January 14, 2014

To the International Accounting Standards Board

Japanese Bankers Association

Comments on the International Accounting Standards Board (IASB)'s Discussion Paper
"A Review of the Conceptual Framework for Financial Reporting"

We, the Japanese Bankers Association ("JBA"), are an organization that represents the banking industry in Japan; and our members comprise banks and bank holding companies operating in Japan.

We would like to express our gratitude for this opportunity to comment on the Discussion Paper "A Review of the Conceptual Framework for Financial Reporting" (DP) published by the International Accounting Standards Board ("IASB").

We respectfully expect that the following comments will contribute to your further discussion on this issue.

1. Overall comment

Firstly, we would like to express our gratitude to the IASB for reviewing the concepts of profit or loss, OCI and other areas in this Discussion Paper (DP) in response to our comment expressed on the "Agenda Consultation 2011", requesting the concept of other comprehensive income (OCI) should be re-considered.

While we are in support of the proposed treatment in the DP to distinguish profit or loss and OCI items for presentation purposes, the IASB is requested to give careful consideration to the following points: (i) the difference between profit or loss and OCI items is still unclear because the DP does not explicitly define profit or loss, and (ii) some items which are currently classified as OCI may not be eligible to be recognised in OCI under the new conceptual framework.

With respect to liability/equity classification, we would like to express our disagreement with the strict obligation approach proposed in the DP. The classification of liabilities and equity is an issue which was once discussed but could not reach preliminary views and therefore was put off for later discussions. Given this, the IASB should give careful consideration to this issue, taking into account the impact on individual standards. There is also a concern that it is unclear whether the remeasurement of equity claims and the concept of "a transfer of wealth" are useful for investors. The IASB is therefore requested to discuss this issue thoroughly through outreach to market participants and other activities.

2. Comments on specific questions provided in the DP

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?
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 amending Standards?

(Summary)

- We agree to the proposed guidance specifying that profit or loss should represent a total or subtotal of income or expense and should be recognised separately from OCI in the statement(s) of profit or loss and OCI.

  However, it is requested that the IASB should define profit or loss so that it can be clearly distinguished from OCI.

(Basis, etc.)

- As current IFRS does not explicitly define profit or loss and OCI, in developing standards, a conclusion is often led in the following way; if the recognition of some items of income and expense in profit or loss is considered to undermine the appropriate assessment of financial performance, such items should be recognised in OCI.[1] In other words, substantially, there is an established view that items of income and expense necessary to appropriately assess financial performance should be included in profit or loss.
- In Japan, many companies consider profit or loss as a comprehensive performance measure and hence incorporate profit or loss in their profitability measure, investment efficiency measure and other measures that are extensively used. Additionally, as paragraph 8.19 of the DP states, many investors, creditors, preparers and others around the world view profit or loss as a useful performance measure and that 'profit or loss' is

[1] E.g.: Basis of conclusions to recognise changes in the discount rate of insurance contracts in OCI
ED/2013 Insurance Contracts, para. BC119: Entities should segregate the effects of changes in the discount rate that are expected to unwind over time from other gains and losses, so that users of financial statements could better assess the underwriting and investing performance of an entity that issues insurance contracts.

deeply ingrained in the economy, business and investors' minds, as a primary performance measure.

- Therefore, in the context of standard development as well as business practice, it is internationally commonly accepted knowledge that profit or loss generally represents an entity's performance in a period. Given this, clearly defining profit or loss under the Conceptual Framework as "a subtotal of the most primary items of income or expense in appropriately assessing an entity's performance", will benefit future standard development processes and will also improve comparability of profit or loss across entities.
- The DP also proposes approaches to distinguish profit or loss and OCI items. As mentioned in our comment to Question 21, we are concerned that the definition of OCI may become ambiguous because of an unclear definition of the "relevance of profit or loss".

(Considerations for defining "profit or loss")

- The DP stipulates that "all items of income and expense are the result of an entity's financial performance and are included in total comprehensive income" (para. 8.15), defining both profit or loss and OCI items as a result of financial performance. To identify profit or loss items among OCI items, it is necessary to clarify which element of financial performance constitutes profit or loss.
- As previously described, market participants, etc. deem profit or loss to be "a measure that reflects the outcome of business management; namely, return, in a period, on various investments made by management". In line with this common view, income and expenses arising from business investments whose return is not yet recognised and for which an entity is continuously exposed to associated risks, should not be included in profit or loss. Given this, for example, the definition of profit or loss under the Discussion Memorandum "Conceptual Framework of Financial Accounting", published by the Accounting Standards Board of Japan ("ASBJ") in December 2006, can also be adopted in the case of business investments. Under the Discussion Memorandum, profit or loss is defined as "the outcome of investments under which the entity has been released from various associated risks during the annual period".

  This proposed definition is working effectively in Japan and has not particularly been requested by market participants to be reviewed.

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.

(Summary)

- Both Approaches 2A and 2B could not be supported because the definition of profit or loss is unclear. The IASB is requested to first define which items are to be included in profit or loss. Those items of income and expense which do not meet such a definition should be defined as items to be included in OCI.
- The IASB should carry out a careful discussion in defining OCI so that designated investments in equity instruments under IFRS 9 (OCI option) will not be deemed ineligible for and thus excluded from OCI recognition.

(Basis, etc.)

- Paragraph 8.40 sets out the principles that the proposed Approach 2A would apply to determine whether items of income and expense are eligible to be recognised in profit or loss, or in OCI. Of such principles, Principle 2 stipulates that "all items of income and expense should be recognised in profit or loss unless recognising an item in OCI enhances <u>the relevance of profit or loss</u> in that period". However, since the purpose of profit or loss is unclear in the absence of a definition of profit or loss, even the expression "the relevance of profit or loss" is used here, it is difficult to assess such relevance.

  In addition, Principle 3 in the proposed Approach 2B stipulates that "an item that has previously been recognised in OCI should be reclassified (recycled) to profit or loss when, and only when, the reclassification <u>results in relevant information</u>." Similarly, it is unclear as to how to assess this relevance in the context of what objective. Consequently, profit or loss needs to be clearly defined to determine "the relevance of profit or loss".

  In light of this, as mentioned in our comments to Questions 4 and 19, the IASB should clarify the definition of profit or loss.
- Table 8.2 of the DP stipulates that OCI recognition of changes in fair value of designated investments in equity instruments is "unlikely to meet either the bridging or mismatched remeasurement concept," implying that this item is not eligible to be recognised in OCI. However, as noted in Table 8.2 "except, arguably, for some strategic investments", policy-based equity investments made by Japanese banks which are deemed to be the "strategic investments" are assumed to be held over a long-term period for the purpose

of maintaining overall business relationships with corporate customers. Therefore, changes in fair value of such investments should not be included in profit or loss which is a measure of the business performance of an entity, but should be recognised in OCI instead. The IASB is requested to give due regard so that changes in fair value of strategic investments for which the OCI option is elected are allowed to be continuously recognised in OCI under the finalised Conceptual Framework.

- Based on the ASBJ's view[2], items to which the OCI option is applied may be classified as bridging items. With regard to financial liabilities designated as fair value through profit or loss under IFRS 9, Table 8.2 of the DP states that OCI recognition of changes in fair value attributable to an issuer's own credit risk does not fit the concept of the bridging item and places a question mark for whether it could be a mismatched remeasurement. We presume the reason for this is that the IASB is concerned if changes in fair value attributable to issuer's own credit risk are concluded as not qualifying for the concept of mismatched remeasurement, this item will have to be recognised in profit or less, whereas if it is concluded as meeting this concept, it needs to be recycled. To be consistent with this, it is suggested that, until a conclusion is reached, the "Bridging item" column in Table 8.2 for this OCI option should be "Yes" or "?".
- Approaches that may result in both the above OCI options becoming ineligible for OCI recognition under the proposed Conceptual Framework, although consensus has been reached on the reasonableness of OCI recognition in individual accounting treatments, cannot be considered as appropriate. Therefore, the IASB should consider a comprehensive approach which enables an entity to recognise the items set out in Table 8.2 in OCI under the Conceptual Framework as well.

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:

(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)).

[2] See paragraphs 91 and 92 of the following : http://www.ifrs.org/Meetings/MeetingDocs/ASAF/2013/December/AP3%20Profit%20and%20Loss%2c%20Measurement%20and%20OCI.pdf

(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.

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

(Summary)

- We do not agree to the above preliminary view.

(Basis, etc.)

1. Definition of liabilities and equity

- The DP proposes to define liabilities and then, by using the definition of liabilities, to regard equity as the "difference between assets and liabilities". However if equity is not defined, it will be difficult to distinguish equity transactions from transactions that generate income and expenses. In developing individual standards, this may lead to complication in determining whether a transaction is an equity transaction or transaction that generates income and expenses. From this point of view, the IASB is requested to consider defining equity. Further, the definition or presentation of equity based on laws or regulations could also be a benchmark in determining the classification of equity and liabilities. Therefore, from the perspective of consistency of the equity presentation with applicable law or regulation, we respectfully request to consider this point in defining equity.
- In discussing the definition of liabilities and equity, the DP refers to IAS 32 and other existing standards. However, it should be noted that under the IASB's past project on "financial instruments with characteristics of equity", many expressed concerns over complexity of the liabilities and equity classification under IAS 32 and other existing standards. Therefore, the conclusion was postponed.
- Under JGAAP, since the classification of equity and liabilities is based on the legal form, preferred shares are never classified as a liability. Under IAS 32, on the other hand, conditions other than the legal form need to be assessed in some cases, giving rise to considerably complicated practices. For example, preferred shares with the obligation of redemption at par in five years would be classified as a liability under IAS 32.
- Given the above, in developing an exposure draft for the Conceptual Framework, the IASB is requested to define both equity and liabilities in plain words; and, based on such

definitions, review IAS 32 to address the complexity of its equity and liabilities classification.

2. Remeasurement of equity claims and the concept of “a transfer of wealth”

- Both the remeasurement of equity claims and the concept of “a transfer of wealth” proposed under the strict obligation approach are new concepts for the Japanese banks. As the DP does not specify to what extent these are useful to investors and whether they can provide information of high relevance to investors, we do not support the introduction of these new concepts.
- As an example of the transfer of wealth, the DP mentions a change in fair value under a written option on shares recognised in equity. However, Japanese banks do not experience such cases, and hence preparers have no clear view as to what kind of transactions meet the condition of the wealth transfer.
- If the proposed equity claim remeasurement and the concept of “transfer of wealth” are to be adopted, the IASB should give due regard to avoid causing confusion among preparers and users by stipulating the objectives of recognition and by including illustrations in the exposure draft to explain in what cases equity claims should be remeasured and the transfer of wealth should be recognised. Further, since these are new concepts, in drafting the exposure draft, it is necessary to consider carefully, among other things, the significance and usefulness of adopting these new concepts and the degree of impact thereof, through carrying out outreach to investors and prepares and other activities.