

AGENDA PAPER

IFRS Advisory Council Meeting

LONDON 18 – 19 June 2012

Agenda ref 8

TOPIC	Recent developments surrounding financial reporting regulation in Japan
-------	---

PRESENTER	Makoto Sonoda
-----------	---------------

CONTACT	Makoto Sonoda
---------	---------------

This paper has been prepared for discussion at a public meeting of the IFRS Advisory Council. The views expressed in this paper are those of the authors. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS.

Presentation for June 2012 IFRS Advisory Council meeting

Recent Developments surrounding Financial Reporting Regulation in Japan

18th June 2012
IFRS Advisory Council

** This presentation is prepared under the sole responsibility of the presenter.
All remarks represent the presenter's own views, and not those of the FSA.*

History: Movements in Accounting Standards in Japan

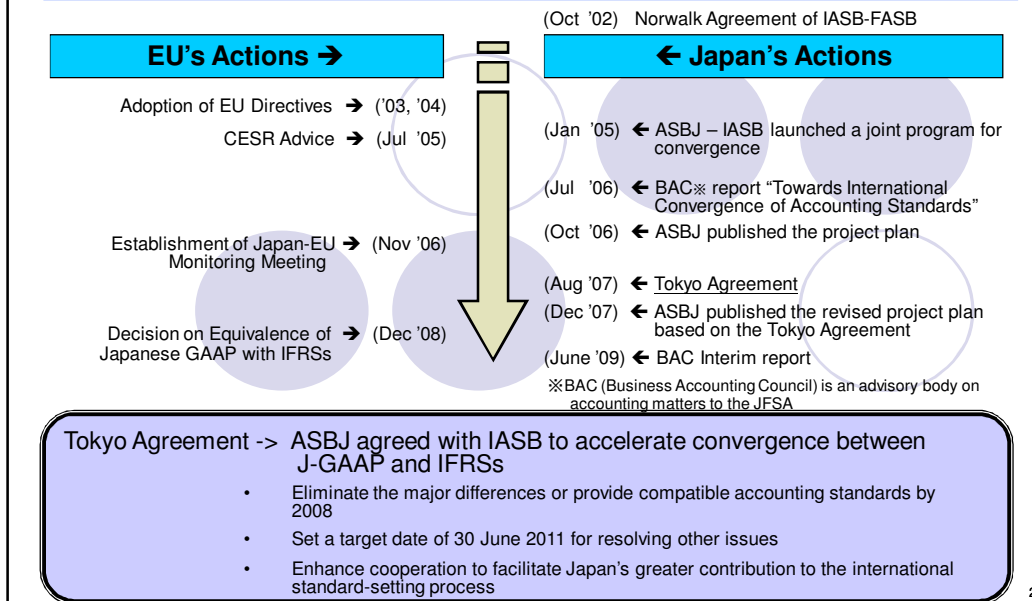
- ✓ 1949 ◆ Issuance of Financial Accounting Principles
- ✓ 1975 ◆ Issuance of Accounting Principles for Consolidated F/S
- ✓ In the late 1990s ◆ “Big Bang” in Accounting Fields
 - Emphasis on Consolidated F/S
 - Requirement to develop Consolidated C/S
 - Drastic Revision in some accounting standards
 - “Financial Instruments”
 - “R&D Costs”
 - “Pension Accounting”



2000s-
Jun '09

Begin dealing with IFRS
Business Accounting Council “Interim Report”

Japan's Convergence Process



Interim Report (June 2009): Basic Concept

Basic Concept for Application of IFRSs in Japan

- ✓ To improve quality and international comparability of financial reporting for investors; and
- ✓ To enhance the international competitiveness of Japanese financial market; etc.

⇒ must draw a roadmap with a concrete vision for the future toward a possible voluntary or mandatory application of IFRSs in the statutory disclosure of financial statements by Japanese companies

Application of IFRSs

Voluntary application from the end of March 2010:

- The consolidated financial statements of certain listed companies whose financial or business activities are conducted internationally

Decision of adoption aimed to be made around 2012:

- Decision regarding mandatory application of IFRSs for listed companies
- If adopting IFRS, preparation period should be Minimum 3 years

Interim Report (June 2009): Key Conclusion

- ✓ Before making a decision regarding mandatory use of IFRSs, JFSA will consider the achievement of some points, such as:
 - whether the governance of the IFRS Foundation is improved
 - whether IFRSs appropriately reflect business practices
 - whether Japanese accounting stakeholders express opinions to IASB proactively and effectively
 - whether IFRSs are appropriately and promptly translated into Japanese
 - whether education and training on IFRSs are sufficiently conducted

4

Voluntary Application of IFRSs

On December 11, 2009, FSA published the set of revised Cabinet Office Ordinances

Criteria for voluntary application of IFRSs

- ✓ Listed on a Security Exchange in Japan
- ✓ Disclose in their Annual Securities Reports information regarding specific efforts to ensure appropriateness of their consolidated financial statements
- ✓ Allocate executives or employees with ample knowledge about Designated IFRSs and have in place a structure that enables them to properly prepare consolidated financial statements in accordance with Designated IFRSs
- ✓ Companies, parent companies, other related companies or parent companies of the other related companies shall either:
 - (a) disclose under laws and regulations of foreign jurisdiction periodically as required thereby, documents on their business conditions prepared in accordance with IFRSs;
 - (b) disclose under rules set by foreign security exchange markets periodically as required thereby, documents on their business conditions prepared in accordance with IFRSs; or
 - (c) own a foreign subsidiary whose capital is equal to or exceeds the equivalent of 2 bln yen.

Effective Date

- ✓ Starting from the consolidated fiscal years ending on or after March 31, 2010

Changes in Circumstances since the “Interim Report”(1)

There have been many changes since the release of “Interim Report”.

- Publication of the US SEC staff’s work plan (February 2010)
- Announcement of a few months’ delay in the completion of the convergence project by IASB and FASB (April 2011)
- Publication of a report by the Panel on Non-consolidated F/Ss (April 2011)
- Submission of a request by the industry* (May 2011)

6

Changes in Circumstances since the “Interim Report” (2)

- Publication of the US SEC staff’s work plan for the consideration of incorporating IFRS** (May 2011)
- Release of “Priority Policy Actions 2011-2012” by Japanese Trade Union Confederation (Rengo) *** (June 2011)
- Outbreak of the Great East Japan Earthquake and tsunami
- Increase in competition for greater influence on IFRS in the international arena, including in Asia

7

Changes in Circumstances since the “Interim Report” (Notes) (1)

* Outline of the “Requests on how to deal with IFRS in Japan (May 2011)” by 21 firms from the industrial sector

- (1) A prompt discussion is needed on the general design of the accounting system including the appropriateness of IFRS application to the consolidated financial statements of listed companies based on proper analysis and sharing of information on international developments.
- (2) If it takes time to reach a conclusion on the design of the entire system, it is necessary to provide a sufficient time period for preparation (e.g., five years) and extend transitional measures (continued acceptance of disclosure using US GAAP), so that the industry would not incur unnecessary costs for preparation.

** “Work Plan for Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers-Exploring a Possible Method of Incorporation”

8

Changes in Circumstances since the “Interim Report” (Notes) (2)

*** “Priority Policy Actions 2011-2012 (June 2011)” by the Japanese Trade Union Confederation, or Rengo

- (4) Reforming corporate related legal framework and realizing accounting standards, that would benefit a wide range of stakeholders such as workers
 - b) It should be promptly made clear that mandatory application of IFRS to the consolidated financial statements of listed companies should not take place for the time being. Also, as for accounting standards for non-consolidated financial statements, while ensuring transparency by means of footnotes etc., convergence should take place only for those standards deemed appropriate based on the industrial structure and actual business operations in Japan, and the resulting differences in accounting standards between those used for consolidated and non-consolidated financial statements should be accepted.

9

Clarified Issues about IFRS Application in Japan

- The timing of mandatory application of IFRS (if decided)
 - Not to take place from the business year ending March 2015
 - To require sufficient time for preparation: i.e., 5-7 years
- To allow the continued use of US GAAP for disclosure purpose in Japan

10

Meeting of the BAC (since June 2011)

- For the consideration on the application of IFRS, a meeting of the Business Accounting Council (BAC) was called in June 2011.
- Expectation for BAC discussion
 1. To pay due attention to the fact that the “accounting standards” are not merely technical issues, but much broader issues highly relevant to the status of Japanese firms closely related to the country’s history, business culture, and national heritage, as well as related legal systems including Companies Act and the tax system, and the firms’ global competitiveness
 2. To take account of the views of a wide range of stakeholders
 3. To carefully pay close attention to domestic developments and the situation in other countries

11

Main Topics considered at the BAC (1)

- Overall design of accounting standards and disclosure system in Japan
- Analysis of international demands, diplomatic policies and foreign situations
- Ideal accounting system that contributes to economic activities
- Impact on using principle-based approach accounting standards
- Impact of IFRS introduction on regulatory environments and legal/contract environments
- Impact of IFRS introduction on SMEs and non-listed companies

12

Main Topics considered at the BAC (2)

- Communication between investors and preparers in Japan
- Japanese audit firms' readiness for appropriate auditing of IFRS-based financial statements
- Consideration of current situations of IFRS voluntary application in Japan
- Governance of the ASBJ (Japanese national standard setter)
- Governance of the IASB



To be a comprehensive and mature discussion

(discussion is still ongoing)

13

Appendix

Legal Status of IFRSs in Japan (1)

Financial Instruments and Exchange Act

Financial Statements shall be prepared in conformity with the terms, forms and preparation methods which the Commissioner of the JFSA prescribes in a Cabinet Office Ordinance in accordance with the manner generally accepted as fair and proper.

14

Appendix

Legal Status of IFRSs in Japan (2)

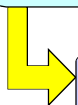
Cabinet Office Ordinance

Regulation for Consolidated Financial Statements

Certain Japanese companies whose financial or operational activities are conducted internationally may prepare their consolidated financial statements in accordance with IFRSs designated by the Commissioner of the JFSA.

Requirements for IFRSs Designation by the Commissioner of the JFSA

- i. Clearly drafted and made generally known to the market in advance;
- ii. Carefully considered by various stakeholders;
- iii. Assessed by a large number of stakeholders as reasonable standards reflecting actual economic conditions; and
- iv. Widely received by stakeholders as fair and appropriate financial reporting standards.



✓ IFRSs are designated with no carve-ins or carve-outs.

15



Thank you!

Makoto SONODA

Financial Services Agency
Government of Japan

<http://www.fsa.go.jp/en/index.html>