

November 12, 2001

Mr. Shizuki Saito
Chairman
Accounting Standards Board of Japan

Dear Mr. Saito,

The Theme Advisory Council held its first meeting on November 1, 2001. As a result of these meeting the Council proposes that the agenda to be considered by Accounting Standards Board of Japan and the priority be as set forth in the attached sheet.

I would be grateful if you could consider our proposals.

Yours faithfully,

Hiroshi Kawakita
Chairman
The Theme Advisory Council

Proposals from the first meeting of the Theme Advisory Council

I. Views of the Theme Advisory Council members

In order to make proposals for agenda to be considered by Accounting Standards Board of Japan (hereafter referred to “ASBJ”), the Theme Advisory Council (hereafter referred to “the Council”) requested its members to propose agenda and then the Council reviewed and summarized the proposed agenda. The proposals for agenda and their priority are as written in Section “II Proposals for Agenda” later in this document. The proposals are made based on the views expressed during the first meeting of the Council on November 1, 2001.

1. Establishment of fundamental concepts

Establishment of fundamental concepts of assets, liabilities, profits and hedges, etc., are required in order that the ASBJ is able to develop consistent accounting standards, but such fundamental concepts do not exist. Therefore, the establishment of fundamental concepts should be included in the agenda. In other words, not only a study of the issues required for business practice, but also establishment of fundamental concepts is required for the development of accounting standards which are orderly and systematic.

2. Harmonization with International Accounting Standards

Japanese accounting standards are required to be harmonization with International Accounting Standards reducing major differences between the two in order to have international confidence on financial statements prepared in Japan and to respond to the globalization of the economy, and priority should be given to the agenda that are easy to resolve technically. Some members expressed their opinion in the meeting that the ASBJ should study project selected by the IASB to suggest the activities of the IASB and to reflect Japanese views in the discussion of IASB.

Another opinion was that the research and study should be conducted for accounting standard of the development so that Japanese accounting standards would have originality, rather than simply copying overseas accounting standards in order to increase Japanese influence.

3. Swift response to the changes in economic society

Priority should be given to agenda that would require urgent consideration how to apply in the practice due to revisions of laws and

regulations such as agenda related to accounting standards for treasury stock required by the revision of the Commercial Code, for implementation of the consolidated tax payment system and retirement benefit plans. The development of accounting standards for these agenda should be commenced as early as possible to provide sufficient preparatory time for corporations to implement the accounting standards. The accounting standards should be carefully developed in such a way that the disclosure should not mislead the users of financial statements, and the development of accounting standards should be speedy to respond to the dynamic change in economic society.

4. Priority

Various agenda were presented by the Council members and although the Council considers each agenda to be important, the decision was made to give relative priority to agenda with reference to the views of the members and to take into consideration of the overall balance among the agenda because the human resources of the ASBJ are limited, and the Board must respond to the dynamic changes in the economy flexibly.

The Council divided the agenda into short-term agenda and medium-term and long-term agenda and also categorized them in two groups: one with a relatively high priority (level 1) and the other composed of the remaining agenda (level 2). These classifications are not absolute and some of medium-term and long-term agenda may include agenda that required prompt attention and vice versa. The Council wishes that the ASBJ would understand the discussion of the above and will deal with the agenda flexibly and swiftly, in line with the direction of the economy.

The Council divided the agenda into a level 1 group, a level 2 group and a group on which the ASBJ needs to coordinate with the laws and regulations to develop the accounting standards. It is desirable to segregate these agenda from the agenda in the level 1 and level 2 groups, and development on the accounting standards the agenda that would require a coordination with the laws and regulations should be commenced as soon as the required environment is established.

II. Proposals for Agenda

1. Contents

1-1 Short-term agenda

Level 1

1. Accounting standards for the acquisition and disposition, etc., of treasury stocks required by revision of the Commercial Code in 2001
2. Accounting standards required by implementation of the consolidated tax payment system
3. Accounting standards related to retirement benefit plans
4. Implementation guidelines for impairment accounting
5. Fixed assets accounting (except for impairment accounting)
6. Accounting standards for stock options
7. Implementation guidelines for business combinations
8. Accounting standards for leasing transactions

Level 2

1. Accounting standards for inventories
2. Accounting standards for bonds with warrants and convertible bonds
3. Segment classification according to business types
4. Accounting for financial instruments

Agenda requiring coordination with the laws and regulations

1. Standards for disclosure of going concerns
2. Statement of changes in shareholders' equity

1-2 Medium-term and long-term agenda

Level 1

1. Measurement and reporting of performance and disclosure format (including recognition and measurement of revenue)
2. Study of fundamental concepts
3. Inventory taking of existing accounting standards

Level 2

1. Accounting standards for leasing transactions
2. Accounting for financial instruments

3. Accounting standards for provisions
4. Accounting standards for intangible assets
5. Consistency of interim and annual financial statements
6. Improvement of “Accounting Principles for Business Enterprise”
7. Improvement of “Cost Accounting Standards”
8. Study on the application of accounting standards by companies which are not subject to an audit

Agenda requiring coordination with the laws and regulations

1. Retroactive adjustments of previous financial statements
2. Quarterly reporting
3. Reviewing difference between the regulations on financial statements under the Commercial Code and the Securities and Exchange Law
4. Accounting standards by specific industry

Please note that the numbers assigned to the agenda under each category do not imply any order of priority.

2. Details of agenda

2-1 Short-term agenda

Level 1

1. Accounting standards for the acquisition and disposition, etc., of treasury stocks required by revision of the Commercial Code in 2001

Acquisition and disposition of treasury stocks was made possible by revision of the Commercial Code in June 2001. The revision allows reduction of legal reserves with certain restrictions and surplus from capital reduction is excluded from legal reserves. This revision complicated the distinction between the distributable income stipulated by the Commercial Code and the capital and profit in accounting and accordingly, accounting standards are required to be established.

2. Accounting standards required by implementation of the consolidated tax payment system

The consolidated tax payment system is expected to be implemented by revision of the taxation system scheduled for fiscal year 2002. Standards of the tax effect accounting under

consolidated financial statements and non-consolidated financial statements are required to be examined.

3. Accounting standards related to retirement benefit plans
The enactment of the Defined-Benefit Type Corporate Pensions Law facilitated the change of pensions to other type of plans, including the giving up of the agent part of the welfare pension fund managed on behalf of the government to the government. The enactment of the Defined-Contribution Type Corporate Pensions Law facilitated transfers from current corporate pension schemes to defined-contribution pension plans. Relevant accounting standards are required to be clarified because the impact caused by the changes of the regulations is significant.
4. Implementation guidelines for impairment accounting
The Business Accounting Council is currently discussing accounting standards for impairment accounting. Implementation guidelines should be prepared promptly to provide sufficient time for corporations to be prepared for it and to create an environment to facilitate the implementation of the accounting standards without confusion.
5. Fixed assets accounting (except for impairment accounting)
Fixed assets are a major item in financial statements but there are no established accounting standards for them. Accounting standards for fixed assets to capture the actual economic status are required because of the difference that exists between theoretical accounting and actual taxation accounting. For example, it is necessary to establish reasonable depreciation method appropriate to individual circumstances since many companies currently calculate depreciation in accordance with the method in the tax law. Issues such as the extent of incidental costs at the time of the acquisition of the fixed assets and the clarification of timing for the recognition of profit and loss on sales should be investigated.
6. Accounting standards for stock options
Revision of the Commercial Code to allow a new stock options system (allowing gratis new share subscription right) is anticipated at an extraordinary session of the Diet in the autumn

of 2001 so that the revision may become effective on April 1, 2002. The use of stock options plan will be more brisk as the last revision of the Commercial Code allowed the holding of treasury stock, but accounting standards for stock options have not been established. Accounting standards of stock options is stipulated by SFAS123 in the US. The IASB is dealing with the accounting standards as one of the projects given highest priority and is expected to complete the standardization shortly. A thorough study is required because this agenda includes the fundamental argument of whether new share subscription rights are liabilities or equity.

7. Implementation guidelines for business combinations

As the Commercial Code and the tax law were revised, it is expected that mergers and split-ups will be increased. The Business Accounting Council is discussing the accounting standards for business combinations. It is necessary to prepare implementation guidelines and Q & A as early as possible and to provide sufficient preparation time for corporations and to create an environment to facilitate the implementation of the accounting standards without confusion.

8. Accounting standards for leasing transactions

The accounting of leasing transactions involving finance lease arrangements that do not involve the transfer of ownership (off-balance transactions), which are actually major leasing transactions, is accepted as an exception in Japan and does not prevail in international accounting practice. Off-balance transactions like this may become an obstacle to the implementation of impairment accounting of fixed assets and so the relevant accounting standards should be reviewed.

Level 2

1. Accounting standards for inventories

Japanese accounting methods for inventories allow companies (1) to select and use either cost method or lower-of-cost-or-market method, (2) to make valuation using the replacement cost method (when the lower-of-cost-or-market method is used) and (3) to use cost method using the last purchase price. All of these three types of transactions are peculiar from the view of international accounting and

consideration is required.

2. Accounting standards for bonds with warrants and convertible bonds

The rights of warrants and conversion are accounted for as liabilities when bonds with warrant and convertible bonds are issued. When the rights are exercised, they will be transferred to capital, and if not exercised, the rights will be transferred to profit. IAS and US standards stipulate the rights to be transacted as equity at the time of issue of such bonds and so Japanese accounting standards should be reconsidered. The accounting standards of the warrant and the convertible bonds represent similar problems as stock options and so it is desirable that the accounting standards of the warrant and the convertible bonds be reviewed together with the accounting standards of stock options.

3. Segment classification according to business types

Almost twenty percent of major companies in Japan don't segment their business into business types, insisting either that their business is a single entity or that auxiliary segments are not material, resulting in inadequate functioning of the current system. An effective method to determine business segments should be reconsidered including an study of the "management approach" used in the US.

4. Accounting for financial instruments

Currently in Japan, financial liabilities are measured by the nominal amount of debt. It is necessary to establish accounting standards which at least allow measurement of financial liabilities using amortized cost method to keep pace with the development of international accounting standards for financial instruments. The accounting of financial liabilities, which are currently dealt with as provisions (provisions for potential loss of guarantee), should also be reconsidered.

Agenda requiring coordination with the laws and regulations

1. Standards for disclosure of going concerns

The Business Accounting Council is currently revising auditing

standards and it is expected that the auditing of the financial statements under a going concerns assumption will be included in the standards. Standards for disclosure of management views on risks related to events, circumstances, management policies for measures and financial statements which raise serious doubt about going concerns will be required to audit of the financial statements under a going concerns assumption. The revision is expected to be effect for the fiscal year ending March 2003. If the revision requires the development of disclosure standards, then as soon as the revision is finalized, prompt consideration of disclosure standards will be required.

2. Statement of changes in shareholders' equity

The number of items that are directly recognized in equity is increasing under the current accounting standards (as valuation differences of available-for-sale securities and currency exchange translation adjustment, etc.). There is also a tendency for factors that cause change in equity such as profit and loss on disposition of treasury stock and reduction of legal reserves to increase because of revision of the Commercial Code. It is desirable for a disclosure system for statement of changes in shareholders' equity to be introduced in order to ensure transparency of disclosure.

1-2 Medium-term and long-term agenda

Level 1

1. Measurement and reporting of performance and disclosure format (including recognition and measurement of revenue)

(1) Measurement and reporting of performance and disclosure format

With regard to reporting performance, issues related to measurement including fundamental theories should be studied with the view of using the results of the study as the base of future accounting standards. The reporting performance should be examined from the viewpoint of its usefulness of information in Japan taking into account the fact that the IASB is dealing with this issue as one of the highest priority projects and the fact that the concept of the theoretical method of reporting performance is under discussion in the US. The number of items which are directly recognized in equity is increasing under the current

accounting standards in Japan. A comprehensive income concept and reporting format should be studied.

The effect of separate disclosure of profit and loss recognized by discontinuing operations and the separate disclosure of accumulated profit and loss recognized by change in accounting policy that are employed in accounting standards overseas is increasing; study of such description should be performed.

(2) Recognition and measurement of revenue

There is only general and abstract description about standards for the recognition of revenue in “The Accounting Principles for Business Enterprise” in Japan. The study of recognition and measurement of revenue is widely undertaken for accounting standards in overseas. Medium-term and long-term study of revenue recognition and measurement is also required in Japan, and study of the convergence for percentage of completion basis and strict applications of shipment basis which are stipulated by accounting standards overseas are being deliberated.

2. Study of fundamental concepts

Study of fundamental concepts of financial statements, etc., which will be used in a guidelines for the preparation and interpretation of accounting standards is vital to improve Japanese accounting standards in the future. In other words, the study of fundamental concepts for assets, liabilities, profits and hedges is vital to develop individual accounting standard. The study of fundamental concepts is an important agenda for the medium-term and long-term.

3. Inventory taking of existing accounting standards

Conflicting standards exist in the current accounting standards, implementation guidelines and Q & A because of changes in the economic environment and the implementation of new accounting standards and this may cause confusion in accounting practice. The official pronouncement of the Business Accounting Council and the Japanese Institute of Certified Public Accountants in the past should be reconsidered to clarify effectiveness, duplications and contradictions and to improve the fundamental system in order to develop new accounting

standards, etc.

Level 2

1. Accounting standards for leasing transactions
The IASB includes the overall revision of leasing accounting as a second phase project. On-balance treatment of non-cancellable operating leases has been discussed. These studies should also be performed in Japan.
2. Accounting for financial instruments
With regard to non-consolidated financial statements, the equity method does not apply to investments in subsidiaries and associated companies. There are many issues to be reconsidered such as the application of the equity method and the revision of hedge accounting in financial instrument accounting standards from the viewpoint of their usefulness in providing information.
3. Accounting standards for provisions
A study to revise the concept for provisions from the viewpoint of the definition of liability is vital and should include a study of the transaction of provisions for repairs and clarification of the extent of provisions for future losses.
4. Accounting standards for intangible assets
An international study into intangible assets is currently underway. It is necessary to investigate the conditions which will allow the capitalization of intangible assets also in Japan. For example, studies of capitalization of investment in research and development and investment to establish brands should be performed.
5. Consistency of interim and annual financial statements
The first half of fiscal year is now regarded as being independent terms because interim financial statements are prepared by discrete view. There is a great deal of accountancy work required to maintain consistency in interim and annual financial statements and study of consistency is required.
6. Improvement of “Accounting Principles for Business Enterprises”
The current “Accounting Principles for Business Enterprises”

were established in 1949 (partly revised in 1982) and should be revised because some of the principles conflict with new accounting standards due to recent changes in accounting and economical circumstances and international trends.

7. Improvement of “Cost Accounting Standards”

The current “Cost Accounting Standards” were established in 1962 and are not appropriate for the actual performance status and therefore should be revised.

8. Study on the application of accounting standards by companies which are not subject to an audit

It is necessary to survey and clarify the actual application of accounting standards by companies that are not subject to an audit under the Securities and Exchange Law, such as medium and small companies, and measures should be investigated.

Agenda requiring coordination with the laws and regulations

1. Retroactive adjustments of previous financial statements

Retroactive adjustments of previous financial statements are not allowed in Japan because of restrictions imposed by the Commercial Code and the tax law. However, changes in presentation, accounting policy and segments, fundamental errors and so on may significantly affect comparability between the years presented unless retroactive adjustments are made. It is desirable that previous financial statements be adjusted, at least for public companies whose consolidated financial statements are regarded as major financial statements. A study of this issue is required.

2. Quarterly reporting

The number of companies that release quarterly reports is increasing, in response to the need for timely disclosure of financial information to investors. However, companies use various accounting standards and presentation format because there are not standards for quarterly reporting is available. This makes comparison of results between companies impossible. It is desirable to study quarterly reporting by carefully observing development in the disclosure of quarterly results.

3. Reviewing the difference between the regulations on financial statements under the Commercial Code and the Securities and Exchange Law

The differences between the disclosure format of financial statements stipulated by the regulations on financial statements under the Commercial Code and the Securities and Exchange Law should be reviewed. There are also matters requiring coordination between the two with accounting standards including the concept of capital transactions and profit and loss transactions, the extent of deferred charges and the accounting standards for goodwill.

4. Accounting standards by specific industry

The accounting standards for businesses including financial institutions such as banks, security companies and insurance companies, and companies in construction, communication and electricity business, etc., being regulated by specific law are required to be improved in the medium-term and long-term. Particularly, the study of accounting for insurance should be conducted in accordance with the activities of the IASB.