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

Comments on the Exposure Draft of *An Improved Conceptual Framework for Financial Reporting*

To the Board Members:

The Japanese Institute of Certified Public Accountants appreciates the continued efforts of the International Accounting Standard Board (IASB) on the conceptual framework project and welcomes the opportunity to comment on the Exposure Draft of *An Improved Conceptual Framework for Financial Reporting*.

The following is our response to the items in 'invitation to comment' with which we disagree or have questions or concerns.

I. General Comments

1. Authoritative status of the framework

The boards state that they have not reached a common conclusion on the authoritative status of the common conceptual framework. However, we believe that the purpose of the framework and its status within the hierarchy of standards should be defined prior to the discussion of its contents. In addition, according to the paragraph P14 of the Exposure Draft, the common framework will not override financial reporting standards. This statement appears to contradict the common goal of the boards in this project as set

forth in the paragraph P4. We believe that the common conceptual framework should be positioned above all standards. To illustrate this in the extreme, all individual standards could be viewed as application guidance of the framework and therefore should be consistent with the framework. The meaning of the framework should be to ensure internal consistency using a principles basis, and accordingly we believe that the Boards must make clear that any standard-setting process must respect this concept. Finally, we believe that any existing standards that are not consistent with the framework should be subject to a review process.

2. Scope of general purpose financial reporting

In the paragraph OB3 of the Exposure Draft, the scope of general purpose financial reporting includes but is not limited to financial statements. On the other hand, the paragraph OB16 of the Discussion Paper, *Preliminary Views on an improved Conceptual Framework for Financial Reporting – The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information* – published in July 2006 included a description about the relationship between financial reporting and financial statements, which stated that financial and non-financial information other than financial statements could be included in general purpose financial reporting as set forth in the framework. We believe it is doubtful that such information can always satisfy the qualitative characteristics, such as faithful representation, mentioned in Chapter 2. We also believe it is necessary to give some consideration to whether such information could be audited. While the boards concluded that consideration of specific issues concerning the boundaries of financial reporting and distinctions between financial statements and other parts of financial reporting should be deferred to a later phase of the conceptual framework project (the paragraph OB4), we believe that it is necessary to deliberate these issues as early as possible as it is conceivable that the conclusion will have no small impact on discussions in other phases.

Of the questions indicated in the Exposure Draft, comments are provided below only for those questions with respect to which the JICPA does not agree with the proposal, or has questions or concerns.

II. Specific Comments

Chapter 1 *The objective of financial reporting*

Question 1

The boards decided that an entity's financial reporting should be prepared from the perspective of the entity (entity perspective) rather than the perspective of its owners or a particular class of owners (proprietary perspective). (See paragraphs OB5–OB8 and paragraphs BC1.11–BC1.17.) Do you agree with the boards' conclusion and the basis for it? If not, why?

Comment:

We neither agree nor disagree.

Unlike the Discussion Paper, the Exposure Draft has extended its explanation about the conceptual foundation on why the entity perspective is more useful (paragraphs BC1.11 through BC1.16). Therefore, we do not consider that the theoretical basis and explanation supporting the entity perspective is particularly insufficient in the Exposure Draft. On the other hand, this is a truly fundamental issue in financial reporting and there are many different opinions about what is the most appropriate view. Moreover, the boards state that they had not yet considered all the possible implications of that decision on future phases of the framework project. Therefore, we believe that some room and flexibility for possible reconsideration of this issue depending on the direction of future discussions should be provided for.

Chapter 2 *Qualitative characteristics and constraints of decision-useful financial reporting information*

Question

Chapter 2 describes the qualitative characteristics that make financial information useful. The qualitative characteristics are complementary concepts but can be distinguished as fundamental and enhancing based on how they affect the usefulness of information. Providing financial reporting information is also subject to two pervasive constraints—materiality and cost. Are the distinctions—fundamental and enhancing qualitative characteristics and pervasive constraints of financial reporting—helpful in understanding how the qualitative characteristics interact and how they are applied in obtaining useful financial reporting information? If not, why?

Question 1

Do you agree that:

(a) *relevance* and *faithful representation* are fundamental qualitative characteristics?

(See paragraphs QC2–QC15 and BC2.3–BC2.24.) If not, why?

(b) *comparability*, *verifiability*, *timeliness* and *understandability* are enhancing qualitative characteristics? (See paragraphs QC17–QC35 and BC2.25–BC2.35.) If not, why?

Comment:

(a) We agree that they are fundamental qualitative characteristics.

However, we believe that the words “free from material error” in the paragraph QC7 should be deleted.

(b) We believe that Verifiability should be stated as a component of faithful representation.

In the paragraph BC2.28, it states that strict adherence to verifiability could result in some information being excluded from financial reporting and less information content. However, verifiability provides assurance about what the accounting information represents, and therefore should be considered as a component of faithful representation.

Question 2

The boards have identified two fundamental qualitative characteristics— *relevance* and *faithful representation*:

(a) Financial reporting information that has *predictive value* or *confirmatory value* is relevant.

(b) Financial reporting information that is *complete*, *free from material error* and *neutral* is said to be a faithful representation of an economic phenomenon.

(i) Are the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?

(ii) Are the components of the fundamental qualitative characteristics appropriately identified and sufficiently defined for them to be consistently understood? If not, why?

Comment:

We agree to the ideas expressed in both (i) and (ii), but please refer to the comment on Question 1(a) above.

In addition to the comment above, we believe that the boards should reconsider the

following paragraphs.

(1) Paragraph QC3

In the paragraph QC3, it states that:

“...Whether information about an economic phenomenon is capable of making a difference is not dependent on whether the information has actually made a difference in the past or will definitely make a difference in the future....”

We believe that the boards should clarify its intent of the sentence above in the paragraph QC 3. In the paragraph BC2.3, it states that for the information to be relevant, the IASB Framework requires that the information *actually makes* a difference in a decision—whereas the FASB Framework requires that the information is *capable of making* a difference in a decision. Given the context of the sentence above and the statement in the paragraph BC2.3, we understand that the sentence above was inserted since the boards adopted the latter definition in the Exposure Draft.

In order to clarify such intent, we suggest that the sentence above should be replaced as follows:

“...Whether information about economic phenomena is capable of making a difference in a decision, i.e., whether it is relevant, is a matter of possibility, which does not require that the information has actually made a difference in the past or will definitely make a difference in the future...”

(2) Paragraph QC8

The relevance of the paragraph QC8 is unclear.

Although this paragraph explains that a single economic phenomenon may be represented in multiple ways and that a single depiction in financial reports may represent multiple economic phenomena, we believe that the explanation does not fit the context in which it is placed. It is unclear how the explanation relates to the components of faithful representation, such as being neutral, complete and free from material error.

Question 3

Are the enhancing qualitative characteristics (*comparability, verifiability, timeliness and understandability*) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not, why?

Comment:

We believe that *consistency* should be included among enhancing qualitative characteristics instead of *comparability*.

In the paragraph QC16, it states that *comparability* is the goal; *consistency* is a means to an end that helps in achieving that goal. Therefore, *consistency* is the necessary qualitative characteristic that is required by *comparability*, while *comparability* alone does not contain any substance as an enhancing qualitative characteristic.

Question 4

Are the pervasive constraints (*materiality* and *cost*) appropriately identified and sufficiently defined for them to be consistently understood and useful? If not, why?

Comment:

We believe that the boards should reconsider the explanation supporting the conclusion that materiality is a pervasive constraint on financial reporting (paragraphs BC2.58 and BC2.59), since it is insufficient one.

In the paragraph QC28, it states that when considering whether financial information is a faithful representation of what it purports to represent, materiality is taken into account from the perspective of whether there are any material omissions or misstatements. We understand that it indicates that materiality is to be a threshold or a criterion, rather than a constraint on financial reporting. Omission of material information means avoiding cost by focusing on material information. Therefore, we believe that such an idea is already included in the concept of cost, which is another constraint.

Beyond the discussion whether the materiality is included in the concept of cost or not, the boards should also consider that disclosure of information other than material one could create irrelevant results. If it is understood in this context, materiality may be considered to be a component of relevance.

Yours faithfully,

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Executive Board Member - Accounting Standards

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