

(Tentative translation)

# **Towards the International Convergence**

## **of Accounting Standards**

July 31, 2006  
Business Accounting Council  
Planning and Coordination Committee

### **1. Developments in the convergence of accounting standards**

#### **(1) Developments in Japanese accounting standards**

Japanese accounting standards have undergone significant improvement particularly since the late 1990s, in line with the global developments in accounting standards, aimed at providing investors with an enhanced set of information. Within a short period of time, new sets of standards (e.g. those for consolidation, financial instruments, post-retirement benefits, impairments of fixed-assets, and business combinations) have been formulated, and today, Japanese accounting standards can be considered as of high quality. Besides, they are, taken as a whole, consistent with global accounting standards, albeit some differences.

#### **(2) Developments in the global convergence of accounting standards**

The rapid globalization of capital markets, however, has resulted in further acceleration in the global convergence of accounting standards, as national accounting standards are being converged with one another.

In recent years, the use of International Financial Reporting Standards (IFRSs) has been expanding. While the consistency in their application remains yet to be confirmed, IFRSs is used, mandatorily or optionally, in many countries, including Member States of European Union (EU). In several other countries, their national standards are converging with IFRSs.

Even in the United States (US), the FASB (US Financial Accounting Standards Board) and the IASB (International Accounting Standards Board) have been pursuing the convergence talk since “Norwalk Agreement” in 2002. February 2006 marked their renewed commitment towards the convergence, in the form of the Memorandum of Understandings (MOU), which specified a set of items for which either the convergence or the measurable progress is to be achieved by 2008.

The ASBJ (Accounting Standards Board of Japan) also started in March 2005 the discussion with the IASB towards the convergence of the two standards, and agreed at their third meeting in March 2006 to accelerate the process. Furthermore, the ASBJ embarked on similar discussion with the FASB in May 2006.

### **(3) Developments in policies of securities regulators**

The progress in the convergence has provided an impetus to negotiations for the mutual recognition of accounting standards among securities regulators of major capital markets.

Following the mandatory application of IFRSs to listed companies in the EU markets, the US Securities and Exchange Commission (SEC) published in April 2005 a staff statement titled “A Securities Regulator Looks at Convergence” (so-called “Roadmap”). The Roadmap proposed a timetable for a possible elimination by 2009 of the reconciliation requirements currently applied to financial reporting based on the IFRSs, taking account of, inter alia, the expected progress in the convergence.

On the other hand, the European Commission (EC) launched a new European policy to require IFRSs or its equivalent standards for third country issuers whose securities are publicly offered in the EU markets. In line with the policy, the EC carried out dialogues with regulators of Japan, Canada, and US, to decide on the equivalence of third country accounting standards. The Committee of European Securities Regulators (CESR) in this context advised that Japanese GAAP, taken as a whole, be considered as equivalent to IFRSs, subject to suggested remedies (e.g. additional disclosures) for 26 items. Recently, the EC proposed to defer, from January 2007 to January 2009, the implementation of its planned policy, having recognized the progress in the international convergence. It is also proposed that the EC would carry out a close monitoring on the ongoing progress in the convergence between IFRSs and the third country GAAPs, and eventually develop an assessment report by April 2008 in order to conduct the final equivalence assessment.

## **2. The way forward**

### **(1) A more proactive approach to the convergence**

The convergence of accounting standards is critically important to our future economic strategy. In order to make our economy more dynamic and competitive, the country needs to have fair and transparent markets, which could maintain and foster market vitalities. The importance of investors’ viewpoint needs to be reaffirmed, and the confidence in our capital markets needs to be enhanced.

The accounting standard is a measure by which investors choose issuers and markets. Investors would invest in companies and in markets, only to the extent they could rely on the quality of the measure. The accounting standard is indeed one of the most important infrastructures of capital markets. The globalization of markets and trades would presuppose a set of high quality and globally consistent accounting standards, which could win the confidence of both domestic and foreign investors.

In addition, business activities of Japanese companies could face difficulties in raising capital in foreign markets, should Japanese accounting standards be not fully accepted in foreign markets.

The accelerated trends in the global convergence among national standards, particularly in the US and the EU, invite a more proactive approach towards the convergence of accounting standards in search of a higher quality. The Japanese accounting standards should maintain its global feature, not to become a local rule, which would continue being accepted in global markets. In this context, it is expected that all involved parties engage themselves into the convergence with a heightened cooperative spirit.

The convergence of different accounting standards would need to be contemplated in the context of different legal systems and trade practices. Needless to say, all standards should be developed through the appropriate due-process, which takes account of the market experiences in their application.

## **(2) A time-framed approach to the EU equivalence assessment**

While Japanese accounting standards have rapidly improved within the last decade, further efforts towards the convergence could be expected under the current developments in the global environment.

Given the time-table for the equivalence assessment by the EU, it is critical to reciprocally achieve, by early 2008, the convergence for items which would only take a short period of time; at the same time, measurable progress of the convergence would need to be gained even for items which could take a longer period of time. It is appropriate that a time-framed convergence programme be developed accordingly, and be shared with both domestic and foreign parties.

In proceeding with the reciprocal convergence in the context of the EU equivalence assessment, focus could be placed on the 26 items for which the remedies were advised by the CESR during the equivalence assessment process. Particular attention could be given to the items for which the significant remedies (e.g. supplementary statements) were advised.

## **(3) More dialogue with foreign securities regulators towards mutual recognitions**

The EC plans to publish the report for the equivalence assessment by early 2008, and accordingly monitor the progress of the convergence on an on-going basis. In this context, the FSA is expected to develop, jointly with the EC, a two-way monitoring framework on the convergence progress, to move towards the mutual recognition.

Another future agenda for the FSA is to explore a possibility of mutual recognition between Japanese GAAP and US GAAP. This may not be an easily achievable task, given that the SEC, in recognizing foreign accounting standards, assumes such

accounting standards be widely used in the US market, in addition to being comprehensive and of high quality, and consistently interpreted and applied. However, it is important for the FSA to maintain an uninterrupted dialogue with the SEC.

**(4) More human resources for international rule setting process**

One of the important factors supporting the formulation of well-planned convergence strategies is human resources that are capable of participating in the global accounting standard settings. It is noted that the IASB had extended an invitation to receive ASBJ staff in its convergence programs with the FASB. It is expected that such invitation be met favorably, with a view to enhancing Japanese involvement in the international standard setting process. Business and accountancy industries are also expected to provide a full cooperation in ensuring qualified human resources.