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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
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Dear Sir David:

re: Comments on "Financial Statement Presentation"

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on the International Accounting Standards Board (IASB or the Board)'s discussion paper "Preliminary Views on Financial Statement Presentation". SAAJ is a not-for-profit organization providing investment education and examination programs for securities analysts. Its certified members exceed 23,000. The CAC is a standing committee of SAAJ composed of 13 members, most of whom are users including equity and credit analysts, and portfolio managers, while a few are academicians and certified public accountants.

General Comments

The discussion paper is the product of joint work between the Board and the US Financial Accounting Standards Board (FASB). Needless to say, we greatly appreciate the efforts of the two boards in producing such an ambitious and intellectually stimulating discussion paper which could result in revolutionary changes to financial statements. Under the circumstances where both Japan and the US have announced plans to adopt IFRS, we are most pleased to have had the opportunity to consider financial statement presentation from a completely new perspective. We think it right that the boards decided to keep net income, comprehensive income, and recycling in the paper. Indeed, the vast majority of our over 23,000 members demand disclosure of both net income and comprehensive income, and we understand the decision of the boards to properly reflect such views of financial statement users.

The discussion paper also enables breakeven point analysis by disclosing line items in cost of goods sold and selling, general & administrative expenses in a statement of comprehensive income. Japanese financial reporting requires disclosure of both consolidated and non-consolidated statements, but breakeven analysis is only possible on a non-consolidated basis because a breakdown of cost of goods sold is not available in a consolidated income statement. Making breakeven point analysis possible on a consolidated basis represents substantial progress and we thus highly evaluate the discussion paper in this context.

Securities analysts process financial data in various formats. This is because important items and ratios differ according to which industry a company is in, a company's specific situation, and ever changing themes in the market. From this standpoint, a one-size-fit-all financial statement that dispenses with analyst processing completely cannot, by definition, exist. Hence, financial statements should be simple with a flexible structure and enough line items to enable processing. The examples shown in the discussion paper have many more line items than those currently available which will be applauded by financial statement users.

Believing that the "Financial Statement Presentation" and "Revenue Recognition" discussion papers are very important and will define the foundation of IFRS going forward, SAAJ commissioned Professor Eiko Tsujiyama of Waseda University to write an explanatory booklet, which has been distributed to all members. Further, SAAJ held seminars for members in Tokyo and Osaka inviting Professor Tsujiyama as a lecturer and asked participants for their overall impression of the proposals contained in the discussion papers. Questions and responses regarding the "Financial Statement Presentation" were as follows:

Question: Compared to current Japanese financial statements, do you think the proposed new financial statements are improved so as to facilitate company analysis and performance comparisons?

Answer:	*Improved*	*20%*	
	Cannot judge	*61%*	
	Not improved	*13%*	
	No answer	*6%*	*Number of respondents=151*

Unfortunately, the discussion paper was not warmly welcomed by our members. The main reason, we assume, is that it contains so many radical changes that it is difficult for the average financial statement user to determine how analysis could be conducted within the proposed new format.

We have heard from preparers of financial statements that they are very much against the many propositions in the discussion paper as they would require fundamental changes to the current financial reporting system which would mean a substantial increase in costs. Although the discussion paper offers some important benefits as mentioned earlier, considering the rather strong opposition of the preparers, we regret to say that we could not identify enough positive reasons to support the discussion paper as a whole. Below, you will find our comments on major issues. Question numbers in parentheses after headings are the same as numbers shown on pages 7-12 of the discussion paper.

Role and Format of Financial Statements and Line Items Shown (Question 1)

The discussion paper proposes financial statements with a completely new format and content, but we do not think this will be particularly useful to investors in making decisions. The paper seems to propose the new format in order to secure statement cohesiveness––achieved by having horizontal bars and using the same category and line items throughout the three statements. This is an ambitious attempt, but, while cohesiveness seems to be accomplished, we do not think the new statements are superior to existing ones, where cohesiveness is realized as a whole because three apparently different statements each play their own unique and mutually complementary roles. We think the traditional balance sheet is superior to the proposed statement of financial position in understanding the financial position of a company at a glance. The proposed statement shows assets and liabilities of a company on a net basis according to operating, investing, and financing categories. However, a major function of a balance sheet is to show gross assets and liabilities employed by a company for its business as a whole. A net amount presentation is not suitable to fulfill this role. The balance sheet is extensively used for financial safety and robustness analysis. Numbers used in such analysis are not easily obtained from the proposed format. If the proposed financial position statement were to be actually adopted, we think many analysts would reproduce the traditional balance sheet themselves.

On the other hand, the discussion paper makes a major step forward in disaggregating information. Analysts want information on variable and fixed costs and the discussion paper discloses expenses both by nature and function. We welcome this as it substantially enhances investment decision usefulness.

Problems Distinguishing Between Business and Financing, and Management Approach (Questions 2, 7)

The discussion paper distinguishes between business and financing, and the former category is further divided into operating and investing. Therefore, operating plant & equipment investments will be included in the operating category. In traditional financial analysis, operating income and operating cash flow are compared, and plant & equipment investments and financing cash flow to finance the investments are collated.

In the proposed statements, it is difficult to conduct such analysis.

The above mentioned categorization, according to the discussion paper, will be made by the management approach. While the management approach has an advantage in understanding the business philosophy of the manager, it has a disadvantage in making intercompany comparison difficult, because each manager has his/her own business philosophy. This point is particularly relevant in distinguishing between 'operating' and 'investing'. Japanese companies have a tradition of mutually holding each others' shares. Whether these investments would be considered operating as a strategic investment or investing as a non-core business solely depends on the manager's decision. There might also be a risk that decisions could be arbitrarily changed from time to time. If the management approach is adopted, very detailed guidelines would be needed in regard to the operating and investing distinction, albeit this is against principle-based standard setting.

Single Comprehensive Income Statement (Question14)

As mentioned under General Comments above, we highly evaluate the discussion paper in presenting both comprehensive income and net income with recycling. Net income is one representative performance indicator of a company's operations. If comprehensive income is considered to add risk exposure information to net income, then prominently disclosing both numbers will enhance decision usefulness. In an opinion survey we conducted in the fall of 2005, 54% of the respondents supported seeing both numbers as below.

Survey result:

（1） Comprehensive Income and Net Income （International issue）

Under current Japanese standards, the bottom line of the income statement is net income. International standard setters are considering replacing net income with comprehensive income. What is your opinion of the proposed change?

＊ *Comprehensive income: Based on current Japanese standards, comprehensive income is net income plus/minus changes in 'valuation differences in other securities' and 'foreign currency translation adjustments'. These items which are currently directly injected into capital are in aggregate called 'other comprehensive income'. Comprehensive income is exactly the same as changes in equity except capital transactions like dividend payments or the new issue of stock. On the other hand, stock markets and currency exchange rates could make comprehensive income more volatile than net income.*

(%)

A	*Agree. Comprehensive income should be the bottom line and net income should be*	*5.0*

	abolished.	
B	*Agree, but both comprehensive income and net income should be shown (comprehensive income as the bottom line and net income as a sub-total).*	*53.7*
C	*Disagree. The bottom line of the income statement should continue to be net income (comprehensive income should be disclosed in the stockholders' equity statement or as a note).*	*32.9*
D	*Disagree. Comprehensive income is not really necessary and the bottom line of the income statement should be net income.*	*3.8*
E	*Don't know.*	*4.2*
F	*Other.*	*0.4*

(SAAJ Survey, Oct. 2005, 974 respondents, 8.3% response rate. Full survey results available upon request.)

The CAC's opinion was divided as to whether to have a single statement or two separate statements. Some supported a single statement as it more clearly shows differences in net income and comprehensive income, while others argued that as the real bottom line is net income, two statements should be used, making the comprehensive income statement a supplementary statement to the net income statement. However, as all CAC members agreed having both net income and comprehensive income, the one or two statement argument is not an essential issue.

Direct Cash Flow Statement and Reconciliation Statement (Questions 19, 23)

We are against the mandatory use of a direct method cash flow statement. Direct method cash flow statements have a great advantage for users because they enable the grasping of cash sales––such statements could be a powerful tool in analyzing companies that have special difficulties in day-to-day cash management. As a matter of fact, banks and credit agencies request such companies submit a statement of cash receipts and disbursements, which is close to a direct method cash flow statement, on a monthly, weekly, and sometimes even daily basis. However, an annual or quarterly cash flow statement would not be so useful in predicting bankruptcies even if they were based on the direct method. Further, analysts typically cover listed companies with a healthy financial base. In analyzing the performance and cash flow of these companies, a typical first step is to check operating income and/or EBITDA based on operating income. The first role of the cash flow statement is to confirm how operating income and EBITDA are backed by cash. In this regard, it is important to reconfirm the effects of an increase/decrease in working capital through balance sheet, income, and cash flow statements. The second role of cash flow statements is to show how plant & equipment investments have been financed. In this regard, it is essential to be able to reconfirm the relationship between an increase/decrease in debt & equity and plant & equipment investments. In short, a cash flow statement is a bridge between the income statement which shows current income under accrual accounting, and the balance sheet which shows an asset/liability snapshot at the closing date. The keyword for the bridge is cash. If we define the role of the cash flow statement in this way, it is clear that the indirect method cash flow statement better fulfills the role. Also, assuming use of the cash flow statement above, the first line of an indirect method cash flow statement should be operating income rather than net income so that operating cash flow is clearly shown, followed by non-operating cash flow, and investing and financing cash flows.

We hear that some US and European analysts have serious problems with the current cash flow statement. We assume the source of this discontent lies in the relatively scarce number of line items in US and European companies' financial statements, which makes it rather difficult to reconcile an increase/decrease in working capital and debt. In other words, the real issue lies not in how the cash flow statement is made, on a direct or indirect basis, but in the number of line items disclosed. If the number of line items shown in examples in the discussion paper is actually incorporated in future statements, then discontent will disappear no matter how the cash flow statement is prepared.

We understand that the discussion paper requires a reconciliation statement as a note because it is difficult for the direct method cash flow statement to show the relationship between income statement and balance sheet. We think a well-designed indirect method cash flow statement with a sufficient number of line items would negate the need for a reconciliation statement. The reconciliation statement should be made mandatory for only those companies which use a direct method cash flow statement.

Field Test

During deliberations at the CAC, what kind of analysis could be conducted if the new financial statements proposed in the discussion paper were actually adopted was discussed. In this regard, we are very interested in the findings of our colleagues who will participate in the field test. We expect detailed results of the test will be disclosed.

Concluding Remarks

We strongly support the discussion paper with regard to (1) parallel disclosure of comprehensive income and net income with recycling, (2) disclosure of details of cost of goods sold, and selling, general & administrative expenses that enable breakeven point analysis, (3) parallel disclosure by function and nature of costs and expenses, and (4) more line items throughout the three statements. On the other hand, since current analytical methods are already well established and there is deep concern amongst preparers regarding direct method cash flow statements and reconciliation statements, we do not think the current format of traditional financial statements should be changed substantially. Adding an expense statement by nature as a note to the current three statements would enormously increase decision usefulness.

In Japan, ministerial regulations specify what line items should be disclosed in each and all cases, making Japanese statements informative and easy to compare. IFRS are principle-based standards which emphasize the management approach. We are afraid that under principle-based standards and the management approach, companies might arbitrarily limit the number of line items disclosed. Detailed guidelines to secure meaningful disclosure are highly desired.

Some readers might feel it rather absurd that we have exhibited some empathy for preparers in this comment letter, but preparers' costs are ultimately born by us investors. For some of the proposals in the discussion paper, we simply could not identify enough benefits that would outweigh the anticipated increase in costs.

Should you have questions or need further clarification, please contact Mr. Sei-Ichi Kaneko, Executive Vice President, SAAJ (s-kaneko@saa.or.jp).

Sincerely yours,

Keiko Kitamura

Keiko Kitamura
Chair
Corporate Accounting Committee