Convergence of Accounting Standards and Institutional Reformation in Japan : With Special Reference to EU's Assessment of Equivalence between Third Country GAAP and IAS/IFRS

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This paper aims at considering what are the main subjects in terms of institutional reformation in Japan facing up to the convergence of accounting standards, which has been going on over the world. The special topic to be considered here is EU's assessment of equivalence between third Country GAAP and IAS/IFRS.

In 2005, CESR (Committee of European Securities Regulators) published the "Technical Advice on Equivalence of Certain Country GAAP and on Description of Certain Countries Mechanisms of Enforcement of Financial Information," that proposes 26 remedies for the significant differences between IFRSs and Japanese GAAP, while they define the equivalence as not being identical but instead what is necessary for enabling investors to take similar investment decision (par. 80).

We review underlying viewpoint of Japanese policy for coping with EU's equivalence project, by analyzing comments made by main authorities concerned such as Financial Services Agency (securities regulator in Japan) and Accounting Standards Board of Japan (standards setter) on CESR's technical advice. Their basic standpoint is very close to the one expressed in CESR's original definition of equivalence mentioned above. We may be able to describe the idea as "substantial function-based approach," where standards could be considered as equivalent if they would substantially assure the same function in helping investors' decision making. From this viewpoint, Japanese authorities have been making their comments on convergence projects and/or equivalence, and accepting third countries' GAAP as equivalent in home capital market as well.

We infer, from the preceding discussion, what Japan should do in case EU adopts the CESR's advice as it is, by referring to (1) how to deal with third countries' GAAP, especially IFRS endorsed in the EU, in home capital market, (2) possibility of moving on to what's called "adoption approach" to the convergence, (3) its possible impacts on legal system in Japan, and (4) economic impacts of the remedies on Japanese firms financing in oversea capital markets, particularly in EU. According to the philosophy embedded in Japanese policy as seen above, our conclusion would be that quality of accounting standards should not be assessed by any powers that be, but by markets, i.e. investors as a whole, in the end, as far as objectives of financial reporting is to make markets fair and efficient through providing useful information to investors in economic decision making.