

**Opinion on the Application of International
Financial Reporting Standards (IFRS) in Japan
(Interim Report)**

June 30, 2009

Business Accounting Council

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Please refer to Japanese version as the formal text.

Please also be noted that this translation will be subject to change anytime.

Interim Report:

Application of International Financial Reporting Standards (IFRS) in Japan

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I. Global Developments in Accounting Standards

1. Progress in Convergence of Accounting Standards

Japanese accounting standards have undergone extensive improvement since the latter half of the 1990s, in accordance with global developments in accounting standards and with adequate attention paid to the state of business management, business and accounting practices at Japanese companies, so that the Japanese accounting standards are currently of high quality in international level.

In the global arena, on the other hand, rapid progresses have been made in the convergence of accounting standards between the International Financial Reporting Standards (IFRS) and the generally accepted accounting principles in the United States (US GAAP), especially since 2002 when the so-called "Norwalk Agreement" was reached between the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB).

In face of these developments, movements toward the convergence of accounting standards have been accelerated, alongside improvement in the quality of accounting standards, since the Accounting Standards Board of Japan (ASBJ) and the IASB reached an agreement in 2005. In addition, the Planning and Coordination Committee published in July 2006 its report titled "Towards the International Convergence of Accounting Standards," urging all stakeholders to push for convergence.

In August 2007, the ASBJ announced the "Tokyo Agreement" with the IASB on their efforts to accelerate convergence with IFRS, with attention also to the equivalence assessment by the European Union (EU). In the Tokyo Agreement, it was agreed that (1) major differences identified in EU's equivalence assessment (26 items) were to be eliminated by the end of 2008 as a general rule; (2) the remaining differences other than the aforementioned major differences were to be removed by June 30, 2011; and (3) regarding accounting standards currently being developed at the IASB that were scheduled to become effective after June 30, 2011, the ASBJ and the IASB would work closely to ensure the acceptance of the

international approach in Japan, when these new standards became effective.

As a result of proactive convergence efforts by the ASBJ and other stakeholders, in accordance with the project schedule developed based on the Tokyo Agreement, the European Commission (EC) announced in December 2008 its final decision that Japanese GAAP is, as well as the US GAAP, equivalent to the IFRS adopted by the EU.

2. Developments in Other Countries toward Application of IFRS

In the EU, the use of IFRS was made mandatory for listed companies in the EU since January 2005. Furthermore, the use of IFRS or equivalent accounting standards is mandatory for third country issuers outside the EU in January 2009. In other jurisdictions than the EU, the use of IFRS is being widespread, with a variety of coverage, such as (1) allowing use of IFRS by domestic listed companies; (2) mandating use by a part of domestic listed companies; or (3) mandating use of IFRS for all domestic listed companies.

In the United States, the Securities and Exchange Commission (USSEC) published in April 2005 its “Roadmap” aimed at elimination of the reconciliation requirements to non-US registrants in the US market using IFRS, following the fact that IFRS has been made mandatory for all listed EU companies. However, the USSEC published its final rule in December 2007 allowing IFRS application without the reconciliation requirements for non-US registrants, which became effective on the financial statement for the fiscal year ending after November 15, 2007. Furthermore, the USSEC proposed its Roadmap for US issuers in November 2008, aimed at optional use and mandated use of IFRS for US issuers. Under the Roadmap, issuers that satisfy certain requirements are allowed to use IFRS for filing after early 2010 and the USSEC will determine in 2011 whether to require all US issuers to use IFRS beginning in 2014.

II. The Direction for Japanese GAAP

1. The Need for Continuing Convergence of Japanese GAAP

Accounting standards serve as an important infrastructure in capital markets, employed as the yardstick for investors in making investment decisions for their assessment of the business performance and fiscal status of companies.

For this reason, an erosion of the credibility of accounting standards would lead to obstacles to companies’ fund raising in domestic and overseas markets and to investors’ investing of

funds. In other words, such erosion would lead to a malfunction of capital markets in fulfilling their objective of efficient resource allocation. Ultimately, this could lead to a loss of attractiveness of the markets themselves.

Especially in conducting international business activities of Japanese companies and their listings to exchanges overseas, its financial reporting is necessary to win trust and credibility in foreign markets. The globalization of markets and trade would presuppose a set of high quality and internationally consistent accounting standards that could win the trust of both domestic and foreign investors.

Furthermore, in order for accounting standards to fully function as an information infrastructure of financial markets, it is vitally important that stakeholders such as preparers, auditors, investors and regulators could appropriately prepare, audit, analyze and supervise the financial reports, in addition to the quality of the accounting standards.

The EU's decision on the equivalence assessment of Japanese GAAP can be regarded as a proof of the outstanding quality and international consistency not only of the accounting standards themselves but also of its accounting practices based on the standards at this point in time. However, in view of the importance of accounting standards and their application in capital markets as mentioned above, the fairness and transparency of Japanese markets as well as the country's stance on investor protection need to be reaffirmed and the convergence efforts should be continued toward development and application of high-quality and internationally consistent accounting standards, including those being reviewed by the IASB (other than the remaining differences mentioned in the Tokyo Agreement), in order to enhance the attractiveness of the Japanese capital markets and ultimately to maintain and foster its economic vitality.

(Note) On the approach of the “advanced review” of accounting standards for consolidated financial statements in continuing and accelerating convergence

As mentioned in the body text, the convergence of accounting standards must continue based on the Tokyo Agreement. At the same time, however, there are various issues for accounting standards to be addressed, such as those related to existing accounting practices, trade practices and relations with business partners, as well as those related to the Companies Act and to taxation. Considering these conditions, one of the practical approaches to making sure the achievement of convergence in the future could be a relaxation of the ties between consolidated financial statements and non-consolidated financial statements. By swiftly reviewing the accounting standards for consolidated financial statements ahead of those for non-consolidated financial statements, which are more closely linked to Japan's unique trade practices and traditional accounting practices, priority would be given under this approach to the alignment of the accounting standards

for consolidated financial statements, from the standpoints of improving the international comparability of consolidated financial statements and reinforcing their function of disseminating information.

In this connection, attention must be paid to the fact that the IASB has announced its intention to continue improving IFRS, based on the memorandum of understanding agreed with the FASB. In addition, the EU's assessment on Japanese GAAP is founded on the ASBJ's commitment to convergence by 2011, based on the aforementioned Tokyo Agreement, as the EU has adopted a "holistic approach", which is to assess the progress of convergence as well as the future convergence plan. It must be noted, therefore, that the EU is expected to conduct follow-ups in the future on whether the convergence work is making progress as planned even after its final decision as equivalence.

2. Issues Concerning the Application of IFRS in Japan and the Required Approach

(1) Basic concept regarding the application of IFRS by Japanese companies

As a result of proactive efforts by all stakeholders toward convergence of Japanese accounting standards, the major differences with IFRS have been removed, and Japanese GAAP have been internationally recognized as equivalent to IFRS.

Nonetheless, given the growing acceptance of IFRS in various jurisdictions — with jurisdictions that have already adopted IFRS and with the US and other jurisdictions outside the EU moving toward future application — there is a possibility that these standards will be applied to all major financial and capital markets in the world outside Japan.

In face of these developments, many have expressed opinions that Japan must not only pursue the convergence of accounting standards but must also draw a roadmap with a concrete vision for the future toward a possible optional or mandatory application of IFRS in legal financial statement disclosure by Japanese companies, based on the following perspectives:

- (i) Alongside the acceleration of convergence, in face of the globalization of these markets and the growing speed of international movements of investment funds, IFRS-based financial reporting is expected to enhance the international comparability of financial statements from the investor standpoint and ultimately the international attractiveness of Japan's financial and capital markets,
- (ii) The greater ease for foreign investors in understanding and analyzing financial statements prepared by Japanese companies is expected to contribute to a cost reduction related to funds-raising and to facilitate international funds-raising by Japanese companies.

- (iii) For Japanese companies engaged in overseas business operations, it is expected to contribute to the improvement in the efficiency of financial management at their overseas offices and operations and to the improvement of financial reporting as a result of the unification of accounting standards across the member companies and the affiliate companies of a corporate group, and ultimately to enhance international competitiveness of Japanese companies.
- (iv) It is expected to contribute to maintaining and enhancing the international status of Japanese auditing firms.

At the same time, in order to achieve the abovementioned improvement in the quality of financial reporting and in the international competitiveness of Japanese markets and companies, there are issues that must be solved regarding the practicability and application of IFRS.

- (i) Because IFRS are said as principles-based accounting standards, the development of training programs and establishment of system for preparers, auditors, investors and regulators are essential and with a reasonable period for adequate implementation. For this reason, efforts and ideas must be directed to enabling preparers and other stakeholders to organize training and to build frameworks including accounting system modification, both efficiently and systematically, without incurring too much costs.
- (ii) Regarding the contents of IFRS and possible future changes in the standards, close attention to these developments is necessary, and Japan must actively express its views that are internationally acceptable, while taking into account Japan's own trade practices, business operations and accounting practices. In this respect, many have suggested that, in view of the fact that the international convergence of accounting standards is evolving around IFRS, Japan should gain a greater presence in the standards-setting process alongside IFRS application in the country. Furthermore, the IFRS and its standards-setting process have been discussed extensively at various international fora such as the Financial Stability Forum to address the current financial crisis. From now on, Japan must work more actively to present its opinions and make its contributions to IFRS and to its development process.
- (iii) Considering that accounting standards fulfill the role of delivering highly reliable financial reports to investors together with accounting practices across the various stages in the accounting process — including preparation, auditing, analysis and oversight of financial statements — whether IFRS application will truly contribute to the international comparability of financial statements and, finally to the enhancement of the functions of financial and capital markets, depends on the convergence of practices and international cooperation in enforcements. Therefore, international cooperation in the area of convergence of accounting practices and in IFRS

implementation is extremely important.

For this reason, Japanese accounting experts should discuss how to deal with IFRS upon sharing their medium- to long-term perspectives, while working on these issues. As global conditions surrounding Japanese accounting standards involve many uncertain factors, such as the progress made in governance reform of the International Accounting Standards Committee Foundation (IASCF) and developments in the US, it is important to adapt flexibly to changes in future conditions.

(2) Issues to be addressed toward the Application of IFRS

Defining specific details in the roadmap toward IFRS application may be beneficial for the future. In order to pave the way for smooth implementation of IFRS in Japan, however, a specific application outline depends significantly on the progress in the action taken to resolve various issues, including preparations and adaptation to actual accounting practices. For this reason, stakeholders are required to make proactive efforts to address the following.

i) Quality of IFRS

As mentioned earlier, accounting standards can be regarded as fully functional only if financial reports are appropriately prepared, audited, analyzed and overseen by regulators and only if such reports are delivered to investors. Therefore, IFRS must accurately reflect the economic reality of businesses and trade practices in Japan. In addition, IFRS must continue to be a set of appropriate standards that reflects the conditions of today's global financial and capital markets

Therefore, the various stakeholders involved in accounting in Japan must monitor and examine closely how IFRS undergoes development and modification, as well as how deliberations of such issues are being conducted. At the same time, it is also essential that they express appropriate opinions as needed to represent the voice of Japan's accounting sector and have IFRS appropriately reflect them.

Meanwhile, it is essential that continuing efforts be made toward the convergence of standards with IFRS to gain greater prominence in the international deliberations about accounting and, furthermore, for Japan's accounting standards to continue to be internationally recognized for their outstanding quality.

ii) Language to be used upon the application of IFRS

Because of the need to be understood by Japanese financial report preparers, investors, etc., the IFRS text must be translated into Japanese so that an authentic Japanese version can be made available.

iii) Due process for setting of IFRS

Since accounting standards are founded on actual practices, as mentioned earlier, and they wield de facto normative power as "generally accepted accounting practice" in filing financial reports, when application of IFRS is allowed in Japan, it is important to ensure due process of the IASCF and to improve its governance, to be represented by enhanced accountability to regulators and market participants and enhanced feedback to stakeholders regarding standards setting.

In this respect, a governance reform is currently underway at the IASCF, a private organization. In particular, the January 2009 amendment of its constitution regarding the establishment of the Monitoring Board consisting of financial regulators representing Japan, the US and Europe, along with the International Organization of Securities Commissions (IOSCO), holds great significance in the progress toward optional application. In the future, all stakeholders must exert their efforts to ensure that the Monitoring Board functions appropriately. Furthermore, it is also believed necessary for the IASCF to continue to work diligently toward the realization of other governance reforms (such as improvement in the functions of the Standards Advisory Council and the ensuring of stable fund-raising).

iv) Practical measures, training and education for the better understanding of IFRS

Knowledge and understanding of IFRS, US GAAP and other international accounting standards is believed to have spread steadily among investors, financial report preparers, auditors and other stakeholders, through past discussions on convergence. However, unlike in the case of convergence, it is essential that involved parties in Japan gain an understanding of IFRS and be capable of applying them with ease for IFRS to be employed by Japanese companies in financial reporting. For this purpose, the parties involved must actively address issues such as the following. Even in the stage of optional use, it is necessary to confirm that steady progress is being made toward the development of IFRS training programs and teaching materials etc, and toward a greater understanding of IFRS among investors, preparers, auditors, regulators and other parties involved.

A. Investors

For investors and administrators to secure a level of understanding of IFRS adequate for satisfactory financial analysis, etc., in making investment decisions, it is necessary to make preparations in a broad range of channels, from advanced academic education and education for working adults to training materials and programs designed for accounting specialists and experts.

B. Financial report preparers

Preparers of financial reports have been expected to respond actively to new developments,

by taking such actions as gaining an accurate understanding of the revisions in standards implemented alongside convergence, training to ensure appropriate financial reporting, conducting a review of the direction of application of new standards vis-à-vis conditions in each company, and providing feedback on the standards-setting process based on their experiences.

Application of IFRS requires adequate understanding of IFRS itself, which is said to be principles-based, and appropriate application based on the practical experience of each party. For this reason, each company is required to make adequate preparations in various areas, by, for example, establishing specific details in accounting processes, defining the various financial reporting procedures, and developing internal controls and systems to support these operations, so that IFRS is applied appropriately to the entire corporate group.

For this purpose, preparers of financial reports may be required to set out the company's accounting method related to the application of IFRS as accounting indicators (manuals), etc., corresponding to conditions at the company, and to disclose the policy and outline of the accounting system in disclosure documents, such as annual securities reports, in order to ensure that IFRS, which is principles-based, is appropriately implemented in practice.

Specifically, to encourage actions to prepare consolidated financial statements appropriately, disclosure related to financial statements may include the current state of the actions (including the policies to deal with revisions of accounting standards and their status of implementation, the state of development of appropriate accounting manual and implementation of training, such as participation in external training programs, related to accounting standards (including IFRS)).

Especially, if optional use of IFRS is permitted at a stage prior to the establishment and dissemination of IFRS-based financial reporting practices in Japan, it may become necessary for companies planning to submit financial reports based on IFRS to inform investors that a system has been developed to enable financial reporting based on IFRS through producing and disclosing their accounting indicators voluntarily.

Furthermore, one alternative may be, for instance, to actively recruit certified public accountants (CPAs) who are familiar with IFRS and persons who have passed CPA examinations, given that a considerable amount of time is required to train personnel to nurture experts on IFRS in corporate organizations.

C. Auditors

For auditors in Japan, it is necessary to build a system that enables appropriate auditing of IFRS-based financial statements at the offices of auditing firms engaged in auditing of the

companies in question.

Although understanding of IFRS is necessary even at the present time, greater understanding of the auditing approach, methodologies and techniques, etc., is believed necessary in addressing these reporting standards.

It may become necessary, for instance, for auditors (persons who perform audit and persons in charge of reviews) involved in IFRS-based auditing to get education and training to a certain extent and have relevant knowledge, capabilities, and experience. Moreover, in auditing firms that are engaged in IFRS-based auditing, it is necessary to develop a system that sets out necessary policies and procedures in areas such as education and training, business operations (including assignment of persons who perform audit), review, and response to inquiries regarding specialist perspectives. Furthermore, it is considered necessary to review guidance on auditing practices.

D. Regulators

The education, training, guidance, etc., at regulators in charge of auditor oversight and of executing must be re-examined.

In view of the need to achieve convergence of accounting on the international scale for the purpose of improved comparability of financial statements as mentioned earlier, it is now necessary, for instance, to foster greater understanding of IFRS and to assess the actual conditions in accounting practices. Also, it is necessary to re-examine the regulations on information disclosure, auditing standards, etc., and in the case of specific business operations, it is necessary that the relevant regulators take early action to review the need for adaptation from their own perspectives.

In addition, the content of practical training for persons who have passed CPA examinations needs to be reviewed. When the mandatory application is decided, the scope and subjects of the CPA examinations will also be necessary to be under review.

E. Educators

In order to build human resources with an understanding of IFRS, the education and training of students and educators at universities, graduate schools, etc. have to be reviewed. Cooperation with CPAs and regulators and other administrative bodies must be strengthened.

F. Market Establishers

In promoting the activities by investors and financial report preparers mentioned above, relevant markets establishers are expected also to be proactive to offer IFRS training programs and to monitor the state of IFRS application by preparers.

v) Strengthening Japan's involvement in the setting of IFRS and governance of the IASCF

If IFRS are to be applied, it is important to strengthen the global presence of Japan in various areas related to accounting standards, such as increased participation and public relations by Japan regarding the setting of IFRS and governance of the IASCF.

Looking at jurisdictions where IFRS are applied, there are cases of increased activities by the national accounting standards-setting bodies themselves to express their views on the IASB's standards-setting process. In Japan, it is essential to strengthen the ASBJ's functions of gathering human and other resources, in order to boost the quality of Japanese GAAP further and increase the representation of Japan's views on IFRS. At the same time, it is necessary to secure a broad-based, stable source of funding to lay the foundation for financial support to the ASBJ and the IASCF.

To this end, active support by a broad range of stakeholders is essential and, if a company participates in, and contributes to, standards-setting discussions (including provision of financial support), the reference thereof may be treated as information to be disclosed in the disclosure of the state of actions for ensuring the aforementioned appropriate financial reporting by preparers.

Moreover, when setting standards at the IASB, it is important to start expressing opinions to the IASB at an early stage of the review process in an active and effective manner. In doing so, it is essential that a wide range of relevant parties, including not only the ASBJ but also preparers, investors, and auditors, express their opinions in partnership with parties in other countries.

vi) Implementing IFRS in XBRL format

In Japan, financial statements are already being prepared based on the XBRL data format (an internationally standardized computer language used for business reporting), which was introduced to ensure comparability of financial reports among different companies or over time and foster greater convenience in using investment data effectively. For this reason, it is necessary to ensure that IFRS application includes preparations of financial statements in the XBRL format.

Although the IASCF has developed XBRL data taxonomy for IFRS, the number of data items in the taxonomy developed by the IASCF is far smaller in number compared to the number in the Japanese GAAP taxonomy. In addition, the IFRS taxonomy does not comply with Japan's electronic disclosure system, the Electronic Disclosure for Investors' NETwork (EDINET), because of a lack of Japanese language support and other reasons.

Hence, it is necessary to direct effort toward international alignment of the number of data items in IFRS-based taxonomies in order to prevent a decline in the level of information to investors after IFRS starts to be applied. At the same time, taxonomies compliant with EDINET must be developed, possibly before optional IFRS application begins in Japan, to pave the way for the availability of such taxonomies by the time mandatory application begins, if the mandatory application is decided.

(3) Optional Application of IFRS

A look into IFRS application in other countries shows that emphasis is being placed on ensuring the comparability of financial statements for investors and, following a specified period for preparation, IFRS were fully introduced at once as mandatory standards

In the US, on the other hand, a scheme has been proposed in view of the high-quality level of its accounting standards compared with other countries. Under the scheme, early optional application to certain companies is accepted with confirmation that investors are assured of financial statement comparability and at the same time with explicit designation of the date for mandatory application, as well as the date of the final decision to be made on enforcement, as mentioned earlier.

Since accounting standards are expected to fulfill their function only when they are able to provide highly reliable financial reports to investors, as mentioned earlier, such reports based on IFRS must be of higher quality than they were before the application of IFRS.

As stated in I-1 above, Japanese GAAP have attained a quality level that excels internationally, through the concerted efforts toward convergence by all stakeholders and in tandem with the practices based on the standards.

Accordingly, prospects for mandatory IFRS application should be defined with close attention to the progress made in the IASCF's governance reform and international developments in Western and other countries, with the view in mind that IFRS application for Japanese companies must be implemented with the aim of achieving financial reporting of high quality and based on past accounting experiences. At the same time, optional application of IFRS should be accepted alongside the steady progress to be made in addressing issues that must be resolved for application. Also, in order to ensure the convenience of investors in obtaining financial information for investment analysis, the following points should be considered:

i) Scope of companies for which optional application is permitted

In permitting Japanese companies to use IFRS, it is essential to confirm that they are giving considerations to, and are prepared for, appropriate IFRS-based reporting as mentioned earlier and are also putting in place the internal frameworks required, including the disclosure framework to provide information regarding the status of the initiatives mentioned earlier.

Furthermore, optional application will allow companies to choose between Japanese GAAP and IFRS, whichever is in their business interest, possibly impeding comparison of financial statements among various Japanese companies. With this point in mind, certain criteria or conditions should also be established in defining the scope of the companies permitted to use IFRS, in order to protect investors.

Specifically, the need for early application is believed to be found among the companies listed in Japan's stock exchanges that are either listed in European or US stock exchanges, or procuring funds through public offerings, and those that have worldwide business operations and are widely recognized among international investors. In addition, it has been pointed out that these companies are either prepared or experienced in IFRS-based financial reporting to foreign regulatory authorities or are likely to start preparations at a relatively early stage, based on IFRS-based accounting experiences of member companies within the corporate group.

Moreover, permitting a certain range of companies to use IFRS was suggested if such companies have the incentive and ability to produce quality financial reports, considering the case the smooth transition of application to a broader range of companies (such as all listed companies) becomes necessary in the future.

At the same time, it is necessary to consider whether the revision of IFRS to reflect the conditions of today's global financial and capital markets can contribute to properly reflecting the actual financial and business conditions of Japanese companies in the financial statements.

Based on these considerations, the range of companies to be permitted to use IFRS could include, for instance, listed companies that have: prepared and disclosed appropriate financial statements on an on-going basis; established an appropriate internal framework for IFRS-based reporting; developed in-house accounting procedures based on IFRS and disclosed the relevant information in their Annual Securities Reports. It is considered appropriate that IFRS are allowed to be used for the consolidated financial statements of companies (and the consolidated financial statements of their listed subsidiaries, etc.) whose financial or business activities are conducted internationally.

In addition, in carefully observing the progress of IFRS revisions, the evaluations of such revisions by the investors and other relevant parties in Japan and other factors, judgment

should be appropriately made by regulators on whether the scope of application should be expanded to those listed companies that are well recognized in the market and above a certain size.

ii) Parallel disclosure

For greater comparability of financial statements of companies adopting IFRS voluntarily and others applying Japanese GAAP, it may be necessary to require those adopting IFRS-based reporting also to disclose information based to a certain degree on Japanese GAAP.

However, it has been suggested that the workload involved in parallel disclosure can become overly burdensome and possibly a major disincentive toward optional use of IFRS. Considering this practicality issue, it may not be desirable to require parallel disclosure in complete form similar to that in the US roadmap.

In view of the above, companies choosing to use IFRS should be required to also disclose Japanese GAAP financial information corresponding to the current and previous year, only in the first year of IFRS application. Considering that a certain level of continuity should be ensured for the information disclosed and that the cost and burden of parallel disclosure should be eased, it would be appropriate to consider a simpler and more effective measure for information disclosure. The measure could include replacing continuous parallel disclosure in subsequent years by adding explanatory notes comparing significant differences between IFRS and the Japanese GAAP when applicable, and excluding the parallel disclosure (for the current year under the Japanese GAAP) in the first year of IFRS introduction from the scope subject to external audits.

iii) IFRS to be applied at the stage of optional application

The issue that requires review for IFRS application in Japan is whether to apply IFRS developed by the IASB, as proposed in the US roadmap, or to make partial modifications or exclusions of IFRS as in the EU.

In the review process, considering that Japan must conduct a strategic review of IFRS application in face of the trend of developments in accounting standards, Japan should conduct a thorough study of IFRS both as it is at present and as it will be in the near future, and undertake surveillance of the status of the setting of IFRS (including due process), while ensuring that Japanese accounting experts will be actively involved in the IFRS setting process to express Japan's opinions.

On this basis, with regard to the optional application, the IFRS as developed by the ISAB could be basically accepted (The IFRS to be accepted with regard to the mandatory application will be discussed later).

iv) Timing

The date for optional application should most likely be as early as possible, considering the worldwide spread of IFRS and the need to boost corporate and market competitiveness. To be more specific, it would be appropriate to allow optional application of IFRS be allowed from the fiscal year ending March 2010.

v) Treatment of non-consolidated financial statements

In the EU, IFRS have been made mandatory for the consolidated financial statements of listed companies. However, application to non-consolidated statements varies by country. In the US, disclosure is required only for consolidated financial statements. For this reason, application of IFRS to non-consolidated statements appears to be not urgently necessary from the standpoint of international comparability of financial statements, ease in fund-raising, and market competitiveness.

Furthermore, these financial statements are used to calculate the distributable surpluses under the Companies Act and taxable income under the Corporate Tax Act and are closely linked to Japan's distinctive trade practices, adjustments between interested parties, and accounting practices. Therefore, time for review and adjustment is necessary for alignment with other systems, if IFRS should be applied to non-consolidated financial statements as well.

Hence, it is deemed appropriate to permit the application of IFRS only to consolidated financial statements and not to non-consolidated financial statements of companies preparing consolidated financial statements, at least during the optional use period.

Still, there are listed companies that do not have subsidiaries to be included for consolidated accounting and do not prepare consolidated financial statements. For such companies, it is possible to permit them to additionally prepare audited IFRS-based non-consolidated financial statements, along with Japanese GAAP non-consolidated financial statements.

(4) Considerations for Future Mandatory Application

IFRS are growing in acceptance in various countries, as mentioned earlier. Should the US make its transition to IFRS during the period between 2014 and 2016, it is possible that financial reporting would be made under IFRS in most of the global financial and capital markets. Suggestions have also been presented that, considering the importance of international comparability, it is not appropriate for multiple accounting standards to be maintained in the same market for an extended period of time. For this reason, Japan must be prepared to take on the issue of mandatory application of IFRS from a broad range of perspectives, defining the path to be taken in the case of making the use of IFRS by a certain

range of Japanese companies mandatory, while attending to the various aforementioned conditions in Japan and abroad. This approach would be appropriate in view of the need to envisage Japan's future in a proactive manner from the stand point of providing information that excels in international comparability of financial statements, ensuring the international competitiveness of Japan's financial and capital markets, facilitating the fund-raising by Japanese companies, maintaining the international presence of Japanese auditing firms, and strengthening the country's capability to have its opinions reflected in the standards-setting process.

On the other hand, the uncertainties in future developments and the need to have all market participants make substantial progress in their response to the issues mentioned in (2) concerning mandatory IFRS application make it appropriate for the final decision on the issue of mandatory application to be made upon adequate study into the state of progress made in these issues.

i) Decision-making factors for mandatory application and its starting period

A) Factors to be considered in the decision on mandatory IFRS application

It is necessary to verify the progress made in tackling issues as mentioned in (2) above, the status of IFRS application during the optional use period, its status of application in professional markets and other conditions. In addition, whether the US will require US companies to comply with IFRS in what is the world's largest capital market, as well as the status of IFRS use in the EU and other countries, are considered to be the factors to be assessed for mandatory application in terms of international comparability and the competitiveness of Japan's corporate sector and market.

B) Timing

Regarding the timing for deciding on the mandatory application, given the need to examine achievements in tackling issues and the status of IFRS application in Japan and abroad as mentioned earlier, it is appropriate to make judgments not now, but rather at a certain period in the future. In discussing the specific timing of the decision, it is necessary, among other matters, to take into account a period of time for putting in place a framework of preparers and auditors, and for making assessments of the status of optional application and international developments in the US, Europe and other areas.

Moreover, attention should also be kept on the various impacts of global financial and economic events for the next few years. In particular, the IASB, in coordination with the FASB, is working on the clarification and review of the IFRS in areas including financial instruments accounting, in response to the current global financial crisis. In deciding the timing of mandatory application, it is necessary to examine, with attention paid to future

developments such as IFRS modification, etc., whether IFRS is of high quality and whether it could be recognized applicable under future financial and economic developments on a sustainable manner.

In the meantime, although the timing may vary depending on the numerous variables mentioned above, the decision regarding the mandatory use of IFRS is aimed to be made in around 2012.

ii) Scope of and method for mandatory application

At this point in time, the enforcement of mandatory application of IFRS to the consolidated financial statements of listed companies is believed appropriate, considering the necessity of improving international comparability of financial statements.

Upon introduction of mandatory application, some experts support the idea of taking a phase-in approach based on criteria such as the gross market value of each company, a scheme proposed in the US roadmap, taking into consideration the capabilities of preparers and auditors as well as the financial costs and other burdens involved when IFRS is employed by all listed companies. On the other hand, from the perspective of providing comparability for investors, it is desirable that IFRS be introduced simultaneously for the consolidated financial statements of all listed companies—even when a phase-in approach is taken, the maximum period of using multiple accounting standards should be three years. With regard to the judgment as to whether a phase-in approach or a simultaneous introduction approach should be taken, it is considered appropriate to discuss and make a decision later when deciding on the mandatory application, based on the status of optional application and carefully observing the capabilities of preparers and auditors.

In addition, in introducing mandatory application, it is considered necessary to provide a preparation period of at least 3 years from the time when the mandatory application is decided, which is necessary for the adaptation of practices (i.e., if the decision of mandatory application is made in 2012, mandatory application will be introduced in 2015 or 2016).

Furthermore, in making a decision on mandatory application regarding whether to apply IFRS as developed by the IASB or to make partial modifications or exclusions of IFRS, it is necessary to review the content of IFRS and the status of the setting of IFRS (including due process).

Concerning mandatory application, because of the grave importance of accounting standards as the yardstick for assessing financial statements—with punitive action under law taken in case of violation—there may be cases in which Japan must suspend application of part of IFRS developed by the IASB that are found seriously inappropriate and cannot be recognized

as accounting standards “that are generally accepted” in Japan.

Therefore, it is appropriate for regulators to develop appropriate rules concerning Regulations for Terminology, Forms and Preparation of Consolidated Financial Statements (Regulations for Consolidated Financial Statements), etc., for permitting the application of individual standards of IFRS.

As for business operations mentioned separately in the Regulations for Financial Statements (separately mentioned businesses) that are subject to the supervision of certain regulators due to their public utility nature, special business characteristics or other reasons, separate discussions will be necessary from perspectives including the operations’ relationship with regulations and supervision, and the burden of preparing financial statements.

iii) Treatment of non-consolidated financial statements

Regarding how non-consolidated financial statements are to be treated in case of mandatory IFRS application, the possible production of such financial statements based on IFRS for alignment with consolidated statements may be considered, in view of the fact that consolidated statements are based on non-consolidated information. IF the standards to be applied for consolidated financial statements differ from the ones for non-consolidated financial statements, differences emerge in profit calculations — the basis for presenting a company's fiscal health and operating results — , which may lead to erroneous decision-making by users of financial statements. The cost of preparing financial statements based on two standards should also be considered.

On the other hand, care should also be taken regarding IFRS application on non-consolidated statements in terms of international comparability, due to the fact that they are not regarded as important as consolidated statements and also due to the need for study and adjustment to define their relationships with the Companies Act and the Corporation Tax Act, as mentioned above.

Therefore, in deciding whether to apply the mandatory use of IFRS to non-consolidated financial statements of listed companies (including companies that do not prepare consolidated financial statements), in addition to mandatory use of IFRS for consolidated financial statements of listed companies, considerations should be given from a wide range of viewpoints.

In doing so, it is also appropriate to discuss what should be disclosed in the non-consolidated financial statements, from the perspective of properly providing investors with necessary information, and in consideration of the content of the information, etc., disclosed in the IFRS-based consolidated financial statements.

In addition, in relation to those listed companies that do not prepare consolidated financial statements, even when they continue to be required to prepare non-consolidated financial statements based on the Japanese accounting standards, it is possible that they will be requested to prepare audited IFRS-based financial statements in addition to the said financial statements.

iv) Treatment of optional application by unlisted companies

Unlisted companies are generally not targeted for global investments, in comparison with listed businesses. It is thought that, for small and medium-sized companies and leading medium-sized companies in particular, the need to use IFRS is low. Considering the burden of preparing and developing the system for preparing IFRS-based financial statements, the application of IFRS to unlisted companies should be carefully reviewed. On the other hand, for subsidiaries of listed companies whose financial and business activities are conducted internationally, unlisted companies that prepare consolidated financial statements and unlisted companies that plan to list in the near future, there seems to be a need toward permitting them to prepare IFRS-based consolidated financial statements, etc. Therefore, taking these factors into consideration, deliberations on whether to allow unlisted companies to use IFRS in their financial reporting should be made separately.

III. Toward Future Action

Concerning the developments regarding Japanese GAAP both in Japan and overseas as mentioned above, the prospects for the eventual application of IFRS on Japanese companies has been defined as above at the present time. However, there are many issues to be resolved before the application of IFRS, such as the importance of examining the details of IFRS, ensuring Japan's active participation in the standards-setting process, the issue of preparations by preparers, auditors, investors and regulators as well as the uncertainties over the future developments in the US. To deal with such issues, cooperative action among all stakeholders must continue, with appropriate steps taken as needed.

In addition, IFRS application requires dramatic progress in convergence between Japanese GAAP and IFRS and in actual practices, and demands further effort by stakeholders. Regulators, on their part, must confirm that advances are being made in convergence of not only the standards but also practices, in cooperation with stakeholders.

Furthermore, the need for Japanese GAAP will never go away even after IFRS are adopted. Stakeholders are expected to continue to study and take necessary action aimed at ensuring that Japanese GAAP continues to be of high quality and internationally consistent.