

Discussion Paper on Treatment of Special Purpose Entities and Related Matters in Consolidated Financial Statements

February 6, 2009

Accounting Standards Board of Japan

Invitation to comment

The Accounting Standards Board of Japan (hereinafter referred to as “ASBJ”) has deliberated issues on treatment of special purpose entities (SPEs) and related matters in consolidated financial statements based on the Tokyo Agreement, i.e. the agreement which the ASBJ and the International Accounting Standards Board (IASB) jointly announced in August 2007 on initiative toward accelerating convergence of the accounting standards. We have deliberated treatment and related disclosures of SPEs in consolidated financial statements including issues regarding definition of control and application of the control criterion, and types of entities subject to consolidation.

Today, ASBJ publishes for public comments the above captioned Discussion Paper (herein after referred to as “DP”) on treatment of special purpose entities and related matters in consolidated financial statements pursuant to the Board’s approval at the 170th meeting on January 30, 2009.

The comment deadline is April 13, 2009.

Summary of the DP

[Issue 1] Definition of Control and Application of the Control Criterion

The DP discusses whether or not the definition of control over other enterprises and the application of the control criterion will have to be improved to serve for the treatment of SPEs in the consolidated financial statements taking into account consistency with other accounting standards and trend of the international accounting standards.

Given the treatment under the ASBJ Statement No.21 *Accounting Standard for Business Combinations* and the treatment under the international accounting standards, a notion of return may have to be added to the definition of control. If this is the case, the definition of control could be a power to direct the activities of other entity to generate returns¹ for the reporting entity and, as a result, clarifies to subsume not only the one applicable to typical business enterprises but also the one applicable to SPEs.

Further, it should be noted that, because the notions of a closely related party (a party who is expected to act in same way for close relationship) and an agreed party (a party who is agreed to act in same way) are used in Japan to widely capture the substantially controlled enterprise in the scope of consolidation, it should be appropriate to continue using that way of thinking regarding the control criterion without distinguishing between typical business enterprises and SPEs even though the definition of control is changed.

[Issue 2] Types of Entities Subject to Consolidation

In many cases, entities subject to consolidation are envisaged to be corporations. However, other types of entities than a corporation can also be consolidated. The DP discusses what types of entities can be consolidated taking into account consistency with other accounting standards as well as current treatment and on-going trend of the international accounting standards.

It is commonly understood that corporations are entities that are eligible to be consolidated and other legal entities than corporations are treated as quasi-corporations. We do not expect this view will be challenged. On the other hand, we understand that there may be needs to review the treatment of a partnership and a trust to form a consistent view on whether they should be

¹ “Return” arises not only from direct investment into other entity but also from wide range of its involvement with other entity. The return varies depending on the activities of that other entity and can be positive or negative.

treated as entities fallen under the category of the quasi-corporations for accounting purposes, because function of a partnership is often analogous to that of a trust but there may be some cases where the accounting by partners of a partnership may differ from that by beneficiaries of a trust.

[Issue 3] Treatment of SPEs

In Japan, it is presumed under the “Guidance on the Review of Scope of the Subsidiaries and Affiliates under the Consolidated Financial Statements System” issued in October 1998 that SPEs that meet certain conditions do not fall under the category of consolidated subsidiaries for investors of the SPEs. In the DP, we have discussed how SPEs should be treated under the control criterion, taking into account consistency with other accounting standards as well as treatment and trend of the international accounting standards.

Given the problem pointed out by constituents and trend of the international accounting standards, it could be anticipated that the abovementioned presumption to exclude certain SPEs from the scope of the consolidation will be eliminated but we will continue to discuss this issue further. If in case the abovementioned presumption is decided to be eliminated, consideration should be given not to expand the scope of the consolidated subsidiaries too widely to include entities that are reasonably considered to be independent of their investors under the control criterion using the notion of a closely related party and an agreed party.

Furthermore, the DP discusses whether or not accounting standard for assets securitization should be amended and whether or not there are additional issues to be taken into account when determining whether or not SPEs fall under the category of an affiliate.

[Issue 4] Disclosure regarding SPEs

In the DP, disclosure regarding SPEs is also discussed while considering the consistency with other accounting standards and trend of the international accounting standards.

It is expected that the notion of SPEs will continue to remain regardless of whether or not the abovementioned presumption to exclude certain SPEs from the scope of the consolidated subsidiaries is eliminated. Considering the trend of the international accounting standards, Implementation Guidance on Disclosure about Certain Special Purpose Entities (ASBJ Guidance No.15) will have to be abolished or amended, and disclosure regarding SPEs and similar entities will have to be extended.

[Issue 5] Treatment of a Subsidiary under Temporary Control

While a subsidiary temporarily controlled by a reporting entity is excluded from the scope of consolidation under existing Japanese GAAP, the international accounting standards do not exclude it from the scope of consolidation for temporary nature of the control but requires to include its assets, liabilities and profits or losses in the consolidated financial statements separately from ordinary assets, liabilities and profits or losses from continued operation if it meets the definition of the entity held for sale or the discontinued operation.

We will continue to discuss difference between the treatment to exclude such a temporarily held subsidiary from consolidation and the treatment to include it in the consolidation with well-devised presentation and disclosures. If in case it is found that no significant difference exists between those treatments, we will have to consider amendment to the accounting standard taking into account the trend of the international accounting standards. If this is the case, it should be appropriate to discuss measurement issues as well as the issues regarding presentation and disclosures.

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