

## **STATEMENT ON JAPAN's PROGRESS TOWARD CONVERGENCE BETWEEN JAPANESE GAAP AND IFRSs**

### **In Reference to Technical Advice on Equivalence by CESR**

January 31, 2006

Accounting Standards Board of Japan

#### **I. Introduction**

The Accounting Standards Board of Japan (ASBJ) believes that convergence toward compatible high quality accounting standards is beneficial for capital markets around the world. Based on this belief, the ASBJ has been developing Japanese accounting standards and has contributed to the International Accounting Standards Board (IASB) actively in working towards the development of International Financial Reporting Standards (IFRSs) by exchanging comments and participating in a working project on performance reporting.

Based on the above policy, the ASBJ and the IASB launched a joint project in March 2005 with the final goal of accomplishing convergence between Japanese GAAP and IFRSs. During the course of this project, both boards have exchanged views and deliberated actively and, as a consequence, the ASBJ has been accelerating its revision of Japanese accounting standards to minimize the differences between the two standards. Since the ASBJ believes that a closer relationship should be established with other standard setters, the ASBJ and the Financial Accounting Standards Board of the United States (FASB) will hold an initial periodical meeting of representatives of both boards in May 2006 in Tokyo.

The current total market value of the Japanese stock markets amounting to approximately U.S.\$5 trillion is comparable with those in the U.S. and European markets. The equity trading volume of overseas investors in Japanese capital markets has been increasing and amounted to 33.7% in 2004. Also, foreigners' share ownership in Japanese public companies amounted to 23.7% in 2004. Accordingly, the capital markets in Japan have developed internationally and Japanese accounting standards have developed in parallel as an important infrastructure of the international capital market. The ASBJ considers the importance of further achievements towards the convergence of accounting standards not only in terms of their significance to overseas capital markets, but also in respect of Japanese capital markets.

This statement has been prepared in order to clarify recent progress towards the convergence of Japanese GAAP in reference to the technical advice on equivalence with IFRSs issued by the Committee of European Securities Regulators (CESR) in July 2005. The ASBJ will make steady progress to eliminate the differences indicated by the CESR as soon as practicable. Current prospects for the convergence status as of 2008 are presented herein, by issue, in Chapter III, "CESR's TECHNICAL ADVICE AND ASBJ's CONVERGENCE PLAN."

## II. Recent Developments in Japanese GAAP

### 1. Issues discussed in the joint project with the IASB

The ASBJ and the IASB have deliberated on five topics in the first phase of the joint project. As a consequence of these deliberations with the IASB, accounting standards are in the process of being issued or are under discussion. In the second meeting, topics such as the cost of issuing new shares and intangible assets were picked up as additional issues. As a result, the ASBJ determined to initiate deliberation on the cost of issuing new shares with a view to the establishment of a new accounting standard in 2006. A research project on intangible assets was set up so that this can be a topic to be addressed in the convergence project as soon as possible. The ASBJ has now commenced discussion on selecting topics to be added in the first phase.

The issues deliberated in the first phase and the ASBJ's candidate issues to be added are summarized as follows:

#### *Issues discussed with the IASB*

Issues	Progress
Valuation method of inventories	The discussion paper was issued in October 2005. Issue of the standard is planned in 2006.
Segment information	The ASBJ has issued comments to the IASB in August 2005. The ASBJ is monitoring the IASB's discussion and is continuing deliberation.
Related party disclosure	Issue of the standard is planned in 2006.
Uniformity of accounting policies on overseas subsidiaries	The exposure draft was issued in November 2005. Issue of the guidance is planned in early 2006.
Investment properties	The ASBJ has exchanged comments with the IASB. The ASBJ will monitor further discussions between the IASB and the FASB. Based on their research, the ASBJ will continue to deliberate especially on the definition of investment properties.
Cost of issuing new shares (*)	Issue of the standard is planned in 2006.
Intangible assets including capitalization of R&D expenses (*)	The ASBJ set up a research project on intangible assets in preparation for discussion on convergence.

(\*) Issues were added at the second meeting in September 2005.

### ***Current candidate issues to be added in the first phase***

<b>Issues</b>	<b>Progress</b>
<ul style="list-style-type: none"><li>• Asset retirement obligation</li><li>• Construction contracts</li><li>• Disclosure of financial instruments at fair value</li></ul>	The ASBJ will establish projects in the first half of 2006 aiming to converge the accounting standards relating to these issues.

In addition to the above issues, the ASBJ set up a project regarding the scope of consolidation (including Special Purpose Entities). Also, the ASBJ will establish projects regarding retrospective restatement, impairment tests, reversal of an impairment loss and business combinations (concerning minority interests at historical cost, step acquisition and date of exchange) considering the progress in the convergence project between the IASB and the FASB.

The joint project between the ASBJ and the IASB has entered its second year and discussions concerning each issue have been made sufficiently by both boards. However, since the joint project was initiated between the ASBJ and the IASB, the international situation on the joint project has changed. As a result of these changes, the ASBJ will discuss with the IASB how to proceed with the joint project at the third meeting which will be held in Tokyo in March 2006.

## **2. Other Issues Undertaken by the ASBJ**

The following are other significant revisions which the ASBJ has undertaken in 2005. The ASBJ and the IASB agreed that those items would contribute to the minimization of differences between Japanese GAAP and IFRSs.

<b>Issues</b>	<b>Progress</b>
Share-based payments	The exposure draft was issued in October 2005. The standard was issued in December 2005.
Presentation of net assets in the balance sheet	The exposure draft was issued in August 2005. The standard was issued in December 2005.
Statement of changes in net assets	The exposure draft was issued in August 2005. The standard was issued in December 2005.
Quarterly reporting (*)	The discussion paper was issued in December 2005. Issue of the standard is planned in 2006.

(\*) Quarterly reporting has been deliberated in light of discussions on the disclosure requirements for listed companies to be changed from a semiannual basis to a quarterly basis.

## **3. Periodical Meetings with the FASB**

The ASBJ believes that the ASBJ, the IASB and the FASB are standard setters whose standards are used in the major international capital markets. Accordingly, periodical meetings with the FASB will be initiated to discuss major issues, those which may require a long period for resolution, and issues which both boards currently have experienced difficulty resolving in promoting the convergence of accounting standards. An initial meeting will be held in May 2006.

### III. CESR's Technical Advice and ASBJ's Convergence Plan

On July 5, 2005, the CESR issued a technical advice on equivalence of third countries' GAAP with IFRSs. The technical advice identified the issues to be remedied in order to accomplish equivalence with IFRSs. The ASBJ believes that the differences which the CESR pointed out will be eliminated as the convergence project with the IASB proceeds. However, due to the importance of resolving the issues which the CESR noted, the ASBJ will make steady progress to eliminate the differences.<sup>1)</sup>

The following is a summary which presents the issues, current developments and prospects for 2008 by issue pointed out in the technical advice. Issues regarding business combinations are separately addressed in Section 4.

#### 1. Issues requiring preparation of a supplementary statement (other than those on business combinations)

Issues, current developments and prospects for 2008 requiring the preparation of a supplementary statement are summarized as follows:

Remedies	Issues	Current developments	Prospects for 2008
Supplementary statement	• Uniformity of accounting policies concerning overseas subsidiaries	• The exposure draft was issued in November 2005 under which the accounting policies are, in substance, to be unified.	The effective date of the guidance is scheduled for April 2008.
	• Scope of consolidation (qualified Special Purpose Entities)	<ul style="list-style-type: none"><li>• Since US GAAP is also subject to a supplementary statement, future discussion is necessary on how this issue will be resolved between the FASB and the IASB.</li><li>• The ASBJ considers this a candidate issue to be discussed at the periodical meetings with the FASB and has set up a project to investigate this issue.</li></ul>	The ASBJ will make at least a tentative decision considering the progress of convergence between IFRSs and US GAAP.

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<sup>1)</sup> When the application of remedies is assessed at the entity level, some of the differences identified by the CESR may be avoidable depending on each entity's rational choices of accounting policies. The ASBJ, however, will undertake the convergence project positively to minimize such differences between Japanese GAAP and IFRSs.

## 2. Issues requiring additional disclosure in financial statements under Japanese GAAP (other than those relating to business combinations)

The ASBJ places a higher priority on addressing issues on which IFRSs and US GAAP have already been converged.

The issues and a plan for their resolution are as follows:

Remedies	Issues	Current developments	Prospects for 2008
Disclosure A, B	<ul style="list-style-type: none"> <li>Asset retirement obligation</li> <li>Construction contracts</li> <li>Disclosure of financial instruments at fair value</li> </ul>	<ul style="list-style-type: none"> <li>Discussion on these issues was started in order to add them as topics for the convergence project with the IASB.</li> <li>These projects will be initiated in the first half of 2006.</li> </ul>	Standards and guidance will be mostly completed due to the progress of our convergence project.
	<ul style="list-style-type: none"> <li>Lower of cost or market method for valuation of inventories</li> </ul>	<ul style="list-style-type: none"> <li>A discussion paper was issued in October 2005. Issue of the standard is planned in 2006.</li> </ul>	Standards and guidance will be in place.
	<ul style="list-style-type: none"> <li>Pension (including discount rate to be used for calculating retirement benefit obligations)</li> </ul>	<ul style="list-style-type: none"> <li>Due to the stability of interest rates in Japan, it is considered that no significant differences have arisen.</li> </ul>	The ASBJ will make at least a tentative decision considering the progress of convergence between IFRSs and US GAAP.

### 3. Issues requiring additional disclosure in financial statements under both Japanese GAAP and US GAAP (other than for business combinations)

With regard to additional disclosures which are required for both Japanese GAAP and US GAAP, the ASBJ needs to consider the progress on convergence between the IASB and the FASB to know in which direction the two standards will be converged. The ASBJ will make comments on these issues to the IASB and the FASB, when necessary, from the early stages. Deliberations on revisions to Japanese GAAP will be initiated considering the progress on convergence between IFRSs and US GAAP. The issues and a plan for their resolution are outlined as follows:

Remedies	Issues	Current developments	Prospects for 2008
Disclosure A, B	<ul style="list-style-type: none"> <li>Share-based payments</li> </ul>	<ul style="list-style-type: none"> <li>Disclosure which the CESR proposes as a remedy is required in the standard which will become effective in 2006.</li> </ul>	Standards and guidance will be applied.
	<ul style="list-style-type: none"> <li>Impairment tests and reversal of impairment loss</li> </ul>	<ul style="list-style-type: none"> <li>The ASBJ will assess feedback from market participants on the impairment standard effective 2005 as well as the deliberations by the FASB which has standards similar to Japanese GAAP.</li> <li>The ASBJ will initiate deliberations considering the timing when the IASB and the FASB initiate their convergence project.</li> </ul>	The ASBJ will make at least a tentative decision considering the progress of convergence between IFRSs and US GAAP. When a difference in IFRSs is converged with US GAAP, the difference with Japanese GAAP will then be converged.
	<ul style="list-style-type: none"> <li>Investment property</li> </ul>	<ul style="list-style-type: none"> <li>This issue is being deliberated in the first phase of the convergence project with the IASB. The ASBJ will continue to provide its own comments to the IASB.</li> <li>Deliberations by the FASB, which has a standard similar to Japanese GAAP, will be considered.</li> </ul>	
	<ul style="list-style-type: none"> <li>Uniformity of accounting policies of associates</li> </ul>	<ul style="list-style-type: none"> <li>The ASBJ will initiate deliberation and research issues relating to the implementation of IFRSs in 2005.</li> <li>Discussion of this issue could be proposed for the agenda of a periodical meeting with the FASB as the CESR proposed an additional disclosure related to this issue to the FASB.</li> </ul>	
	<ul style="list-style-type: none"> <li>Capitalization of development costs</li> </ul>	<ul style="list-style-type: none"> <li>A research project has been established in preparation for discussion with the IASB.</li> <li>Deliberations by the FASB, which has a standard similar to Japanese GAAP, will be considered.</li> </ul>	

<b>Remedies</b>	<b>Issues</b>	<b>Current developments</b>	<b>Prospects for 2008</b>
Disclosure A, B	<ul style="list-style-type: none"> <li>• (Financial Instruments)</li> </ul>	<ul style="list-style-type: none"> <li>• The CESR is continuing its own assessment of standards for financial instruments as these are complex. Deliberations by the FASB and the IASB will be monitored.</li> </ul>	The ASBJ will make at least a tentative decision considering the progress of convergence between IFRSs and US GAAP.
	<ul style="list-style-type: none"> <li>• Use of LIFO for inventory valuation</li> </ul>	<ul style="list-style-type: none"> <li>• The ASBJ considers the LIFO method as a future topic of convergence; whether or not the LIFO method will be allowed as one of the accepted optional methods of valuation will be deliberated.</li> <li>• No significant differences are expected as only a few companies apply the LIFO method.</li> </ul>	
	<ul style="list-style-type: none"> <li>• Agriculture</li> </ul>	<ul style="list-style-type: none"> <li>• Agriculture is considered as a future topic of convergence.</li> <li>• No significant differences are expected as only a few publicly listed companies are engaged in agricultural business.</li> </ul>	

#### 4. Issues concerning business combinations

As a new Japanese standard on business combinations will become effective in 2006, the ASBJ will make at least a tentative decision after reviewing the responses from market participants, the implementation of IFRSs and new developments discussed by the IASB and the FASB.

Issues relating to business combinations are summarized as follows:

Remedies	Issues	Current developments	Prospects for 2008
Supplementary statement	<ul style="list-style-type: none"> <li>Pooling-of-interest method</li> </ul>	<ul style="list-style-type: none"> <li>The pooling-of-interest method is applied for business combinations in limited situations where no party obtains control over the other. The ASBJ will review the implementation of the new Japanese accounting standards.</li> <li>Future discussions overseas will be also monitored.</li> </ul>	<p>The ASBJ will make at least a tentative decision after reviewing the responses from market participants on the new Japanese standard, the implementation of IFRSs and new developments discussed by the IASB and the FASB.</p>
Disclosures A, B	<ul style="list-style-type: none"> <li>Translation of goodwill</li> </ul>	<ul style="list-style-type: none"> <li>Whether or not goodwill denominated in foreign currencies is to be translated at the current rate of exchange will be assessed.</li> </ul>	
	<ul style="list-style-type: none"> <li>Capitalization of R&amp;D in process</li> </ul>	<ul style="list-style-type: none"> <li>A research project has been established in preparation for discussion on convergence with the IASB.</li> </ul>	
	<ul style="list-style-type: none"> <li>Minority interests at historical cost</li> <li>Step acquisitions</li> <li>Date of exchange</li> </ul>	<ul style="list-style-type: none"> <li>Projects on these issues will be initiated considering future discussions between the IASB and the FASB.</li> </ul>	
	<ul style="list-style-type: none"> <li>Negative goodwill</li> </ul>	<ul style="list-style-type: none"> <li>Information proposed by the CESR as Disclosure B (amount, reason, depreciation method and period) is already required under the new standard which will become effective in 2006.</li> </ul>	