with the DP. Specifically, the DP states the following:

(a) Paragraph 6.15 of the DP states that measurement affects both the statement of financial position and the statement(s) of profit or loss and OCI;

(b) Paragraph 6.76 of the DP states that one possible way of dealing with uncertainty about how an asset will contribute to future cash flows would be to provide more than one measure of the asset and this could be done by using one measure in the statement of financial position and using a different measure to determine the amounts recognised in profit or loss; and

(c) Paragraph 8.55 of the DP states that the IASB may occasionally decide that an asset or a liability should be remeasured, but that information in profit or loss should be based on a measurement that differs from the one used in the statement of financial position provided both measurements are meaningful, understandable and clearly describable.

139. The DP classifies OCI items into three categories, namely "bridging items," "mismatched remeasurements" and "transitory remeasurements." However, we suggest a single category, namely "the linkage factor," based on the definition suggested in paragraph 137 of this comment letter.

140. Some may argue that comprehensive income can be determined systematically based on the changes in net assets but that profit or loss cannot. However, we take a different view that the difference between comprehensive income and profit or loss arises solely from the differences in the measurement bases used for certain assets and liabilities, and that both comprehensive income and profit or loss are systematically determined based on the changes in net assets. Accordingly, the difference between comprehensive income and profit or loss is essentially a timing difference and conceptually the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of comprehensive income for all accounting periods.

Nature of profit or loss

141. We suggest describing the nature of profit or loss in the following manner:

 Profit or loss represents an all-inclusive measure of irreversible outcomes of an entity's business activities in a certain period.

142. We think that the key concepts in describing the nature of profit or loss are "irreversible outcomes of an entity's business activities" and "all-inclusive." In the following paragraphs, we discuss these two key concepts in more detail.

Irreversible outcomes of an entity's business activities

143. The phrase "irreversible outcomes of an entity's business activities" means that the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are irreversible or deemed irreversible.

144. Users of financial statements need information to help them assess the prospects for future net cash inflows to an entity[16]. Information about a reporting entity's past financial performance and how its management discharged its responsibilities is usually helpful in predicting the entity's future returns on its economic resources[17].

145. We think that profit or loss should represent the "irreversible outcomes of an entity's business activities" that reflect an entity's past financial performance in order to help users assess the prospects for future net cash inflows to the entity. It is important to report on "irreversible outcomes of an entity's business activities" because information is not sufficiently robust if profit or loss includes the outcomes of an entity's business activities whose uncertainty has not been reduced to the point where the outcomes are irreversible or deemed irreversible and such information may mislead users in assessing the prospects for future net cash inflows to the entity.

146. When an entity enters into business activities, the entity has an expectation that certain future cash flows will be generated. However, the outcomes of an entity's business activities normally are initially uncertain. We think that profit or loss should be recognised when the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are irreversible or deemed irreversible[18].

147. For example, in the case of debt securities, an entity could generate cash flows equivalent to the

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[16] Please refer to paragraph OB3 of the existing *Conceptual Framework.*

[17] Please refer to paragraph OB16 of the existing *Conceptual Framework.*

[18] For example, profit or loss would be recognised when an asset is sold because the uncertainty regarding the outcomes of an entity's activities is totally extinguished through the transfer of control. In addition, we think that recognising expenses can be explained using this concept. For example, depreciation of property, plant and equipment would be recognised in profit or loss because the uncertainty regarding the outcomes of an entity is deemed irreversible to the extent that the asset's economic benefits have been consumed.

current market price of the asset if it sold the assets at the reporting date, but the entity may not be sure whether it will hold them for collection according to terms or sell them. In this case, the uncertainty regarding how the asset contributes to future cash flows (that is, either holding it for collection according to terms or selling it) has not been reduced to the point where the outcomes are irreversible or deemed irreversible. Accordingly, gains or losses from remeasurements that reflect the changes in the current market price should not be recognised in profit or loss. On the other hand, when the assets are sold, the uncertainty is extinguished and thus profit or loss should be recognised.

148. The phrase "irreversible outcomes of an entity's business activities" does not suggest cash-based accounting. What would be considered as the outcomes of an entity's business activities can vary depending on the initial expectations when the entity enters into business activities.

149. For example, in cases where investments are made for trading purposes, the outcomes of an entity's business activities are deemed irreversible because it is presumed that the entity willingly accepted the uncertainty regarding the fluctuations in the current market price and thus the changes between cost and current market price represent the outcomes of the business activities in light of the purpose of such investments. Accordingly, the changes in the current market price should be recognised in profit or loss as they occur.

150. In addition, we think that the robustness of profit or loss is also necessary from the perspective of stewardship[19]. When an entity provides information regarding how its management discharged its responsibilities, we think that it is important to report profit or loss in instances where the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are irreversible or deemed irreversible.

151. As discussed above, we think that both comprehensive income and profit or loss should be treated as elements of financial statements. Comprehensive income is an important element required to understand the relationships between the primary financial statements, but comprehensive income may not be sufficiently meaningful from the perspective of reporting an entity's *financial performance* because comprehensive income, as suggested in paragraph 135 of this comment letter, would be determined based on the measurements which are relevant from the perspective of reporting an entity's *financial position*. Furthermore, when measuring certain items to determine comprehensive income, the uncertainty regarding the outcomes of an entity's business activities may not have been reduced to the point where the outcomes are irreversible or deemed irreversible because the measurement bases are determined from the perspective of reporting the entity's *financial position*. On the other hand, profit or loss provides information about an entity's past

[19] Please refer to paragraph OB4 of the existing *Conceptual Framework*.

financial performance through the selection of appropriate measurement bases. Accordingly, we think that profit or loss, apart from comprehensive income, is necessary.

All-inclusive

152. The phrase "all-inclusive" suggests that all transactions and events that occur in a certain period are taken into consideration.

153. As described above, we think that the difference between comprehensive income and profit or loss is essentially a timing difference and conceptually the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of comprehensive income for all accounting periods.

154. In addition, we think that the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of net cash flows, other than net cash flows resulting from transactions with owners in their capacity as owners, for all accounting periods. When assessing the value of an entity, users of financial statements normally depend on cash flow information to assess the prospects for future net cash inflows to that entity[20]. Users of financial statements have suggested that profit or loss is one of the most useful indicators that they can refer to. However, these users may find it difficult to refer to profit or loss if the integrity of profit or loss information is not supported by the consistency with cash flows.

155. The concept of "all-inclusive" suggests that both expected and unexpected outcomes are explicitly included in profit or loss. In the course of business activities both expected outcomes and unexpected outcomes, or windfalls which had not been initially expected, can occur. By requiring the concept of "all-inclusive," the so-called "windfall" will be included in profit or loss.

156. Furthermore, we think that the concept of "all-inclusive" is consistent with the stewardship notion. From the perspective of stewardship, financial statements should be all-inclusive and any profit or loss should be disclosed even if certain transactions or events are considered non-recurring because this information has implications for assessing management competence.

157. Profit or loss is different from operating income because it considers all transactions and events that occur in a certain period. The concept of "all-inclusive" ensures the integrity of profit or loss as the primary source of information about the return an entity has generated on its economic resources. We think that operating income is useful in predicting future sustainable income. However, we think that operating income is useful only as long as it is disclosed as a subset of profit or loss which in-turn is consistent with cash flows.

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[20] Stock information can be also useful in assessing future net cash inflows to an entity. In particular, this is applicable to assets that generate cash flows by themselves.

Question 20
The IASB's preliminary view that the *Conceptual Framework* should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26. Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not? If you do not agree, how would you address cash flow hedge accounting?

158. We disagree with the IASB's preliminary view stated in the DP because we think that recycling would be achieved automatically as a mechanism and, therefore, non-recycling items would not exist.

159. We think that OCI is used because although both comprehensive income and profit or loss figures are determined based on the changes in net assets, different measurement bases are used for certain assets and liabilities in determining these figures. In cases where the measurement bases are different from the perspectives of reporting an entity's *financial position* and *financial performance*, we think that recycling occurs when the uncertainty regarding the outcomes of an entity's business activities is reduced to the point where the outcomes are irreversible or deemed irreversible and both measurements become the same amount. For example, recycling occurs when:

(a) related assets or liabilities are derecognised;

(b) impairment losses are recognised for related assets; or

(c) a natural reverse occurs with the passage of time.

160. When assets or liabilities are derecognised, the carrying amounts of the assets or liabilities would be reduced to zero. If different measurements are used from the perspectives of reporting an entity's *financial position* and *financial performance*, comprehensive income will vary from profit or loss by the amount equal to the difference between the amounts those assets or liabilities had previously been recognised at when such assets or liabilities are derecognised. As a result, recycling would be achieved automatically.

161. An example of the situation referred to in paragraph 159(b) of this comment letter would be when impairment losses are recognised for available-for-sale securities under IAS 39 *Financial Instruments: Recognition and Measurement*, where the different measurement bases are used from the perspectives of reporting an entity's *financial position* and *financial performance*. When impairment losses are recognised, both measurements would be reduced to fair value and thus comprehensive income would differ from profit or loss by the amount equal to the difference

between the amounts the assets had previously been recognised at. As a result, recycling would be achieved automatically.

162. An example of the situation referred to in paragraph 159(c) of this comment letter would be the effects of interest rates relating to debt financial instruments which meet the definition of FVOCI under IFRS 9 *Financial Instruments*. The difference between the effects of a current rate at the end of the period which are included in fair value, and the effects of the rate that applied at initial recognition used for amortised cost calculation would unwind naturally over time.

163. Under all the situations referred to in paragraph 159 of this comment letter, recycling would be achieved automatically as a mechanism. Accordingly, the difference between comprehensive income and profit or loss is essentially a timing difference and conceptually the accumulated amount of profit or loss for all accounting periods should equal the accumulated amount of comprehensive income for all accounting periods.

164. We note that almost all of the Japanese constituents, including preparers, users and auditors, support our view that all OCI items should be recycled.

Question 21
In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94). Which of these approaches do you support, and why? If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

165. In the first place, we strongly disagree with Approach 1 because we believe that profit or loss should be treated as an element of financial statements.

166. We disagree with both the narrow approach and the broad approach. As described in paragraph 137 of this comment letter, we suggest that OCI be defined as an element of financial statements in the following manner:

  OCI is "the linkage factor" that is used when the measurements that are relevant from the perspective of reporting an entity's *financial position* differ from the measurements that are relevant from the perspective of reporting an entity's *financial performance*.

167. Our approach is different from the narrow approach regarding the classification of OCI items. Specifically, the DP classifies OCI items into three categories, namely "bridging items,"

"mismatched remeasurements" and "transitory remeasurements." However, we suggest a single category, namely "the linkage factor," based on the definition suggested in paragraph 137 of this comment letter.

168. The concept which explains OCI as "the linkage factor" is broader than "bridging items" proposed in the DP. We disagree with the description in paragraph 8.59 of the DP which states that, for the IASB to consider the use of two different measurements, both would need to provide useful information about different facets of the entity's financial position and financial performance and for this to be the case, the cumulative amount recognised in profit or loss since the entity acquired the asset or incurred the liability should be consistent with the results of a meaningful, understandable and clearly describable measure of the asset or the liability. We do not think that it is necessary for the cumulative amount recognised in profit or loss to be meaningful[21] but it is sufficient if the measurement bases are determined from the perspective of reporting an entity's *financial performance* for each period. Accordingly, OCI items may be used as "the linkage factor" more often than "bridging items."

169. Furthermore, our approach is different from the broad approach of the DP in that we think that non-recycling items would not exist. As in our response to Question 20, when OCI items are considered to be "the linkage factor," recycling would be achieved automatically as a mechanism and, therefore, non-recycling items would not exist.

[21] For example, the cumulative amount of depreciation of property, plant and equipment may not be meaningful, understandable and clearly describable measure of the asset when the change in estimate occurs in the middle of the depreciation period.

Section 9 - Other issues

Question 22
Chapters 1 and 3 of the existing *Conceptual Framework* Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the *Conceptual Framework* highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters. Do you agree with this approach? Please explain your reasons. If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the *Conceptual Framework*.

170. We are conscious that the IASB published Chapters 1 and 3 of the *Conceptual Framework* in 2010, and does not plan to fundamentally reconsider these Chapters. At the same time, we are aware of various views expressed to these Chapters (notably from European stakeholders), especially with regard to the concepts of "stewardship," "reliability" and "prudence."

171. As noted in paragraph 7 of this comment letter, we have solicited views from Japanese constituents and found that many of the Japanese constituents are strongly interested in these concepts. Comments received from financial statement users and preparers suggested that these concepts (or what is meant by these concepts) should be reinstated or clarified in the revised *Conceptual Framework*.

172. In the following paragraphs, we explain our views with regard to the concepts of "stewardship," "reliability" and "prudence."

Stewardship

173. In recent discussions, many stakeholders have suggested the importance of fulfilling management's "stewardship" or "accountability" as the objective of financial reporting. We agree that it is highly important for management to fulfil these objectives (especially, the importance of fulfilling "accountability" in financial reporting context). However, we do not believe that the concept of fulfilling "stewardship" or "accountability" is *the* most important objective of financial reporting.

174. We believe that information about how efficiently and effectively the entity's management and

governing board have discharged their responsibilities to use the entity's resources[22] (often referred to as the information relevant to fulfil "accountability") and information that is helpful for users to assess the prospects for future net cash inflows to an entity[23] are considered to be the same in most cases. However, in some limited situations, the scope of information relevant to achieve the two objectives would differ. For example, information about compensation to key management personnel may not be necessary in light of assessing future net cash inflows to an entity, but it may be considered highly important for management to fulfil its accountability.

175. Paragraphs OB3 and OB4 of the existing *Conceptual Framework* seem to suggest that information relevant to assess future net cash inflows to an entity *always* encompasses the information relevant for management to fulfil its "accountability." Considering the difference noted in the previous paragraph, we recommend that the *Conceptual Framework* be amended to clarify that these objectives may be different in some respects, although information drawn from the two objectives overlap in most cases.

Reliability

176. As stated in the existing *Conceptual Framework*[24], we believe that financial information should be relevant and faithfully represented in order for financial information to be useful.

177. Based on our understanding, the existing *Conceptual Framework* states that, for information to be useful, both "relevance" and "faithful representation" and their appropriate balance should be considered and that due consideration should be given to the cost-benefit balance[25]. Although it is not explicit in the *Conceptual Framework*, we understand that paragraph QC18 of the existing *Conceptual Framework* acknowledge potential trade-off relationship between "relevance" and "faithful representation."

178. However, we are aware that some are questioning whether the *Conceptual Framework* allows such trade-off relationship. Accordingly, we recommend that the IASB clarify what is meant by paragraph QC18 in the existing *Conceptual Framework*. In doing so, the IASB might find it helpful to provide additional explanations in the Basis for Conclusions of the *Conceptual Framework*.

Prudence

179. The concept of "prudence" is used with different meanings by different people and "a bias towards

[22] Please refer to paragraph OB4 of the existing *Conceptual Framework*.
[23] Please refer to paragraph OB3 of the existing *Conceptual Framework*.
[24] Please refer to paragraph QC4 of the existing *Conceptual Framework*.
[25] Please refer to paragraphs QC18 and QC35-QC39 of the existing *Conceptual Framework*.

conservatism" and "the exercise of caution when making estimates and judgments under conditions of uncertainty" are fundamentally different. In our deliberations, it was noted that it is important to exercise sound caution and that such notion should be made explicit. Both financial statement users and preparers also provided similar feedback to us. Accordingly, we believe that it would be very useful to clarify what is meant by "prudence" in the revised *Conceptual Framework*.

180. Having understood that the pre-2010 *Conceptual Framework* provided some explanations as to what is meant by "prudence," we recommend that the IASB reinstate the discussion while reinforcing the description which highlights the importance of having a cautious mind in the revised *Conceptual Framework*.

Question 23
Business model The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities. Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not? If you agree, in which areas do you think that the business model concept would be helpful? Should the IASB define 'business model'? Why or why not? If you think that 'business model' should be defined, how would you define it?

181. We agree with the IASB's preliminary view that financial statements can be made more relevant if the IASB considers, when newly developing or revising accounting standards, how an entity conducts its business activities.

182. As noted in paragraph 76 of this comment letter, we believe that a relevant measurement basis for an asset or a liability can be determined based on how the asset contributes to future cash flows or how an entity will settle or fulfil the liability. In this context, we believe that the business model often provides useful evidence as to how an asset contributes to future cash flows or how an entity will settle or fulfil the liability. Accordingly, we support the use of the business model notion in the standard-setting process.

183. In December 2013, the European Financial Reporting Advisory Group (EFRAG) and some European standard setters jointly published a Research Paper *The Role of the Business Model in Financial Statements*. Although the paper noted challenges for providing a universal definition of

a business model, it identified the "manner in which cash flow is generated and value is created" as an important characteristic to identify the business model, and explained the business model focusing on the cash conversion cycle. Furthermore, the paper identified possible criteria that could help the IASB in determining when the business model should be considered, when newly developing or revising accounting standards.

184. Although we do not necessarily agree with every aspect of the paper, we believe that it would be very helpful if the *Conceptual Framework* explained whether, and if so how, recognition, measurement, and presentation and disclosures should differ depending on how cash flow is to be generated and how value is to be created. Accordingly, regardless of whether the term "business model" is used in the *Conceptual Framework*, we recommend that the revised *Conceptual Framework* include relevant discussions using the notions stated in the previous paragraph.

Question 24
Unit of account The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information. Do you agree? Why or why not?

185. We are of the view that the unit of account is extremely important for the development of accounting standards, because it has significant implications to standard-setting decisions, especially as to when and how items should be recognised and derecognised as well as how they should be measured. Accordingly, we disagree with the IASB's preliminary view that the unit of account should be left to standard-setting decisions rather than being addressed at the conceptual level.

186. We understand the challenges to prescribe how to decide on the unit of account, given that the unit of account has been decided on a standard-by-standard basis in the absence of an underlying comprehensive concept. However, having considered its importance, in case the IASB decides not to fully deliberate this issue in this revision of the *Conceptual Framework*, we encourage the IASB to separately consider this issue at the conceptual level.

Question 25

Going concern Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity). Are there any other situations where the going concern assumption might be relevant?

187. We have not identified situations in which consideration of the going concern assumption is relevant, other than those described in paragraphs 9.42-9.44 of the DP.

188. Nevertheless, as noted in paragraph 37 of this comment letter, we do not believe that it is appropriate to refer to the going concern assumption when determining whether a present obligation exists.

Question 26
Capital maintenance Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework* largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change. Do you agree? Why or why not? Please explain your reasons.

189. We agree with the IASB's plan to include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework* largely unchanged until such time as a new or revised standard on accounting for high inflation indicates a need for change.

190. Nevertheless, we note that paragraph 9.54 of the DP discusses the revaluation model prescribed in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. We are of the view that the revaluation model is based on the capital maintenance concept, and believe that relevant accounting requirements should be amended such that revaluation gains or losses are accounted for as direct increases or decreases in equity.

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We hope our comments will contribute to the forthcoming deliberations of the Conceptual Framework project.

Yours sincerely,

Ikuo Nishikawa
Chairman of the Accounting Standard Board of Japan

[Appendix A] Other views from Japanese constituents on the IASB's preliminary views

This Appendix describes the major views of Japanese constituents on the preliminary views in the DP that are not necessarily consistent with the views of the ASBJ but those we believe are useful for the IASB to consider in future deliberations.

Section 3 - Additional guidance to support the asset and liability definitions

(Question 6)

- We received from preparers of financial statements the following view regarding to the meaning of 'present' in the definition of a liability.
  - View 2 is the easiest to understand. However, there exist standards corresponding to View 1 to View 3 under existing IFRSs, and these are all accounting treatments that faithfully represent the economic reality. Specifying one of the Views as a "definition" would conceptually restrict accounting standards from conforming with economic reality and does not seem to be appropriate. At least for the time being, it may be unnecessary to specify one View in the *Conceptual Framework*.

Section 4 – Recognition and derecognition

(Question 8)

- We have received the following comments from preparers of financial statements.
  - We disagree with the deletion of the "probability" criterion from the recognition criteria of assets and liabilities. If the probability criterion were to be eliminated, it would become necessary to employ more complicated measurement techniques to reflect increased outcome uncertainties. This would result in less reliable information, while imposing more costs for financial statement preparers.

Section 5 - the definition of equity and the distinction between liabilities and equity instruments

(Question 10)

- We have received the following comments from preparers of financial statements.
  - Requiring separate presentation of claims does not seem to be consistent with IFRSs' awareness of jurisdictional differences in the breakdowns in the equity category.
  - The IASB has suspended its discussion on the distinction between liabilities and equity instruments and constituents have not yet agreed with its direction. Under this circumstance, it is inappropriate to fundamentally revise the notion of equity.

- The IASB should consider defining equity in the deliberations of the Exposure Draft of the revised *Conceptual Framework* because not doing so might make the distinction between transactions or events that give rise to income/expense and those with owners in their capacity as owners difficult. Legal and regulatory definitions or presentations of equity could be indicators from the perspective of stability of the presentation of equity, and therefore should be taken into account.

- We received the following comment from auditors of financial statements.
  - We agree with the concept that would classify as equity residual interests in the assets of an entity after deducting all of its liabilities because, if assets were defined as economic resources and liabilities were defined as obligations to transfer economic resources, the resulting residual would represent the residual interests in the assets of an entity after deducting all of its liabilities.

  - Regarding the preliminary view (c), the IASB should consider in detail why it is relevant to measure a secondary equity claim in a consistent manner with a comparable financial liability if the IASB pursues remeasurement of the secondary equity claim which is a residual claim.

Section 7 - Presentation and disclosure
(Question 16)

- We have received the following comments from preparers of financial statements.
  - It is necessary to determine the minimum scope of the disclosures as financial information by considering the accuracy, timeliness and verifiability of the information required to be disclosed and judging whether it is appropriate to disclose as financial information instead of non-financial information.

  - We think that forward-looking information, except for qualitative information relating to the assumptions of estimates which are recognised in primary financial statements, should not be included in the notes to financial statements because the objective of the notes to financial statements is to provide supplemental information. We think that forward-looking information basically should be treated as non-financial information.

  - The necessity of individual disclosure requirements should be discussed considering the usefulness of the information and whether the benefits justify the costs. We think that Table 7.1 of the DP would be inappropriate to include in the *Conceptual Framework* because it can be used as a checklist. In particular, we are concerned about the usefulness of 'the sensitivity analysis,' 'maturity analysis' and 'roll-forwards' which are included as types of useful information in Table 7.1 and we think that they should be deleted. In addition, paragraph

7.35 (b) should also be deleted.

Section 8 - Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

(Question 19)

- We have received the following comment from financial statement preparers.
  - We think that **profit or loss** is recognised gains or losses which are released from risks. Furthermore, we think that whether critical decisions are made or not would be one of the indicators to determine if gains or losses are realised.

Section 9 - Other issues

(Question 22)

- We have received the following comment from financial statement preparers.
  - The concept of “reliability” should be made explicit in the *Conceptual Framework*. This is because providing clarify to the concept would be helpful for financial statements to faithfully represent events or transactions without being affected by too much bias.

[Appendix B] Scope of the notes to financial statements

<table>
<tr><td colspan="3" rowspan="3"></td><td colspan="3">Transactions, events and conditions that occurred before year end (including related estimates)</td><td colspan="2">Transactions, events and conditions that have not occurred before year end</td></tr>
<tr><td colspan="2">Recognised on the face of financial statements</td><td colspan="3">Not recognised on the face of financial statements</td></tr>
<tr><td>Items measured by not using estimates *5</td><td>Items measured by using estimates *5</td><td>Unrecognised items</td><td>Non-adjusting events after the reporting period</td><td>Other than non-adjusting events after the reporting period</td></tr>
<tr><td colspan="3">Category</td><td>A</td><td>B</td><td>C</td><td>D</td><td>E</td></tr>
<tr><td rowspan="4">Factual information</td><td>Quantitative information</td><td>Numerical depiction *1</td><td>O</td><td>O</td><td>O</td><td>O</td><td>X</td></tr>
<tr><td rowspan="3">Qualitative information</td><td>Explanatory description related to fact *2</td><td>O</td><td>O</td><td>O</td><td>O</td><td>X</td></tr>
<tr><td>Explanation of factors and circumstances that might affect the items' quality and nature *3</td><td>O</td><td>O</td><td>O</td><td>X</td><td>X</td></tr>
<tr><td>Description of the plans or strategies regarding the risk exposure of the item</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td rowspan="2">Alternative measurements</td><td rowspan="2">Quantitative information/ Qualitative information</td><td>Information relating to measurements using alternative measurement bases</td><td>O *6</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td>Information relating to measurements using alternative inputs *4</td><td>X</td><td>O *7</td><td>X</td><td>X</td><td>X</td></tr>
</table>

<table>
<tr><td colspan="3" rowspan="3"></td><td colspan="2">Transactions, events and conditions that occurred before year end (including related estimates)</td><td colspan="3">Transactions, events and conditions that have not occurred before year end</td></tr>
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<tr><td colspan="3">Category</td><td>A</td><td>B</td><td>C</td><td>D</td><td>E</td></tr>
<tr><td></td><td></td><td>Information relating to measurements using alternative accounting policies</td><td>O</td><td>O</td><td>X</td><td>X</td><td>X</td></tr>
</table>

[Legend]

O: Generally included in notes to financial statements

X: Generally not included in notes to financial statements

[Notes]

*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 sensitivity analysis.

*5: The term 'estimates' include fair value estimates.

*6: In very limited situations where the IASB may determine to use one measurement basis even when it is relevant to use two measurement bases from the perspectives of reporting an entity's *financial position* and *financial performance*.

*7: Only when uncertainty of estimates is high.

Our analysis focuses on the nature of the items which are to be included in the notes to financial statements. When developing disclosure requirements, standard-setters should consider whether the benefits overweigh the costs and whether such disclosures can be audited.