

THE IASB AND ASBJ CONCEPTUAL FRAMEWORKS: SAME OBJECTIVE,
DIFFERENT PERFORMANCE CONCEPTS

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Synopsis

A comparison shows that although the objectives in the 2010 IASB and 2006 ASBJ Conceptual Frameworks are the same, the performance concepts embodied in the definition, recognition, measurement and disclosure of the elements of financial statements are different. The paper then discusses the thinking behind the ASBJ's released-from-risk concept of performance, and interprets the ASBJ's normative choices between theoretical viewpoints as logical within the Japanese social and institutional environment. Currently, the IASB working on completing its Conceptual Framework, and will need to make normative choices between theories on how to account for income and capital in its Conceptual Framework. This paper provides inputs to the income theoretical debates that will need to take place after discussion papers and exposure drafts have been issued.

Introduction

Objective of the paper

This conceptual paper contributes to the debate on decision-usefulness and performance concepts in three ways. First, it shows that, although the 2010 International Accounting Standards Board (IASB) and the 2006 Accounting Standards Board of Japan (ASBJ) conceptual frameworks share the same decision-usefulness objective for general purpose financial reporting, both frameworks are based on different performance concepts. The IASB framework has adopted the balance sheet approach to income determination but no explicit concept of performance, which produces an incoherent mixed attributes model of accounting. The ASBJ framework is primarily based on the released-from-risk net income concept of performance which produces a clearly defined mixed attributes model of accounting potentially resulting in a coherent and consistent set of accounting standards.

The IASB resumed working on its Conceptual Framework project in 2012, and aims to complete it in 2015. OB1 in Chapter 1 of the 2010 IASB Conceptual Framework claims that the definition, recognition and measurement of the elements of the financial statements flow logically from the objective of general purpose financial reporting. Because both frameworks can and do make decision-usefulness operational in different ways, the claim in OB1 appears to be faulty.

Second, this paper discusses the accounting thought underpinning the released-from-risk net income concept of performance in the 2006 ASBJ Conceptual Framework. It presents two essential income theoretical issues within the decision-usefulness frame of reference on which the IASB, too, ultimately will need

to take a normative position. When it does, the IASB must justify its choices to its constituents and the general public. First, the IASB will need to explain why its performance concept better enables investors to predict future cash flows than other accounting models do, and second why it better enables investors to adjust their expectations on the basis of reported income.

Third, the paper interprets the thinking behind the ASBJ's choice of performance concept from a comparative institutional perspective. It shows that it is logical for people in different institutional environments to attach relatively more or less importance to arguments for increasing efficiency and arguments for reducing risk and uncertainty, depending on historically determined institutional complementarities. As the international accounting standard setter, the IASB will need to take both types of arguments very seriously when choosing a performance concept.

Research question and structure of the paper

The objective of general purpose financial reporting forms the foundation of the Conceptual Framework. Other aspects of the Conceptual Framework – a reporting entity concept, the qualitative characteristics of, and the constraint on, useful financial information, elements of financial statements, recognition, measurement, presentation and disclosure – flow logically from the objective. (IASB, 2010: OB1) Both the 2010 IASB Conceptual Framework and the 2006 ASBJ Conceptual Framework share the same decision-usefulness objective as this was adopted from the FASB Conceptual Framework. Therefore, if the claim in OB1 were true, and if the IASB and ASBJ frameworks are both logically coherent, the income concepts in both frameworks would have to be largely identical. But are they?

To answer this question, the second section of this paper compares the 2010 IASB and the 2006 ASBJ conceptual frameworks chapter by chapter, or where that is not possible, item by item. It shows that the objective of general purpose financial reporting, the qualitative characteristics of useful information, and the definitions of assets and liabilities in both frameworks are very similar. However, the two frameworks set out fundamentally different income concepts. Section 3 discusses the accounting thought underpinning the ASBJ's choice of performance concept, and Section 4 interprets and contextualises the comparison and the ASBJ's thinking from a comparative institutional perspective, followed by a conclusion indicating how the findings and their interpretation are relevant both to accounting theory and the current IASB Conceptual Framework project.

Analytical perspective of the paper

Chapters 1 and 3 of the 2010 IASB Conceptual Framework are the result of a joint convergence project with the Financial Accounting Standards Board (FASB). This time, however, the IASB will work on Chapters 2 and 4 on its own. Both the USA and Japanese regulators have recently postponed adopting IFRS. The SEC is unlikely to yield its standard setting sovereignty. Initially, the Japanese regulator appeared not particularly averse to yielding standard setting authority as such. However, criticism of inconsistencies in the IASB Conceptual Framework and particularly the lack of an explicit and coherent conceptual approach to income determination caused many in Japan to question both the wisdom of adopting IFRS and yielding standard setting sovereignty. Many Japanese think that the 2006 ASBJ Conceptual Framework is more coherent than the 2010 IASB Conceptual Framework. Both Americans and Japanese

use the argument that IFRS may not be suited to their respective institutional environments.

There is a distinct possibility that the institutional argument is a convenient excuse. After all, if the regulators of all countries thought like that, the idea of international financial reporting standards would be history. Nevertheless, the institutional economics literature shows that institutions matter for economic growth, development, performance (e.g., North, 1990) and for social choice (Olson, 1965 and 2000). Institutions are both formal and informal mechanisms that guide economic and social exchanges and interactions (Wysocki, 2011: 310).

This paper is written from the perspective that institutional environments are best understood by knowing how institutions promote efficiency, as well as knowing how they deal with risk and uncertainty. Accounting and reporting are part of the institutional mechanisms for the efficient allocation of resources and the fair distribution of surplus (i.e., income and capital) which impact on the sustainability of the system. We accept the New Institutional Accounting (NIA) premise that accounting and other institutions are designed to increase efficiency in market exchanges by lowering ‘transaction costs, reducing information costs and information asymmetry, lowering coordination costs, enforce and protect property rights, protect deadweight loss, internalise externalities and address other possible market failures. (Wysocki, 2011: 311). On the other hand, we also accept the political economy premise that many of those very same institutions are also designed to reduce the risk and uncertainty, and reconcile the conflicting interests associated with market and other exchanges.

These perspectives on accounting and other institutions are not worlds apart, but rather two sides of the same coin of which we can only really see one side at a time. Ideally, accounting and other institutions would be designed to increase efficiency and reduce risk and uncertainty equally well. As articulated by Leuz (2010: 248), the existence of institutional complementarities means that reporting regulation must be considered in combination with other elements of the institutional infrastructure.

To the extent that institutions which increase efficiency also reduce risk and uncertainty, and institutions that lower transaction costs also reduce risk and uncertainty, there is no problem. However, when institutions that are designed to increase efficiency also increase risk and uncertainty, or when those that are designed to reduce risk and uncertainty also reduce efficiency, it becomes necessary to balance the interests of those affected. Over time and across jurisdictions, there is variation in how much attention is paid to each function, but neither function can totally dominate or entirely disappear. Our interpretation of the differences between the performance concepts in the 2010 IASB and the 2006 ASBJ frameworks suggests the existence of an efficiency perspective and a risk and uncertainty reduction perspective on performance.

Comparison of the ASBJ and IASB conceptual frameworks

This section identifies the similarities and the main differences between the 2006 ASBJ and the 2010 IASB conceptual frameworks. It starts with a comparison of the structure of both frameworks, and continues by comparing the objective of general purpose financial reporting, the qualitative characteristics of decision-useful

information, and the definition, recognition and measurement of the elements of financial statements.

Structures of the frameworks

The 2006 ASBJ Conceptual Framework was modelled after the 2001 IASB Conceptual Framework so as to make it compatible. Although the framework could have had any structure, the ASBJ Committee thought that following the IASB structure, terminology and approach would facilitate communication and mutual understanding (ASBJ, 2006: Preface). The latest version of the IASB Conceptual Framework was issued in September 2010. It has a slightly different structure, but it also consists of an introduction and four chapters. Chapter 2 on the reporting entity does not yet have any content, and Chapter 4 is the remainder of the 1989 IASC/2001 IASB Conceptual Framework. Table 1 shows the comparative structures of the frameworks.

Objective of financial reporting and users/beneficiaries

Both the ASBJ and the IASB conceptual frameworks are premised on the idea that the main objective of financial reporting is providing information that is useful for investors¹ when making decisions about providing resources to the entity (IASB, 2010: OB2) (ASBJ, 2006: CH 1, Par. 2), or decisions to buy, hold or sell securities in secondary markets. The assumption in both frameworks is that all investors make these decisions based on an assessment of the timing, risk and amount of the future cash flows they expect to receive either in the form of cash dividends, or in the form

¹ OB2 of the IASB Conceptual Framework also mentions lenders and creditors.

of realised or realisable capital gains, or a combination thereof (IASB, 2010: OB3) (ASBJ, 2006: CH 1, Par. 3).

The Preface notes that the ASBJ Conceptual Framework had been developed for public companies raising debt and equity capital on securities markets and indicates that this objective may change over time as it is the result of social a consensus.² Furthermore, it states as a secondary objective of financial reporting enabling the resolution of conflicts of interests between privately contracting parties and the use in laws and regulations that affect the general public (ASBJ, 2006: CH 1, Par. 11-12).

The reporting entity

Chapter 2 of the IASB Conceptual Framework is meant to define the reporting entity and will set out the conceptual basis of consolidation and group reporting. Implicit in the ASBJ Conceptual Framework are two assumptions regarding the business accounting entity. First, the scope of the consolidation is based on the criterion of effective control over the resources of any subsidiary companies. Second, financial information in the consolidated financial statements is primarily meant to meet the needs of the controlling shareholders of the parent company. However, the Japanese accounting standards for unconsolidated financial statements are as extensive as for single entity financial statements. All parent companies and their subsidiaries are required to prepare a full set of unconsolidated financial statements.

² In Japan, the social consensus on the objective of financial accounting and reporting has shifted in the past twenty years from the protection of creditor and long-term shareholder interests to decision-usefulness for investors.

Qualitative characteristics of useful financial reporting information

The IASB Conceptual Framework assumes that the information most useful to existing and potential investors has two fundamental characteristics. It must, on the one hand, be relevant to their decisions and material enough to be able to affect their decisions, and on the other hand faithfully represent the phenomena it purports to represent. Faithful representation is defined as complete, neutral and free from error (IASB, 2010: QC5-16). It then identifies comparability, verifiability, timeliness and understandability as enhancing characteristics (IASB, 2010, QC17-32). Finally, it identifies costs as a pervasive constraint on the production and disclosure of information (IASB, 2010: QC35-39).

The ASBJ Conceptual Framework first defines decision-usefulness as ‘useful for investors in predicting future cash flows’ (ASBJ, 2006, CH 2, Par. 1). Decision-usefulness is supported by decision-relevance and reliability (ASBJ, 2006, CH 2, Par. 2-7). Information value and the satisfaction of information needs are the two lower level characteristics supporting relevance (ASBJ, 2006, CH 2, Par. 3-5). Reliability is supported by neutrality, verifiability and representational faithfulness (ASBJ, 2006, CH 2, Par. 6-7). Internal consistency and comparability serve as general constraints on accounting standards (ASBJ, 2006: CH 2, Par. 9-12). Decision-usefulness requires that accounting standards are internally consistent. This means that no accounting standard may contradict any of the other accounting standards or any of the basic accounting concepts within the system (ASBJ, 2006: CH 2, Par. 9). Table 2 compares the qualitative characteristics in the two frameworks.

Definitions of the elements of the financial statements

Table 3 summarises the definitions of the elements of the balance sheet in the 2006 ASBJ and 2010 IASB conceptual frameworks. Keep in mind that the definitions in Chapter 4 of the IASB Conceptual Framework have been carried over from 1989.

Between the two conceptual frameworks, the definitions of assets and liabilities are very similar. Importantly, the ASBJ Conceptual Framework distinguishes between net assets and owners' equity (the latter of which must have been released-from-risk³) whereas the IASB Conceptual Framework defines equity as net assets.

Table 4 summarises a comparison of the definitions of the elements of the income statement in the 2006 ASBJ and 2010 IASB conceptual frameworks, and Table 5 summarises the definitions of net income and comprehensive income, which, like in the FASB Conceptual Framework but unlike in the IASB Framework, have been defined in the ASBJ Framework.

Neither Framework appears to make a distinction between revenues and gains or between expenses and losses (IASB, 2010: 4.29 and 4.33) (ASBJ, 2006: CH3, Par. 25). However, the IASB defines income and expenses with reference to its definition of assets and liabilities, as increases or decreases in economic benefits (IASB, 2010: 4.25). Gains may include both realised and unrealised gains (IASB, 2010: 4.31).

On the other hand, the ASBJ Conceptual Framework defines revenues/gains and expenses/losses as increases or decreases of net income and the minority interests'

³ Released-from-risk is the recognition concept in the ASBJ Framework. It is broader than the realisation concept but narrower than the 'realisable' concept.

share of earnings corresponding to the increases in assets or decreases in liabilities that have been released-from-risk⁴ (ASBJ, 2006: CH 3, Par. 13 & 15). In other words, the ASBJ designates released-from-risk net income as the primary income and performance concept. It defines the relation between comprehensive income and net income as follows (ASBJ, 2006: CH 3, Par. 12).

$$CI = \text{Released-from-risk NI} + (\text{Risky OCI} - \text{Recycled OCI} + \text{Minority interests})$$

$$\text{Released-from-risk NI} = CI - \text{Risky OCI} + \text{Recycled OCI} - \text{Minority interests}$$

Recognition in the financial statements

According to the 2010 IASB Conceptual Framework, an element may be recognised in the financial statements if it both meets the definition of an element and satisfies the two following criteria: (1) it is probable that future economic benefits associated with the item will flow to or from the entity, and (2) the item has a cost or value that can be measured with reliability (IASB, 2010: 4.38).

In the 2006 ASBJ Conceptual Framework, the basic constraint on the recognition and measurement of income is that total net income over the life of the entity (Total NI) must equal total net cash inflows over the life of the entity (Total NCF) (ASBJ, 2006: CH 3, Par. 10). This is the basis for the released-from-risk recognition concept that is built into the definition of owners' equity, net income, revenue/gains and expenses/losses in the 2006 ASBJ Conceptual Framework. Table 6 contrasts the recognition constraints in both frameworks.

⁴ Released-from-risk is the recognition concept in the ASBJ Framework. It is broader than the realisation concept but narrower than the 'realisable' concept.

Both frameworks consider probability a constraint on the recognition of elements in the financial statements. However, the 2010 IASB Conceptual Framework's revenue/gain and expense/loss recognition constraint is framed in terms of the measurability and sufficient certainty of future economic benefits. The ASBJ frames the recognition constraint in terms of the release-from-risk of cash flows.

Measurement of the elements in the financial statements

Measurement constitutes a large part of the 2006 ASBJ Conceptual Framework, whereas in the 2010 IASB Conceptual Framework it barely features. The IASB Framework describes four measurement bases: historical cost, current cost, realisable value and present value (IASB, 2010: 4.55) for assets and liabilities. It states that most entities adopt historical cost in combination with other measurement bases (IASB, 2010: 4.56) but does not explain the reasoning behind selecting different measurement bases.

Assets and liabilities Table 7 compares the descriptions of the above four measurement basis for assets between the two frameworks. The ASBJ Framework describes the measurement bases for assets with reference to the objective of financial reporting and the potential contribution to released-from-risk net income generated by the asset. Measurement bases are considered meaningful to the extent that they give information about the certainty of the cash inflow or the return associated with the investment in that particular asset. According to the ASBJ Framework, this depends firstly on the objective with which the asset is held and secondly on the market conditions of the particular market for that asset (ASBJ, 2006: CH 4, Par. 56-58).

The ASBJ Framework makes a distinction between assets that are held for the entity's normal business purposes and those that are held as financial investments (ASBJ, 2006: CH 4, Par. 57). The ASBJ Framework assumes that, in the case of a going concern and without unexpected changes in the economic environment, when the assets are held for the normal business purposes of the entity, amortised cost (for non-current assets) and historical cost (for current assets) (ASBJ, 2006: CH 4, Par. 8-10) provide the most useful information for investors in the entity. In the case of receivables, this would be net of an allowance for irrecoverable receivables, i.e., the recoverable amount (ASBJ, 2006: CH 4, Par. 26). Re-measurement of assets held for business purposes at current cost or net realisable value may be necessary when there are unexpected changes in the economic environment (ASBJ, 2006: CH 4, Par. 16 and 18).

Measurement of assets at Market Price (when there is a quoted price) or Market Value (when there is none) in the 2006 ASBJ Framework is shown in Table 8. In the ASBJ Framework, measurement at market value and re-measurement at market price or market value is supposed to apply only to assets held as financial (as opposed to normal business) investments, and only to those assets for which the entry price equals the exit price (ignoring transaction costs) because this will be the equilibrium price or market clearing price (ASBJ, 2006: CH 4, Par. 12). In other words, the expectation is that the present value of the financial asset equals its market price. The ASBJ Framework sets out the measurement of financial assets in markets where the entry price does not equal the exit price depending on whether or not cash flows and discount rates are continuously revised.

If both the cash flows and the discount rate are continuously revised, the discounted cash flow can be used to estimate either value-in-use (ASBJ, 2006: CH 4, Par. 20) or fair value (ASBJ, 2006: CH 4, Par. 23). When only cash flows are revised, the estimated amount reflects the recoverable amount (ASBJ, 2006: CH 4, Par. 24-25).

In the case of liabilities, the 2006 ASBJ Conceptual Framework discusses settlement amount (or payable amount) (ASBJ, 2006: CH 4, Par. 30), amount of cash received in return for an obligation to provide goods or services (ASBJ, 2006: CH 4, Par. 32), discounted value (ASBJ, 2006: CH 4, Par. 34), and market price (ASBJ, 2006: CH 4, Par. 43). Table 9 shows measurement of liabilities at discounted value in the 2006 ASBJ Framework.

Income and expenses The IASB Conceptual Framework does not discuss the measurement of revenues, gains, expenses or losses as these are considered to arise from changes in assets and liabilities, and are therefore assumed to follow from the measurement of assets and liabilities. It does, however, describe financial and physical concepts of capital and capital maintenance (IASB, 2010: CH 4, 4.57-4.65).

With respect to the measurement of revenues, gains, expenses and losses, the 2006 ASBJ Conceptual Framework makes a distinction based on whether the elements arise from transactions (ASBJ, 2006: CH 4, Par. 44 for revenues/gain and Par. 48 for expenses/losses), market price changes (Par. 45 and 49), the partial execution of contracts (Par. 46 and 50), or the results of the activities of investee companies (Par. 47 for income) and usage (Par. 51 for expenses). The idea behind this distinction is that there is a fundamental difference between business investments and transactions

related to normal business operations on the one hand, and financial investments and transactions for speculative purposes on the other. Table 10 below summarises the measurement of income and Table 11 summarises the measurement of expenses.

Summary of the findings

Nominally, both frameworks are based on the same decision-usefulness objective. Both frameworks identify decision-relevance as an important characteristic. In the 2010 IASB Conceptual Framework the second characteristic is representational faithfulness (supported by completeness, neutrality and freedom from error). In the 2006 ASBJ Conceptual Framework, it is reliability (supported by neutrality, verifiability and representational faithfulness), as it was in the previous 1989/2001 IASB Framework.

From the above comparison it is clear that, in spite of sharing the same decision-usefulness objective, the performance concepts in the 2006 ASBJ and 2010 IASB frameworks are different. In other words, the frameworks are based on different assumptions as to the performance concept that best serves the needs of investors aiming to predict the entity's net cash inflows. As a consequence, both frameworks have made the decision-usefulness objective operational in different ways. If the logic of the claim made in OB1 of the 2010 IASB Conceptual Framework is to hold with necessity, the objective of general purpose financial statements would need to be related to an explicit performance concept. This way the meaning of the objective cannot become `lost in translation` across different institutional environments.

The thinking behind the ASBJ's concept of performance

In the 2010 IASB Conceptual Framework, the definition, recognition and measurement of the elements of financial statements are presented as if they are self-evident truths quite independent from any specific performance concept or decision-usefulness objective. This is perhaps because the 1989 framework was intended to apply to all accounting models (IASB, 2010: Introduction).

In the 2006 ASBJ Conceptual Framework, the released-from-risk net income concept of performance is consistently built into the definition, recognition and measurement of the elements of the financial statements. On the one hand, the ASBJ thinks that financial statements based on the released-from-risk net income concept of performance provide more relevant information to investors aiming to predict the entity's future cash flows than those solely based on comprehensive income. On the other hand, the ASBJ also believes that such financial statements best serve the needs of investors aiming to adjust their expectations.

The main function of this section is to discuss the arguments and evidence underpinning the ASBJ's choice of performance concept. It does so in three parts. First, it discusses the empirical evidence and theoretical arguments on the usefulness of realised net income for the estimation of income ex ante. Second, it discusses the theoretical arguments on how realised net income fulfils the feedback function of income ex post. Third, it discusses the need for and implications of extending the realisation concept to the released-from-risk concept.

In January 2003, a working group organised by the ASBJ started its task to draft a conceptual framework. After consideration of the empirical evidence (Yaekura, 2005:

91) and the theoretical arguments on the decision-usefulness of realised net income and comprehensive income, the Concepts Working Group made a choice in favour of realised net income as the primary performance concept. However, as a strict version of the realisation concept did not accommodate market values for trading securities, the Concepts Working Group developed the released-from-risk net income performance concept. This Concepts Working Group, consisting of nine academics⁵ and the seven ASBJ members, issued a first full draft of a Discussion Paper (DP) in July 2004. The DP was revised in response to comments. As by that time the IASB and FASB had started their joint convergence project and Japan was being considered in the equivalence assessment by the EU, the ASBJ Conceptual Framework was again issued as a DP in December 2006 (Saito, 2007: Chapter 1). It is not clear if there will ever be a final version.

The ASBJ Framework was developed at a time that a number of standard setters in Anglophone countries had shown a preference for the disclosure of comprehensive income over net income (or earnings) as the ‘bottom line’ (e.g., Cearnis et al, 1999). Because of that, the arguments brought forward by the Concepts Working Group and other Japanese accounting scholars often contrast realised net income with comprehensive income.

Usefulness for estimating income ex-ante

A comprehensive review of the Anglophone value-relevance literature by Obinata (2002) revealed that there was little credible empirical evidence that comprehensive

⁵ Shizuki Saito (chair), Eiko Tsujiyama, Katsunobu Mandai, Shinya Saito, Takashi Obinata, Takashi Yaekura, Masaki Yoneyama,, Yoshinori Kawamura, and Yuko Katsuo.

income on its own would be more useful than realised net income to investors aiming to predict the entity's future income, cash flows, dividends, and stock price.

Obinata (2002: 392-393) discussed empirical studies investigating the information value of other comprehensive income (OCI) in its entirety, of the separate components of OCI (Obinata 2002: 393-397) and of the goodwill and PPE revaluation surplus as the components of dirty surplus (Obinata 2002: 397-400). He concluded that comprehensive income could provide useful information in addition to realised net income (Obinata 2002: 400). After the ASBJ Framework was issued, Obinata (2008) updated his review but did not significantly change his conclusions. Japanese empirical studies by Katsuo (1998) and Yoneyama & Katsuo (1998) suggested that even for the financial sector realised net income appeared to provide more value-relevant information than elements of comprehensive income.

The Working Group argued that as long as there is evidence that realised net income is useful, it does not make sense to replace it with comprehensive income (Yoneyama, 2007: 18-20). Particularly because there is no way of knowing how people's expectations and behaviour would change under a comprehensive income only regime based on research done under a system where net income is being used (Saito, 2011: 113). Hence, the Working Group sought to try and understand what it is that investors aim to predict and what properties of realised net income make it more useful and relevant than comprehensive income for doing so.

Within a decision-usefulness framework, investors are assumed to form expectations about the entity's future income, cash flows and share price partly on the basis of

financial reporting information. Following Beaver (1989: 87-101)'s description of valuation in imperfect of incomplete markets, Obinata (2002: 379) describes the process as follows. Investors use current income to predict the entity's future income, on the basis of which they estimate the entity's future cash flows. Then they use the estimated future cash flows to predict the future market value of the entity's shares. For investors, the ultimate goal is to forecast their own expected future cash receipts (dividends) and capital gain associated with investing their cash. They invest their cash knowing that they take the risk of their expected future cash inflows not materialising (Sakurai, 2002; Saito, 2006 and 2007: 6,).

Investors use current reported income as an input to predict an entity's economic income or income ex ante. The Concepts Working Group found that Hicks (1946:178) had defined income ex ante as permanent income (i.e., maintainable income) because windfall profits or losses are, per definition, unpredictable. Hicks (1946: 179) defined income ex post as income including both permanent income and windfalls (See also Edwards & Bell, 1961: 32), but stated that the 'income that is relevant to conduct must always exclude windfall gains; if they occur, they have to be thought of as raising income for future weeks (by the interest on them).

However, as pointed out by Kaldor (1969: 168-169), under uncertainty 'neither income ex ante nor income ex post can be objectively measured, or inferred from market prices (...).' So the income that medium or long-term investors predict would be the permanent income that maintains capital intact so that it will be able to produce a standard stream of income into the future, but which is subjective and cannot be objectively measured.

In the earnings quality literature, the empirical evidence suggests that the value-relevance of components of reported income is positively associated with their recurrence (Barker, 2004). Statistical properties of reported income (or of components of income) such as persistence and variability indicate the degree to which reported income is permanent or transitory (Linsmeier et al, 1997: 124). Hence, reported income or elements of income that show greater persistence and less variability are deemed to of higher quality and more useful for predicting future income.

Barker (2004: 161) points to Ohlson (1995)'s residual income valuation model where the degree of persistence of abnormal earnings determines the weights applied to the book values and abnormal earnings variables in the model, and Feltham & Ohlson (1995) which makes a distinction between operating assets and financial assets where the latter generate zero abnormal earnings by definition. As realised net income has a higher degree of persistence it is a better measure of an entity's sustainable income (the accounting approximation of permanent income) than comprehensive income is.

Like Bromwich et al (2005: 4), Fukui (2007: 76) argues that using the stock-based asset-liability approach to determining reporting income approximates Hicks (1946: 173-175)'s Income No. 1 (expressed in terms of capital value). In other words, it measures an entity's comprehensive income. On the other hand, using the flow-based revenue-expense approach to determining reporting income approximates his Income No. 2 (expressed in terms of maintainable or permanent income). In essence, it attempts to measure an entity's sustainable income. He makes the point that interest

rates and the cost of capital are not stable, and therefore the revenue-expense approach is more appropriate for determining sustainable income.

Usefulness of realised net income ex-post

Subjective goodwill (Edwards & Bell, 1961: Chapter 2) is the reason why people invest. It arises because ‘the investor values the investment or the entity concerned more highly than the market values the underlying resources. (...) (I)t gradually diminishes in value as it is converted into market values, owing to the eventual realization of the previously anticipated benefits’ (Lee, 1985: 122).

Investors formulate their ex ante estimations of the subjective goodwill (= subjective economic value of an asset – market price of the asset) of their investment in an entity in the way described in the previous section. ‘The process of forecasting requires not just looking ahead, but also learning from the inaccuracy of prior forecasts. (Barker, 2004: 162)’ Investors need to determine to what extent their ex ante estimations of the subjective goodwill have been realised as income ex post (Tsujiyama, 2002: 352) and ultimately to what extent their subjective expectations have materialised as cash receipts (Tsujiyama, 2002: 358) (i.e., the previously anticipated benefits referred to by Lee above). See also Saito (1999: 173)

If investors want to adjust their expectations, they need an accounting approximation of the sustainable income that has been generated by the entity’s business operations and they need to understand its sources. Non-operating, non-recurring and externally driven items (i.e., the transitory components) of comprehensive income provide limited feedback value because they do not challenge the assumptions originally made

(Barker, 2004: 163) in the ex-ante estimation of the subjective goodwill associated with the investment. Realised net income performs this feedback function better than comprehensive income because it provides reliable, objective and hard accounting information (Ijiri, 1975: 35-40) ‘uncontaminated by speculative information (Penman, 2003: 88)’. Saito (2011: 114) describes the ASBJ’s released-from-risk income concept as an appropriate accounting measure to approximate Hicks’ Income concept No. 2 ex post because it excludes windfalls.

Where realisation becomes released-from-risk

The term ‘released from risk’ first appears in the definition of net income (CH3, Par. 9). Explanations are given in CH 3: Par. 23 and CH 4: Par. 56, 57 and 58, but to the uninitiated, they raise more questions than they answer. For example, ‘the results of investments being released from risks means that the result expected at the time of the investment have become definite as facts. In particular, for business investments, their results are considered to be released from risks when independent assets that are not subject to business risks are considered to be obtained in exchange for the assets subject to business risks. (ASBJ, 2006: Par. 57, 2007 English translation)’

However, because the Japanese accounting standards, like the FASB’s accounting standards, required the measurement of cash equivalents and trading securities at their market price and the inclusion of their valuation differences in net income, the traditional realisation concept needed to be extended. The traditional realisation concept whereby a transaction was realised at the exchange of cash or when a sale has taken place was too narrow, but Tsujiyama (1991: Chapter 7 and 2005: 115-119) and Obinata (2007: Chapter 3) criticised what they call ‘the realisable concept’ associated

with the asset-liability approach and current value measurement. Recognising a change in the market price of assets or liabilities as net income simply when it is measurable with an otherwise unspecified degree of certainty would introduce too much subjectivity and risk into the measure of performance.

Thus, the Concepts Working Group developed the released-from-risk concept which distinguishes between what it calls ‘business investments’ and ‘financial investments’. Business investments carry subjective goodwill because they are made with the intention of generating profit from sales. Financial investments are made with the intention of generating capital gains due to favourable changes in the market price over time (i.e., speculation) or for the purpose of investing surplus cash in very liquid and low-risk cash-equivalent securities. They yield the same cash flow irrespective of whoever holds them and hence do not carry any goodwill (Saito, 1999: 171 and 173) even though they may be made on the basis of subjective goodwill expectations.

This distinction is similar to Feltham & Ohlson (1995)’s distinction between operating assets (which are meant to generate abnormal returns) and financial assets (which cannot generate abnormal returns) for valuation purposes. It is also similar to Penman (2007: 38-39)’s distinction between the situation where the business model adds value to market prices and the situation where ‘value is determined solely by exposure to market price; that is, shareholder value is one-to-one with market prices.’ Penman (2007: 39) uses this one-to-one condition for the application of fair value, in a similar way as the ASBJ framework uses the distinction between business and financial investments for the determination of measurement and recognition rules.

Business investments must be accounted for using historical cost (or the lower of cost or market). Financial investments may be measured at their market price. Only changes in the market price of financial investments that do not carry goodwill may be recognised as realised net income. For example the investment of surplus cash in cash equivalents will generate the same cash flows irrespective of who holds them and subjective goodwill does not exist. The market price is truly the consensus price and there is no difference between exit and entry price, apart from possible transaction costs. Therefore, the market value of the investment will almost certainly be realised and valuation at market price does not carry any risk (Saito, 1999: 171). The case of cash equivalents and trading securities is where the realisation concept becomes the released-from-risk concept. Even though the cash flows associated with investments in cash equivalents and trading securities have not, strictly speaking, been realised, they are not normally considered to be subject to risk.

The need for recycling of OCI

By now, it will be clear that the Concepts Working Group adopted a mixed attributes approach whereby released-from-risk net income is the primary concept of performance and comprehensive income performs a secondary role. A corollary of this choice is that it is necessary to reclassify elements of OCI into net income upon their release from risk (Tsujiyama, 2000 and 2002: 361-365). The basic income measurement constraint says that the sum of released-from-risk net income over the life of the entity must equal the sum of net cash flows over the life of the entity (ASBJ, 2006, Par. 10). Without it, net income for the period and the net increase or decrease in cash flow statement cannot be reconciled, and the income statement and the cash flow statement would not articulate. As a consequence, total net income over the life

of the entity would not equal total cash flows over the life of the entity (Kawamura, 2011: 200 and Tsujiyama, 2000 and 2002).

Interpretation and contextualisation

The ASBJ's choice for a mixed attributes model based on the released-from-risk net income concept of performance may serve the objective of stabilising the allocation of resources from a longer term perspective. Promoting investment on the basis of realisable profits rather than realised profits appears to distort the allocation of resources in the longer term towards riskier, more speculative and non-value adding activities. This may cause the economic system to become riskier and more unstable.

To the extent that securities are purchased on the basis of long-term considerations, external users of accounting data should prefer current operating income figures (such as released-from-risk net income) to realisable income figures (such as comprehensive income) because they are better indicators of an entity's long-run operating profit possibilities. See also Edwards & Bell (1961: 103). Although some amount of speculative activity helps to make markets more liquid and shift risks in the short term, the basis for sound economic sustainability and growth lies in value adding operations as well as sharing both risks and rewards in the longer term.

Conclusions

Sooner or later, the IASB will need to choose and justify a performance concept that underlies the rest of its conceptual framework. When that time comes, the IASB will need to explain why this concept of performance enables investors to better estimate

income ex ante and adjust expectations ex post than other concepts do. If it chooses comprehensive income as the main concept, disclosing net income without recycling components of OCI upon realisation will be meaningless. If it chooses some kind of realised net income as the main concept, disclosing comprehensive income and elements of OCI will still add informational value, but recycling will be necessary. Either way, the IASB will need to clarify and justify its stance on the age old problem of the distinction between income and capital and how to account for both. The added complication for the IASB is that the accounting for income and capital must be done in the best interests of the international general public across different institutional environments.

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Tables

Table 1: The structures of the two frameworks

	2006 ASBJ Conceptual Framework	2010 IASB Conceptual Framework
1	Objectives of financial reporting	The objective of general purpose financial reporting
2	Qualitative characteristics of accounting information	The reporting entity (does not yet have any content)
3	Constitutive elements of financial statements	Qualitative characteristics of useful financial information
4	Recognition and measurement in financial statements	The Framework (1989): the remaining text

Table 2: Comparison of the qualitative characteristics of useful information

Pervasive constraint:	General constraints:
Cost	Internal consistency and Comparability
Enhancing characteristics:	Self-evident constraints:
Comparability, Timeliness,	Understandability, Materiality,
Verifiability and Understandability	Consideration of costs and benefits

	Complete		Neutrality
	Neutral	Information value	Verifiability
Able to affect decisions	Free from error	Satisfying user needs	Faithful representation
Relevance	Faithful representation	Decision-relevance	Reliability
(IASB) Decision-usefulness		(ASBJ) Decision-usefulness	

Table 3: Elements of the balance sheet in the two frameworks

2006 ASBJ Conceptual Framework (Chapter 3)	2010 IASB Conceptual Framework (Chapter 4)
Assets: Economic resources controlled by the reporting entity as a result of past transactions or events (Par. 4)	Assets: Economic resources controlled by the entity as a result of past transactions or events and from which future benefits are expected to flow to the entity (4.4a)
Liabilities: Obligations or their equivalents to give up or transfer economic resources which the reporting entity controls as a result of past transactions or events (Par. 5)	Liabilities: A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (4.4b)
Net assets: The difference between total assets and total liabilities (Par. 6)	Net assets: Net assets = Equity (4.4c) Equity is the residual interest in the assets of the entity after deducting all its liabilities
Owners' equity: A component of net assets contributable to the shareholders who are the owners of the reporting entity (in case of consolidated financial statements the shareholders of the parent company) (Par. 7)	Equity may be sub-classified (4.20)

Table 4: Elements of the income statement in the two frameworks

2006 ASBJ Conceptual Framework (Chapter 3)	2010 IASB Conceptual Framework (Chapter 4)
Revenues and gains: Increases in net income and the minority interests' share of earnings corresponding to the increases in assets or decreases in liabilities that have been released-from-risk (Par. 13).	Income is increases in economic benefits during an accounting period in the form of inflows or enhancements of assets other than those relating to contributions from equity participants (4.25). Income includes revenues and gains.
Expenses and losses: Decreases in net income and the minority interests' share of earnings corresponding to the decreases in assets or increases in liabilities that have been released-from-risk (Par. 15).	Expenses are decreases in economic benefits during the accounting period in the form of outflow or depletion of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants (4.25).

Table 5: Elements of the income statement in the 2006 ASBJ Framework

2006 ASBJ Conceptual Framework (Chapter 3)
Comprehensive income (CI): The change in net assets during a certain period which does not result from direct transactions with the entity's shareholders (who are the owners of the reporting entity), the minority shareholders of subsidiaries, and option holders who may become any of the above in the future (Par. 8)
Net income (NI): The part of the change in net assets during a certain period resulting from transactions or events (except for direct transactions with the entity's

shareholders, the minority shareholders of subsidiaries, and option holders who may become any of the above in the future) which is attributable to the owners of the reporting entity as a result of the entity's investments which have been released from risk. NI will affect only the owners' equity component of net assets (Par. 9). Basic constraint with respect to the measurement of income: the total net income over the life of the entity must equal its total net cash flows (Par. 10). NI requires adjustment for the share that is attributable to minority interests (Par. 11).

Table 6: Recognition constraints in the two frameworks

2006 ASBJ Conceptual Framework (Chapter 4)	2010 IASB Conceptual Framework (Chapter 4)
<p>Triggers for recognition: An item that meets the definitions of an element may be recognised when an underlying contract is executed by at least one of the counterparties. Once recognised, changes in the market value of assets and liabilities may also trigger the recognition of a new element (Par. 3). In the case of financial instruments of which the realisation into cash inflows or outflows related to the change in net position is not subject to risk, even before the parties to the contract have started to execute it, this change may be recognised in the financial statements</p>	<p>Triggers for recognition: An item that meets the definition of an element should be recognised if: it is probably that any future economic benefit associated with the item will flow to or from the entity; and the item has a cost that can be measured with reliability (4.38). Recognition of income: reliable measurement of an increase in future economic benefits related to an increase in an asset or a decrease of a liability (4.47) and a sufficient degree of certainty (4.48). Recognition of expenses: reliable measurement of a decrease in future</p>

(Par. 5).	economic benefits related to a decrease in an asset or an increase in a liability (4.49).
Probability: The recognition of an element must be triggered by the execution of a contract or subsequently a change in market value, and the probability of a future event related to that element of the financial statements occurring, must be above a certain level (Par. 6).	Probability: refers to the degree of uncertainty that the future economic benefits will flow to or from the entity (4.40).
	Reliability of measurement: In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability (4.41). An item that fails to meet the recognition criteria may meet the criteria and qualify for recognition later (4.42). An item that possesses the characteristics of an element but fails to meet the recognition criteria may be disclosed in the notes to the financial statements, supplementary schedules or explanatory materials (4.43).

Table 7: Measurement of assets in the two frameworks

2006 ASBJ Conceptual Framework (Chapter 4)	2010 IASB Conceptual Framework (Chapter 4)
Historical cost (HC) is the amount of cash or cash equivalents paid or the fair value of the goods or services sacrificed to acquire the asset. Because amortised cost is based on HC it is included in the category of HC (Par. 8)	Historical cost (HC) is the amount of cash or cash equivalents paid or the fair value of the considerations given at the time to acquire the assets (4.55, b)
Replacement Cost (RC) is the amount that the entity would have to pay if it were to purchase an equivalent asset at the date of measurement (Par. 15) in a market where there is a difference between exit and entry price for that particular asset (not taking into account any transaction costs).	Current cost (CC) is the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently (4.55, b)
Net Realisable Value (NRV) is the amount of cash that can be obtained from selling an asset after deduction of the estimated selling costs and after sales costs (Par. 17) in a market where there is difference between exit and entry price for that particular asset (not taking into account any transaction costs).	Realisable or settlement value is the amount of cash that could currently be obtained by selling the asset in an orderly disposal (4.55, c)

Discounted value is determined by discounting the future cash flow expected to be generated from the use of the asset until the date of measurement using a certain discount rate (Par. 19).	Present value is the discounted value of future net cash inflows that the asset is expected to generate in the normal course of business (4.55, d)
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Table 8: Measurement of assets at Market Value in the ASBJ Framework

2006 ASBJ Conceptual Framework (Chapter 4)
Market price (MP) is the price formed in the market for a specific asset. MP will have a different meaning depending on the characteristics of the market concerned (Par. 11). In a market where no distinction can be made between the market at which the entity purchases a specific asset and the market in which it sells the asset, the market price represents the economic value of that asset (Par. 12). That is, there is no difference between the entry and exit price of the asset (not taking into account any transaction costs).
Discounted value is determined by discounting the future cash flow expected to be generated from the use of the asset until the date of measurement using a certain discount rate (Par. 19).
Value in use: In cases when both cash flows and discount rates are continuously revised, the discounted value is used to estimate value-in-use (subjective value) (Par. 20)
Fair value: In cases when both cash flows and discount rates are continuously revised, the discounted value can also be used to estimate fair value (a surrogate market price) (Par. 23).

Recoverable amount: When only cash flows are revised, the measurement reflects recoverability (Par. 24-25).
Net amount receivable: Receivables less allowance for receivables (Par. 26-27).
Amount based on net assets of an investee: The amount corresponding to the equity interest of the investing company in the net assets of the investee company (Par. 28).

Table 9: Measurement of liabilities at market prices in the ASBJ Framework

2006 ASBJ Conceptual Framework (Chapter 4)
PV using revised expected cash outflows discounted at the risk-free rate (ignores the entity's own credit risk and default risk) (Par. 35).
PV using revised expected cash outflows discounted at a risk-adjusted discount rate takes account of the entity's credit risk at the measurement date (Par. 37).
Changes in this measurement consist of an interest expense component and a component in the form of gains or losses arising from the change in estimated future cash outflows (Par. 40).
Changes in this measurement represent interest expense calculated using the initial effective interest rate (Par. 42)
MP is the price formed in the market for a specific asset or liability. MP will have a different meaning depending on the characteristics of the market concerned (Par. 11).

Table 10: Measurement of revenues/gains in the 2006 ASBJ Conceptual Framework

	2006 ASBJ Conceptual Framework (Chapter 4)
Exchange transactions	Income arising from business transactions with third parties is measured by the increase in assets (when the consideration received

	results in an increase in assets which is no longer subject to risk) or the decrease in liabilities (when the consideration received results in a decrease in liabilities is no longer subject to risk) (Par. 44).
Changes in market price	Gains resulting from a favourable change in the market price of an asset or liability that can be settled at any time and which the entity's management intends to be for financial/speculative purposes instead of normal business purposes may be recognised as income in the income statement (Par. 45).
Partial execution of contracts	In case of contracts to continuously provide goods or services, the reporting entity may recognise and measure income in proportion to the execution of the contract during the period if it is certain that the counterparty will uphold the contract (Par. 46).
Results of the investee's activities	Investment income may be recognised when the investment account increases owing to the investment results by the investee company. When the investee is integrated with the investor company, investment income is measured as the proportion of the investee's net income that corresponds to the investor company's equity interest (Par. 47).

Table 11: Measurement of expenses/losses in the 2006 ASBJ Conceptual Framework

	2006 ASBJ Conceptual Framework (Chapter 4)
Exchange transactions	Expenses resulting from exchange transactions are measured by the considerations paid by the third party in exchange for goods or services (Par. 48).
Changes in market price	Losses resulting from an unfavourable change in the market price of an asset or liability (Par. 49) that can be settled at any time and which the

	entity's management intends to be for financial/speculative purposes instead of normal business purposes (Par. 45) may be recognised as expenses in the income statement (Par. 49).
Partial execution of contracts	In case of contracts to continuously provide goods or services, the reporting entity may recognise and measure expenses in proportion to the execution of the contract during the period (Par. 50).
Usage	Assets that the entity's management intends to use for normal business purposes will normally be reduced in value in proportion to their usage and/or depletion. Expenses must be recognised that represent the actual usage or depletion of the assets and are measured based on the decrease in the values of the assets in the balance sheet (Par. 51). When actual usage is difficult to measure, systematic cost allocation is applied based on estimates of useful life, residual value and the rate of usage. Significant errors will need to be adjusted for (Par. 52).