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This is the author's manuscript

Original Citation:

Availability:

This version is available <http://hdl.handle.net/2318/1508681> since 2016-09-16T11:10:41Z

Published version:

DOI:10.1108/PAR-11-2012-0056

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Adoption of IFRS in Japan: Challenges and Consequences

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Purpose – The purpose of this study is to provide a rigorous and holistic analysis of the main features of the Japanese accounting environment. It also raises issues related to the adoption of International Financial Reporting Standards (IFRS) in Japan.

Design/methodology/approach – For the purpose of investigating the Japanese accounting system, this study applies the accounting ecology framework developed by Gernon and Wallace (1995) and provides a content analysis of relevant meetings of the Business Accounting Council (BAC) of Japan.

Findings – The findings of this study provide evidence that it would be problematic to require the adoption of IFRS for all listed companies in Japan. The main reason for this is that the Japanese policymakers and standard-setting bodies follow two objectives: enhancing the international comparability of financial reporting and maintaining institutional complementarity between financial reporting and other infrastructures such as accounting-related laws.

Research limitations/implications – This study is relevant for accounting researchers and professionals with an interest in Japanese accounting practices. It is also useful for the International Accounting Standards Board (IASB) and representatives of countries planning to adopt IFRS in the future.

Originality/value – The findings of this study show that contextual issues such as social, organizational, and professional environments cannot be ignored in the adoption of IFRS in Japan.

Keywords:

Global convergence of financial reporting, International Financial Reporting Standards (IFRS), Japanese accounting system

JEL Classification:

M40, M48

Article Classification:

Research paper

Adoption of IFRS in Japan: Challenges and Consequences

1. Introduction

The International Accounting Standards Board (IASB) has been largely responsible for developing a set of financial reporting standards that can be used internationally. The need for convergence¹ of International Financial Reporting Standards (IFRS) has been supported by the assertion that a single set of high-quality accounting standards is an important means, for example, of enhancing the comparability of financial reporting and reducing the cost of its preparation and analysis (Doupnik and Perera, 2012, pp. 92-93). With more than 125 countries currently permitting or requiring IFRS for financial reporting, accounting convergence has become an essential and irrevocable component of globalization.

As a result of this global trend toward convergence, the Business Accounting Council (BAC)² of Japan announced on June 30, 2009, its decision to allow the optional adoption of IFRS starting with the March 2010 fiscal year-end for consolidated financial statements of listed companies. Additionally, in 2009, the BAC announced its intentions to issue a decision concerning the mandatory adoption of IFRS in 2012 (BAC, 2009). However on June 21, 2011, Minister Shozaburo Jimi of the Financial Services Agency (FSA) postponed the decision concerning the mandatory adoption of IFRS for an indefinite time.

Accordingly, the mandatory adoption of IFRS in Japan is likely to be deferred beyond 2015 because at least five to seven years are expected to be needed to prepare the country for this change (Jimi, 2011). The minister's decision was mainly influenced by five factors:

- (1) Announcement to postpone the adoption of IFRS in the United States by the Securities and Exchange Commission (SEC);
- (2) Strong request to postpone the adoption of IFRS in Japan by representatives of 21 leading Japanese companies and the Japanese Chamber of Commerce and Industry;
- (3) Resistance of the Japanese Trade Union Confederation (*Rengo*);
- (4) The unprecedented earthquake and tsunami on March 11, 2011; and
- (5) Contextual factors characterizing Japan's institutional environment, such as its economy and legal system (Jimi, 2011).

As Minister Jimi stated, the consideration of social, historical, political, and economic factors is important for Japanese policymakers because the accounting system in Japan is quite different from those in Anglo-American countries. These differences have forced the Accounting Standards Board of Japan (ASBJ) to develop a complete set of accounting standards and a conceptual framework and to reconcile these accounting standards with related laws (Nippon Steel *et al.*, 2011). These laws include the Financial Instruments and Exchange Act, the Companies Act, and the Corporation Tax Law. To reflect these contextual factors, Japanese policymakers and standard-setting bodies have followed two objectives:

- (1) Enhancing the international comparability of financial reporting and increasing the attractiveness of Japanese capital markets; and
- (2) Maintaining internal and institutional complementarity between the financial reporting system and other infrastructures such as accounting-related laws and human resources.

The aspect of international comparability is especially important for establishing attractive and reliable capital markets within Japan. Similarly, many studies highlight the importance of maintaining systemic links between different institutions so that they fit together well and mutually increase their benefits (Aoki, 1994; Gordon and Roe, 2004; Schmidt and Spindler, 2006). These exogenous and endogenous pressures, which require both international comparability and institutional complementarity, may influence the discussions currently taking place in Japan concerning the adoption of IFRS.

Following Minister Jimi's statement in 2011, the BAC initiated a discussion to decide upon the fundamental policy in regard to the adoption of IFRS. Supporters of Minister Jimi's statement requested a more "cautious convergence approach" in which disparities between Japanese generally accepted accounting principles (GAAP) and IFRS are harmonized. For the purpose of this study, these supporters are called "Conservatives" (*Kokunai-ha*). In contrast, opponents of Minister Jimi's statement support the "direct adoption approach" in which IFRS should replace Japanese GAAP to enhance international comparability of financial reporting. For the purpose of this study, these stakeholders are called "Liberalists" (*Kokusai-ha*).

In regard to IFRS implementation, departures from the direct adoption of IASB standards may lead to opportunities for political interference, delays in the availability of the standards, and concerns about actual IFRS compliance, including for auditing purposes (Zeff and Nobes, 2010). On the other hand, there is growing acceptance that one set of accounting standards does not necessarily fit all types of companies, including small and medium-sized enterprises (SMEs) (e.g., Advisory Council, 2010). Thus, it is timely and important to address key issues of the debate between Conservatives and Liberalists to promote selection of the most suitable solution regarding IFRS implementation in Japan. Therefore, this study should be useful for policymakers and standards setters in Japan as well as the IASB.

Using the accounting ecology framework developed by Gernon and Wallace (1995), this study provides a rigorous and holistic analysis of the main features of the Japanese accounting environment, which should be taken into consideration in the Japanese debate regarding the adoption of IFRS. In particular, the main objective of this study is to examine issues associated with the adoption of IFRS in Japan by analyzing the opinions of key stakeholders included in the minutes of the BAC (BAC, 2011a,b,c,d,f). These stakeholders include financial statement preparers in manufacturing and service industries, analysts in securities companies and credit-rating agencies, persons affiliated with the Tokyo Stock Exchange, the Japanese Institute of Certified Public Accountants (JICPA), the ASBJ and its administrative organization (Financial Accounting Standards Foundation: FASF), the Japan Business Federation (*Nippon Keidanren*), the Japanese Trade Union Confederation (*Rengo*),

and accounting academics.

The remainder of this study is organized as follows. Section 2 describes the theoretical framework developed by Gernon and Wallace (1995). Section 3 outlines the data collection. Section 4 shows the results of the application of the Gernon and Wallace (1995) framework. Section 5 discusses other factors related to the adoption of IFRS. Section 6 summarizes the study and presents conclusions.

2. Theoretical Framework

As differences in the accounting environment of a country may result in problems related to the interpretation and application of IFRS, it is particularly interesting to examine the accounting environment of a country that is considered different from the institutional setting in which IFRS are developed. Japan has a distinct accounting environment and an accounting regime that traditionally has a reputation of being focused on meeting the demands of creditors and insiders (Doupnik and Perera, 2012, p. 272). Japan is usually included in the Continental European model as distinct from the Anglo-American model of accounting, which is largely reflected in IFRS (Nobes and Parker, 2010, p. 72).

Previous literature has suggested that the development of accounting systems is largely a function of environmental factors such as economic and legal systems, financing systems, and culture. However, the number of factors that influence accounting and their individual importance varies greatly in existing frameworks such as that of Schweikart (1985), Gray (1988), Doupnik and Salter (1995), and Nobes (1998). Importantly, these frameworks rely on a causal theory that views accounting as strictly dependent on selected variables of the environment.

Relying on the accounting ecology framework developed by Gernon and Wallace (1995), this study provides a holistic analysis of the accounting environment in Japan. Compared to other frameworks, Gernon and Wallace's (1995) accounting ecology framework incorporates both causes and effects of accounting and allows the study of accounting in a particular country in its natural setting and the exploration of the interaction in its broader institutional context.

Gernon and Wallace (1995) defined the accounting environment as "a multidimensional system in which no one factor occupies a predominant position" (p. 59). This is important because it allows researchers to study the totality of the local and global contexts. Their framework emphasizes the relationships among the environmental factors that influence and are influenced by accounting. It encompasses the following five separate but interacting dimensions:

- (1) Societal environment refers to the structural, cultural, and demographic elements within a society that may affect the demand for financial services.
- (2) Organizational environment refers to elements bearing on rationalizations in the choice and design of accounting systems such as organizational size, technology,

complexity, and human and capital resources.

- (3) Professional environment refers to such aspects of the profession as education, training, registration, discipline, and professional ethics and culture.
- (4) Individual environment refers to the total setting in which individuals lobby standard setters and use accounting numbers to their respective advantage.
- (5) Accounting environment refers to accounting practices, rules, and/or trends that affect or are affected by the other dimensions. Specifically, it includes the disclosure and measurement requirements and practices, as well as types and frequency of accounting reports.

The appropriateness of this framework to examine the accounting environment of a country has been demonstrated by Perera and Baydoun (2007), who provided insights into the accounting environment of Indonesia, and Hellmann *et al.* (2010), who provided an understanding of the features of accounting in Germany.

3. Data Collection

Given that board members of the BAC are selected by formal and fair procedures, the opinion of each board member is expected to reflect a variety of stakeholders (Nishikawa, 2007). Thus, for the purpose of investigating different opinions of key stakeholders concerning the adoption of IFRS in Japan, this study reviews the minutes of the BAC during the period from June 30, 2011, through December 22, 2011 (BAC, 2011a,b,c,d,f).³ This period was important for this study because Minister Jimi postponed the decision concerning the mandatory adoption of IFRS for an indefinite time on June 21, 2011. Following Minister Jimi's decision, the BAC initiated discussions starting June 30, 2011, which lasted until December 22 (BAC, 2011f).

Items included in the minutes that were not related to IFRS were excluded from the analysis. Statements by the chairperson of the BAC were excluded because he did not express his opinions during the meetings, while statements submitted by absentees in the form of documents were included because they consist of stakeholders' opinions. As a result, as shown in Table 1, the pages and the number of statements included in the analysis were 96.6 and 96, respectively.

Insert Table 1

It is assumed that Conservatives are more likely than Liberalists to insist on traditional concepts such as the superiority of Japanese GAAP and institutional complementarity among related infrastructures. According to the number of agreements and disagreements with these traditional concepts, representatives are classified into Conservatives, Liberalists, and Others, as follows (see Table 2):

- (1) Conservatives: Accounting academics, academics (other than accounting), Japanese business federations, the Japanese Trade Union Confederation, manufacturing

- companies, and tax accountants.
- (2) Liberalists: Credit rating agencies, JICPA, securities analysts, service industries, and stock exchanges.
 - (3) Others: ASBJ (FASF) and research institutes.

Insert Table 2

Table 3 exhibits the number of BAC board members, their statements, and each speaker's words in the documented minutes. The number of statements by Conservatives, Liberalists, and Others were 64 (66.7%), 24 (25.0%), and 8 (8.3%), respectively. Conservatives made most statements with 86,173 (65.1%), followed by Liberalists with 37,757 (28.5%) and Others with 8,516 (6.4%). These data provide evidence that the majority of the BAC consists of Conservatives. The data further show that representatives from accounting academics and manufacturing companies are opinion leaders of Conservatives, while representatives of the JICPA are opinion leaders of Liberalists in terms of the numbers of statements and words. However, actual opinion leaders may be representatives from Japanese business federations and the Japanese Trade Union Confederation. The impact of these representatives measured by the ratios (number of statements/number of members; number of words/number of members) is stronger than those of other representatives.

Insert Table 3

4. Application of the Gernon and Wallace (1995) Framework

4.1 Societal environment

The societal environment refers to the structural, cultural, and demographic elements within a society. Based on the gross domestic product (GDP), Japan is the third largest economy in the world after the United States and China (IMF, 2011). It has had large surpluses in trade balances over the past two decades (MOF, 2010). The competitiveness of Japanese firms is especially evident in a variety of manufacturing industries, and specifically in the automobile and electronic industries. Consequently, the total stock prices of Japanese companies in these industries equals 53% of all Japanese listed companies (BAC, 2011d).

The teachings of Confucius have played an important role in forming Japanese economic and accounting systems. Specifically, the stability of society has been achieved by unequal relationships between people, called "filial piety" (*xiao*) and "loyalty" (*zhong*). For example, in the "Japanese seniority system" (*Nenko-joretsu*), salary and promotion are decided based on loyalty rather than ability. Similarly, in the "Japanese lifetime employment system" (*Shusin-koyo*), employees show loyalty to the company in exchange for employment security. The avoidance of conflict is also valued as a cardinal virtue, called "humaneness" (*ren*), in Japanese society. In other words, social relations are conducted so that everyone's "face" (*kao*) is maintained. Other virtue ethics such as thrift and moderation, called "frugal" (*jian*), require not spending more money than necessary, which leads to prudent and conservative

virtues (Suzuki, 2011). These characteristics provide a rationale for suggestions by the majority of Conservatives who highlight concepts such as manufacturing (*Monodukuri*), going-concern, prudence (conservativeness), and long-term perspective. Table 4 demonstrates that Conservatives used these concepts more positively (positively 69 times, negatively 3 times), while Liberalists expressed these concepts more negatively (positively 4 times, negatively 10 times).

Insert Table 4

As with Confucianism, polytheism constitutes an important factor in Japanese cultural values. Most Japanese believe that various gods exist. Specifically, the syncretism of the three main teachings (i.e., Confucianism, Buddhism, and Shinto) has been advocated in Japan since the introduction of the Sung philosophy from China (Suzuki, 2011). This syncretism made it possible for the Japanese accounting system to integrate the German and the United States accounting systems without much resistance (Iino and Inoue, 1984). Moreover, Japanese culture has generally integrated old and new cultures without rooting out the pre-existing culture. One BAC member, an accounting academic (Kurokawa, BAC, 2011d) stated:

Historically, Japanese culture has been formed by integrating new foreign culture with traditional Japanese culture, resulting in the distinct Japanese culture. This integrated culture has contributed to establishing strengths and innovation of Japanese companies.

Polytheism, syncretism, and the cultural tendency to integrate new foreign culture into traditional culture strengthen the case for a cautious convergence approach.

4.2 Organizational environment

The organizational environment refers to elements bearing on rationalizations in the choice and design of accounting systems, such as organizational size, technology, complexity, and human and capital resources. Table 5 provides an overview of the organizational environment in Japan by summarizing the different types of limited companies. About 3,900 publicly traded listed companies (*Jojokigyō*) exist in Japan. The number of listed companies in Japan is greater than that in other developed countries such as the UK, France, and Germany. However, approximately 99% of all Japanese companies are privately owned and small and medium-sized (Advisory Council, 2010; Exploratory Committee, 2012).

Insert Table 5

The fact that most Japanese companies are privately owned is closely related to the financing methods of Japanese companies. The principal source of financing for Japanese companies had been credit from the banking system (Doupnik and Perera, 2012, p. 272). Although after the liberalization of the corporate bond market in the 1980s, large firms have preferred market-financing over intermediated-funding, Japanese SMEs are still dependent on bank

debt (Hoshi and Kashyap, 2001).

Given the predominance of bank credit and retained profits as sources of finance, the financing system in Japan fits the definition of an “insider control” system in which no strong pressure exists to publish detailed financial information because of the accessibility of internal information (Kaplan, 1997; Schmidt and Spindler, 2002, 2006). Specifically, most Japanese firms operate with several banks, but one of them is recognized as the “main bank.” The main bank can monitor lending companies as a representative of creditors or through participating in the board of directors and has access to detailed inside information that would not be disclosed as a set of mandatory financial statements (Hamamoto, 1995; Suto, 2002).

Because external pressures for corporate governance are relatively weak in Japan, the pressure to enhance the transparency of financial reporting is also reduced (Koga and Rimmel, 2007). Importantly, the relationships among various stakeholders such as banks, large corporate shareholders, and other inter-corporate relationships through cross-shareholdings are of a long-term nature and rely less on exit than on voice to mitigate conflicts and maintain harmony (Kaplan, 1997; Schmidt and Spindler, 2006). In other words, Japanese firms are grounded in the idea of group consciousness and group value maximization rather than arm’s-length relationships and maximization of individual interests (McKinnon, 1984; McKinnon and Harrison, 1985; Rahman *et al.*, 2010). These long-term relationships are consistent with the teachings of Confucius and Japanese cultural characteristics emphasizing the stability of society and prudent and conservative virtues. These organizational and cultural factors of the majority of Japanese companies may challenge the globalization of business and accounting practices.

Contrary to these traditions, Liberalists suggest that Japanese companies promote international comparability and enhance transparency of financial reporting so that Japanese capital markets can attract foreign investors. Table 6 shows that Liberalists used “international comparability,” “attractiveness of capital markets,” and “transparency of financial reporting” only positively (18 times), while Conservatives expressed these concepts both positively and negatively (positively 7 times, negatively 4 times).

Insert Table 6

4.3 Professional environment

The professional environment refers to such aspects of the profession as education, training, registration, discipline, and professional ethics and culture. The number of certified public accountants (CPAs) is often used as a proxy to represent the quality of auditing (Saudagaran, 2004, p. 10). In relation to the population size, the number of CPAs in Japan is relatively small compared to Anglo-American countries. Indeed, the number of CPAs per one million people in Japan and the United States is 235 (30,092/128 mil.) and 1,087 (342,490/315 mil.), respectively.⁴ Although the number of CPAs in Japan has increased about threefold during the last two decades (from 11,401 in 1990 to 30,092 in 2010), Japan has only about one-fifth

the number of CPAs as the United States.

Certified public tax accountants (CPTAs: *Zeirishi*) play important roles as accounting professionals in Japan. Because of the close interaction between financial reporting and accounting for tax purposes (called “single-reporting regime”), CPTAs work for SMEs in regard to bookkeeping, preparation of financial statements, calculation of taxable amounts, as well as communication with taxation authorities. Consistent with the fact that more than 2.6 million SMEs exist in Japan (see Table 5), about 70,000 CPTAs work as tax advisors and consultants for SMEs. Two BAC representatives from CPTAs strongly opposed the application of fair value measurement, while supporting the maintenance of the triangular legal system⁵ for SMEs (e.g., Otake, BAC, 2011b).

The JICPA and the ASBJ have also contributed to forming the professional accounting environment in Japan. For example, since the JICPA was established in 1949 as an independent and self-disciplinary association, it has ensured fair business activities of Japanese companies and protected investors and creditors by securing the reliability of financial reporting. Consistent with this organizational goal, five BAC representatives from the JICPA strongly supported the IASB’s proposals and the direct adoption approach. Additionally, the establishment of the ASBJ in 2001 as a private-sector accounting standards-setting body had important implications because the ASBJ is expected to develop Japanese GAAP to meet the fast-changing economic environment beyond the restrictions of the triangular legal system (Saito, 2007).

4.4 Individual environment

The individual environment refers to the total setting in which individuals lobby standard setters and use accounting numbers to their respective advantage. Following Minister Jimi’s statement in 2011, the BAC initiated a discussion to decide upon the fundamental policy regarding the adoption of IFRS. The majority of Conservatives (*Kokunai-ha*) supported the minister and therefore the more “cautious convergence approach,” stating that the competitiveness of Japanese firms has been promoted by a variety of manufacturing industries such as the automobile and electronic industries. They insisted further that these industries prefer Japanese GAAP to IFRS because the BAC and the ASBJ have prepared accounting standards to reflect the economic reality of Japanese manufacturing industries (*Monodukuri*).

To analyze the content of each statement from BAC board members, the following six hypothetical questions (Q1-6) were used as variables and then categorized into three exclusive opinions, namely agree, neutral (or not mentioned), and disagree for all 96 statements of board members.⁶

Q1. Does the board member agree with the opinion that Japanese contextual factors should be reflected in the decision of the BAC concerning the adoption of IFRS?

Q2. Does the board member agree with the opinion that Japanese GAAP are superior for

- Japanese companies (*Monodukuri*) compared to IFRS?
- Q3. Does the board member agree with the mandatory adoption of IFRS?
- Q4. Does the board member agree with convergence toward IFRS?
- Q5. Does the board member agree with the opinion that Japanese authorities should maintain the triangular legal system and/or a close relationship between financial reporting and taxable calculation?
- Q6. Does the board member agree with the separation approach?

Insert Table 7

Table 7 shows the number of statements by Conservatives, Liberalists, and Others. It shows that both parties take the Japanese contextual factors into consideration (see Q1). However, most Conservatives (agree 31, disagree 3) said that the Japanese contextual factors should be reflected in the decision concerning the adoption of IFRS, while opinions of Liberalists were mixed (agree 5, disagree 7). Except for 2 statements (see Q2), 31 Conservatives insisted that Japanese GAAP are superior for Japanese companies (*Monodukuri*) compared to IFRS, while the majority of Liberalists disagreed with this opinion (agree 1, disagree 9). One board member, a representative of a manufacturing company (Wachi, BAC, 2011a) stated:

Japanese manufacturing (Monodukuri) has been supported by Japanese accounting standards which highlight accounting concepts such as going-concern, conservatism, consistency, and prudence. IFRS are more suitable for financial industries than manufacturing industries. As such, if Japanese companies are required to prepare their financial statements according to IFRS, Japanese manufacturing will lose their strong competitiveness.

In contrast, Liberalists (*Kokusai-ha*) supported the “direct adoption approach,” arguing that mandatory adoption of IFRS would enhance international comparability of financial reporting and increase the attractiveness of Japanese capital markets. No Liberalist disagreed on the mandatory adoption of IFRS, while opinions of Conservatives were mixed (agree 11, disagree 9) (see Table 7, Q3). Liberalists emphasized further that Japanese contextual factors and interests can be reflected in IFRS only by adopting IFRS mandatorily and collaborating with the IASB (Yamasaki, chairperson of the JICPA, BAC, 2011a). One board member, a representative of the JICPA (Sekine, BAC, 2011c) explained:

Accounting standards are one of the important infrastructures for capital markets. Accounting information, which includes operating results and financial positions, should be prepared so that investors can compare companies and make decisions adequately. Because global investors cannot understand Japanese GAAP, Japanese companies should prepare their financial reporting by IFRS to enhance international comparability.

Importantly, Liberalists are not necessarily requiring the mandatory adoption of IFRS for all Japanese listed companies (about 3,900 *Jojokigyo*), but for some global enterprises (about

250 enterprises) to minimize negative effects on Japanese listed companies and to mitigate conflicts with Conservatives. This is important to note because the avoidance of conflict is valued as a cardinal virtue in Confucian countries. Fujinuma (BAC, 2011d), the former chairperson of the JICPA, explained:

Financial reporting should provide the real image of business activities. Under the global business environments, no difference concerning business activities and managements exists between Japanese and foreign companies. Consequently, the same accounting standards, namely IFRS, should be adopted for these global enterprises.

Both Conservatives and Liberalists have approved the IASB's proposals in general and support convergence with IFRS. No board member of Conservatives and Liberalists disagreed on the acceleration of convergence of IFRS (agree 15 and 3, respectively) (see Table 7, Q4). However, most Japanese key stakeholders including Conservatives and Liberalists have opposed extensive focus and application of fair value measurement, discarding the traditional concept of net income, and prohibition of the mechanism of recycling from unrealized income to realized income (ASBJ, 2006; METI, 2004, 2010; Nippon Keidanren, 2006; Saito, 2010; Opinions of Conservatives and Liberalists, e.g., Nishimura, BAC, 2011a; Saito, A., BAC, 2011e). The reasons for this can be summarized as follows:

- (1) Prevent excessive volatility caused by the extensive application of fair value measurement;
- (2) Maintain the triangular legal system for some SMEs; and
- (3) Provide reliable information for decision-making, dividends, and taxation purposes.

Overall, Conservatives highlighted the “local context,” whereas Liberalists focused on the “global context.” Although both parties have antagonistic views and conflicts about the adoption of IFRS, shared ideas concerning the restrictive application of fair value measurement, the importance of net income, and the necessity of the mechanism of recycling can be observed.

4.5 Accounting environment

The accounting environment refers to accounting practices, rules, and/or trends that affect or are affected by the other dimensions. The Japanese accounting system has been regulated by three accounting-related laws, the Securities and Exchange Law (re-named the Financial Product Exchange Law in 2007), the Commercial Code (fully revised in 2005 and re-named the Companies Act), and the Corporation Tax Law. Although the objectives of these three laws are different, they are integrated with each other through the “principle of unity” (*Tanitsusei-no-gensoku*), which requires “one and the same” accounting numbers even for different reporting purposes. These include financial reporting, submission to a general meeting of shareholders, credit guarantee, and calculation of taxable income (ICBAS, 1949).

This triangular legal system maintains two major roles of financial reporting: to provide decision-useful information for investors and to reconcile interests among various stakeholders. These dual objectives of Japanese GAAP differ from the objective of the IASB, which relates almost entirely to the information-providing role (METI, 2010).

Business federations have consistently opposed the adoption of IFRS for non-consolidated financial statements and suggested the adoption of IFRS only for consolidated financial statements (Nippon Keidanren, 2008, 2009, 2010). Under this approach (called *Rentan-bunri*, hereinafter, “separation approach”), the relationship between consolidated and non-consolidated financial statements is mostly disconnected. Accordingly, the dependence between the Financial Instruments and Exchange Act, which regulates mainly consolidated financial statements, and the Companies Act, which regulates mainly non-consolidated financial statements, is largely disrupted. In other words, the separation approach makes the maintenance of the triangular legal system less important. Indeed, three Liberalists disagreed on the maintenance of the triangular legal system, while the majority of Conservatives agreed to maintain this system (agree 16, disagree 1) (see Table 7, Q5).

Although Conservatives and Liberalists have a different perspective concerning the adoption of IFRS, the separation approach is supported by the majority of both parties (Izumoto, representative of the JICPA, BAC, 2011c). More than 80% of Conservatives and 90% of Liberalists support the separation approach (agree 16 and 10, disagree 3 and 1, respectively) (see Table 7, Q6). One of the Conservatives, a tax accountant explained:

If the scope of the adoption of IFRS is limited to the consolidated financial statements of some global enterprises, most listed companies in Japan which finance mainly from Japanese capital markets will not adopt IFRS, thereby maintaining the strengths and competitiveness of Japanese manufacturing companies (Otake, BAC, 2011b).

Similarly, one of the Liberalists, the president of the Tokyo Stock Exchange stated:

The companies which finance from foreign capital markets should adopt IFRS to enhance transparency of financial reporting and finance at low cost. Global enterprises are categorized into these companies (Saito, A., BAC, 2011d).

This shared awareness concerning the scope of adoption (i.e., global enterprises) provides evidence that both parties have begun to make compromises to promote the adoption of IFRS in Japan. As Otake (BAC, 2011b) suggested, if the scope of the adoption of IFRS is limited to consolidated financial statements of some global enterprises, the triangular legal system can be maintained for other listed companies and SMEs, which comprise approximately 99% of all Japanese companies (see Table 5).

5. Other Factors Related to the Adoption of IFRS

Endorsement

Because the ASBJ is not a legislator and its standards have no legal backing, accounting standards prepared by the ASBJ need to be endorsed by authoritative institutions. According to the “Regulation Concerning Terminology, Forms, and Preparation of Consolidated Financial Statements” (Article 93), IFRS are included in Japanese GAAP, given that IFRS are endorsed by the minister of the FSA. However, the endorsement process potentially results in differences between “IFRS as issued by the IASB” and “IFRS as endorsed by the FSA.” The BAC (2009) outlined the possibility to make partial modifications and exclusions of IFRS as follows:

Accounting standards are significantly important as yardsticks for assessing the compliance of financial statements, including the process of punitive actions in case of violation of laws. There may be cases in which Japanese authorities must suspend the adoption of IFRS developed by the IASB partially, when IFRS are seriously inappropriate and cannot be recognized as accounting standards that are generally accepted in Japan.

More than 90% of Conservatives believe that Japanese GAAP is superior for Japanese manufacturing companies (*Monodukuri*) compared to IFRS (see Table 7, Q2). They supported the so-called “carve-out” of IFRS and pointed out that some regulations of IFRS should be modified or excluded because of the superiority of Japanese GAAP in these areas. According to Komiyama (BAC, 2011b), these standards include:

- (1) Intangible Assets - Japanese GAAP require both scheduled amortization and impairment procedures, while IFRS relies on only impairment procedures;
- (2) Recycling - Japanese GAAP require recycling from unrealized income to realized income to calculate both comprehensive income and net income, while IFRS does not necessarily apply recycling for some items such as financial instruments and defined benefit plans;
- (3) Development Expenditures - Japanese GAAP recognize them as costs immediately as well as research expenditures in principle, while IFRS requires some items to be recognized on the balance sheet; and
- (4) Retirement Benefits - Japanese GAAP require amortizing actuarial gains and losses over the average length of remaining service and recognizing them as a part of net income, while IFRS recognize them as other comprehensive income immediately.⁷

It is worth pointing out that Conservatives do not necessarily disagree on the IASB’s proposals, including the mandatory adoption of IFRS (see Table 7, Q3). Given that approximately 99% of all Japanese companies are not capital market orientated, Conservatives expressed concerns about the adoption of IFRS for all listed companies and SMEs and about methods for conducting discussions that do not take into consideration Japanese contextual factors such as its history, economy, culture, and legal system (e.g., Hirose, BAC, 2011c).

Cost of IFRS implementation

Both Conservatives and Liberalists favor the adoption of IFRS for consolidated financial statements of global enterprises in Japan by applying the separation approach (see Table 7, Q6). However, the cost of IFRS implementation is expected to be high in countries where the Continental European model is applied. This is because the Anglo-American system is closer to IFRS than the Continental European system (Hellmann *et al.*, 2010). Additionally, in countries where the accounting system and its surrounding infrastructures are well established, the consideration of domestic reconciliation between accounting standards and other subsystems has important implications (Saito, 2010).

The cost of IFRS implementation is closely related to the practical procedure of “carve-outs.” As previously noted, most Conservatives regard Japanese GAAP as superior to IFRS, especially with respect to accounting treatments of intangible assets, recycling, development expenditures, and retirement benefits. These standards may be modified and excluded in applying IFRS. A former Japanese IASB board member, Yamada, stated that the IASB has opposed IFRS carve-outs to enhance international comparability and avoid excessive politics because carve-outs provide discretion to adopt different accounting treatments that apply only in individual countries (Yamada, 2010). In contrast, the ASBJ chairperson, Ikuo Nishikawa, supported carve-outs as a sign of national sovereignty and to take the cost of IFRS implementation into consideration (Nishikawa, 2010).

Interpretation of IFRS

Both Conservatives and Liberalists influence the political process and are heavily involved in the interpretation of accounting rules. A characteristic of code law is that it is more abstract than common law and formulates general rules rather than providing answers to specific cases (Nobes and Parker, 2010, p. 32). In other words, the general rules used mostly in the Continental European model have to be interpreted for specific settings, and guidance for interpretation is necessary. Indeed, the JICPA developed practical guidelines to complement general accounting rules. After the ASBJ was established in 2001, it prepared both general accounting standards and detailed application guidelines. Many Japanese professional accountants and jurists have also been highly involved in the interpretation of the related laws and accounting standards by publishing voluminous commentaries.

Importantly, given the social, organizational, and cultural characteristics, such as the prudent and conservative virtues, long-term orientation, insider control (bank credit oriented), and fewer incentives for disclosure (Kikuya, 2001; Suzuki, 2011), the Japanese accountants described above may interpret IFRS differently than Western accountants. Conservatives expressed strong concerns about the application of a principles-based approach. These include problems related to the discretionary behavior of managers, excessive application of judgments, and reinforcement of procyclicality caused by fair value measurement (e.g., Sato, BAC, 2011c). The code law tradition and the triangular legal system as well as the strict compliance with national legislation in the Japanese accounting system are the main reasons for these concerns about the application of a principles-based approach.

Translation of IFRS

Although no board member of the BAC discussed issues concerning translation of IFRS, translation from English into Japanese is an important part of the endorsement procedure. In particular, translation may cause problems such as time lags, inaccuracies, and mistranslations. Because the IFRS Foundation requires rigorous due processes to ensure accurate translation, a time lag between “IFRS as issued by the IASB” and “IFRS as translated by the IFRS Foundation” exists. In fact, the English version of 2009 IFRS was published in March 2009, while the Japanese version of 2009 IFRS was issued in December 2009.

In addition, literal translation of accounting concepts may be difficult because there can be associations with traditional concepts that have been defined differently in Japanese accounting standards. Previous translations of accounting concepts provide evidence that even some fundamental concepts such as “net income” cannot be translated accurately. For example, IAS 1 defines *profit or loss* as “the total of income less expenses, excluding the components of other comprehensive income” (par. 7). However, the Japanese conceptual framework uses the word *net income* (*Junrieki*) instead of *profit or loss* (*Soneki*). It states: “Net income is determined by deducting total expenses/losses from total revenues/gains, which represents the results of investments released from risks during a certain period” (ASBJ, 2006, par. 11).

Importantly, recycling procedures are not necessarily included in calculating *profit or loss*, but they are included in *net income*. Net income has been used in Japanese GAAP to provide relevant and reliable information not only for investors’ decision-making purposes but also for distribution and taxation purposes (ASBJ, 2006; METI, 2004, 2010; Nippon Keidanren, 2006; Saito, 2010). These two objectives of Japanese GAAP are the main reason why recycling procedures are required in Japan in calculating *net income*. These traditional concepts of net income and recycling are supported by almost all Conservatives and Liberalists (e.g., Sato, Saito, A., BAC, 2011e).

Importance of consistent training and education

Many studies have reported that IFRS may be interpreted and applied differently across countries (Doupnik and Richter, 2003, 2004; Ball, 2006; Doupnik and Riccio, 2006; Patel, 2006). Consistent training and education in IFRS could provide opportunities to reduce different interpretations and applications of IFRS. The BAC (2009, p. 9) recognized the importance of educational programs and stated:

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.

Indeed, the cost of IFRS training and education in Japan is expected to be higher than in other countries, whose concepts and principles are mostly reflected in IFRS (Nippon Keidanren, 2009; Tokyo Stock Exchange, 2009). However, IFRS educational programs could benefit

global enterprises by providing standardized training, transferring employees internationally, and conducting performance reviews more fairly for staff from all around the world (Smith, 2009). This fact provides additional reasoning for both Conservatives and Liberalists who tend to suggest the mandatory adoption of IFRS for global companies (e.g., Yagi, BAC, 2011a,f; Saito, A., BAC, 2011b,c). Importantly, beyond the technical knowledge and understanding, the intended meaning of words and phrases included in IFRS has to be addressed in training and education so that IFRS can be interpreted and applied as intended by the IASB.

To improve judgment skills in the accounting and auditing professions, the JICPA established the Japan Federation for Accounting Education and Learning (JFAEL) in July 2009. Moreover, to develop international accounting professionals who contribute to reflecting Japanese interests in the IASB, the FASF and the ASBJ launched the Accounting Human Resource Development Program in August 2011. Overall, in developing training and educational programs, collaboration among universities, CPAs, regulators, and other administrative bodies is seen as essential (Hiramatsu, 2012).

6. Summary and Conclusions

By using the accounting ecology framework developed by Gernon and Wallace (1995) and conducting a content analysis of relevant meetings of the BAC, this study examined the main features of the Japanese accounting environment and discussed the main reasons why Japan has adopted a cautious convergence approach in contrast to other countries.

Opponents of Minister Jimi's suggestion to postpone the decision concerning the mandatory adoption of IFRS, namely Liberalists (*Kokusai-ha*) of the BAC board members, have supported the "direct adoption approach." They argue that the mandatory adoption of IFRS would enhance international comparability of financial reporting and increase the attractiveness of Japanese capital markets. The concepts of "transparency of financial reporting," "enhancing international comparability," and "attractiveness of capital markets" are largely shared by Liberalists. In contrast, supporters of the minister's statement, namely Conservatives (*Kokunai-ha*) of the BAC board members, have suggested a more "cautious convergence approach." They argue that Japanese manufacturing industries such as the automobile and electronic industries prefer Japanese GAAP to IFRS because the BAC and the ASBJ have prepared accounting standards to reflect the economic realities of Japanese manufacturing (*Monodukuri*).

As one of the board members of the BAC explained, Japanese culture has been formed by integrating new foreign culture with traditional Japanese culture, resulting in the distinct Japanese culture (Kurokawa, BAC, 2011d). Similarly, the Japanese business and accounting systems have been formed by integrating the Anglo-American model with the traditional Japanese model to create a Japanese-specific style of convergence. This Japanese cultural tradition originates in the teachings of Confucius and polytheism, which respect to long-term cooperative relationships, avoidance of conflicts, and integration of heterogeneous values and

concepts. Indeed, the challenge between Liberalists and Conservatives to synthesize their interests and opinions has started to create a Japanese-specific style of convergence.

Although there are inherent conflicts between Liberalists and Conservatives, they have shared their basic ideas and largely approved the IASB's standards and proposals. Conversely, they have mostly opposed the extensive focus on and application of fair value measurement, discarding the traditional concept of net income, and the prohibition of the mechanism of recycling from unrealized income to realized income. This is primarily because the excessive application of fair value measurement may cause intolerable volatility of financial statements, especially for manufacturing industries (ASBJ, 2006; METI, 2004, 2010; Nippon Keidanren, 2006; Saito, 2010; Opinions of Conservatives and Liberalists, e.g., Nishimura, BAC, 2011a; Saito, A., BAC, 2011e). In addition to these shared opinions between Liberalists and Conservatives, the separation approach, which is expected to apply to global enterprises, is supported by almost all board members of the BAC. They also have approved Japanese companies preparing their non-consolidated financial statements with Japanese GAAP because the objective of these statements is to calculate distributable and taxable amounts in compliance with domestic legislation such as the Companies Act and the Corporation Tax Law.

Japanese-specific contextual factors are deeply embedded in Japanese GAAP. In particular, the Japanese business and accounting systems have largely favored statutory and bureaucratic control as well as prudent and conservative values rather than flexibility of accounting standards and the excessive application of accountants' professional judgment. Although foreign investors in Japanese capital markets have gained more importance in recent years, most Japanese listed companies are financing from domestic capital markets and creditors (BAC, 2011d). As a result, Japanese GAAP and underlying accounting principles remain the basis for Japanese companies. These facts provide evidence that Anglo-American accounting practices in general and IFRS in particular may create problems in Japan, which has led Japan to adopt a cautious convergence approach.

Findings of this study suggest that certain characteristics of the Japanese accounting environment may cause problems concerning the consistent application of IFRS and may hinder the comparability of financial reporting with other countries. Important problems that have been identified include the endorsement process of IFRS, interpretation of IFRS by Japanese accountants, and translation of IFRS from English into Japanese. Additionally, although the number of Japanese CPAs increased roughly threefold during the last two decades, problems concerning the lack of accounting professionals may exist in Japan. Indeed, the accounting and auditing profession is relatively small in Japan. Finally, this study shows that controversial issues, such as enhancing the attractiveness of Japanese capital markets internationally and maintaining institutional complementarity among sub-systems domestically, have prolonged the debate on the Japanese-specific style of accounting convergence.

Some limitations in this research should be acknowledged. For the purpose of investigating

different opinions of key stakeholders concerning the adoption of IFRS in Japan, this study collected five sets of minutes from meetings of the BAC. However, the unbalanced composition of the BAC indicates that Conservatives are more likely to be selected as board members than Liberalists, and therefore opinions of BAC board members do not necessarily reflect the opinions of all stakeholders equally. Although minutes of BAC meetings are disclosed, formal procedures to select board members are not available to the public. Despite these limitations, this study contributes to a better understanding of the Japanese accounting system. The findings are important because each country has different motivations, policies, and backgrounds for global convergence of financial reporting.

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Table 1
Sampling Units of the BAC Minutes

No.	Date of meeting	Pages of the minute	Number of statements
1	June 30, 2011	21.8	22
2	August 25, 2011	18.6	23
3	October 17, 2011	23.1	20
4	November 10, 2011	16.8	13
5	December 22, 2011	16.3	18
Total	From Jun 30 to Dec 22, 2011	96.6	96

Table 2
Basis for the Classification: Conservatives (*Kokunai-ha*), Liberalists (*Kokusai-ha*), and Others

Representatives from	(1) Superiority of Japanese GAAP to IFRS			(2) Maintenance of institutional complementarity			(3) Total (=1)+(2)			Basis for classification
	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	
Accounting academics	6	2	11	3	1	15	9	3	26	Agree > Disagree
Academics (other than accounting)	1	0	6	1	0	6	2	0	12	
Japanese business federations	5	0	5	1	0	7	6	0	12	
Japanese Trade Union Confederation	4	0	1	3	0	3	7	0	4	
Manufacturing companies	11	0	6	6	0	11	17	0	17	
Tax accountants	4	0	2	2	0	5	6	0	7	
Credit rating agencies	0	1	1	0	0	2	0	1	3	Agree < Disagree
JICPA	1	6	5	0	2	10	1	8	15	
Securities analysts	0	1	3	0	0	4	0	1	7	
Service industries	0	1	2	0	0	3	0	1	5	
Stock exchanges	0	0	3	0	1	2	0	1	5	
ASBJ (FASF)	0	0	5	0	0	5	0	0	10	Agree = Disagree
Research institutes	0	0	3	0	0	3	0	0	6	
Total [(1), (2):96, (3):192]	32	11	53	16	4	76	48	15	129	

Note: Neutral: a neutral stance or no statement.

Table 3
Composition and Statements of BAC Board Members

Representatives from	Number of board members	Number of statements	Number of statements/ number of members	Number of speakers' words in the minutes	Number of words/number of members
Conservatives (<i>Kokunai-ha</i>)					
Accounting academics	9 (20.0%)	19 (19.8%)	2.1	36,921 (27.9%)	4,102
Academics (other than accounting)	5 (11.1%)	7 (7.3%)	1.4	5,420 (4.1%)	1,084
Japanese business federations	2 (4.4%)	9 (9.4%)	4.5	10,410 (7.9%)	5,205
Japanese Trade Union Confederation	1 (2.2%)	5 (5.2%)	5.0	6,597 (5.0%)	6,597
Manufacturing companies	10 (22.2%)	18 (18.8%)	1.8	22,106 (16.7%)	2,211
Tax accountants	2 (4.4%)	6 (6.3%)	3.0	4,719 (3.6%)	2,360
Sub Total	29 (64.4%)	64 (66.7%)	2.2	86,173 (65.1%)	2,971
Liberalists (<i>Kokusai-ha</i>)					
Credit rating agencies	1 (2.2%)	2 (2.1%)	2.0	2,267 (1.7%)	2,267
JICPA	5 (11.1%)	12 (12.5%)	2.4	19,499 (14.7%)	3,900
Securities analysts	3 (6.7%)	4 (4.2%)	1.3	4,383 (3.3%)	1,461
Service industries	1 (2.2%)	3 (3.1%)	3.0	4,482 (3.4%)	4,482
Stock exchanges (Tokyo, Osaka)	2 (4.4%)	3 (3.1%)	1.5	7,126 (5.4%)	3,563
Sub Total	12 (26.7%)	24 (25.0%)	2.0	37,757 (28.5%)	3,146
Others					
ASBJ (FASF)	3 (6.7%)	5 (5.2%)	1.7	4,465 (3.4%)	1,488
Research institutes	1 (2.2%)	3 (3.1%)	3.0	4,051 (3.1%)	4,051
Sub Total	4 (8.9%)	8 (8.3%)	2.0	8,516 (6.4%)	2,129
Total	45 (100%)	96 (100%)	2.1	132,446 (100%)	2,943

Note: The number of board members includes both Business Accounting Council (BAC) and Planning and Coordination Council (PCC) members as of June 30, 2011.

Table 4**Institutional Complementarity and Its Relevant Concepts**

	Manufacturing (<i>Monodukuri</i>)		Going-concern		Prudence (Conservativeness)		Long-term perspective		Total	
	positive	negative	positive	negative	positive	negative	positive	negative	positive	negative
CON	27	2	17	0	11	1	14	0	69	3
LIB	0	4	2	1	1	5	1	0	4	10
OTH	0	0	0	0	0	0	0	0	0	0

Note: CON: Conservatives (*Kokunai-ha*); LIB: Liberalists (*Kokusai-ha*); OTH: Others.

Table 5
Types of Limited Companies in Japan

	Numbers	FPXL	CA	External Audit	Consolidated Financial Statements	Non-consolidated Financial Statements
FPXL's publicly traded listed companies	3,900	applied to public companies	applied to all companies	applied to public and large companies	J-GAAP, IFRS or U.S.GAAP	J-GAAP
FPXL's publicly traded unlisted companies	1,000				J-GAAP	J-GAAP
CA's large unlisted companies	10,000	N/A		N/A	N/A	Simple J-GAAP
Other private companies	2,500,000				N/A	J-SME or N/A

Sources: Numbers of companies are quoted from Advisory Council (2010).

Notes: **FPXL:** the Financial Product Exchange Law, **CA:** the Companies Act, **CA's large companies:** paid-in capital; 500 million yen or total liabilities 20 billion, **J-GAAP:** Japanese GAAP, **J-SME:** Accounting standards for small and medium-sized enterprises (SMEs). **IFRS:** optional adoption commenced with the March 2010 fiscal year-end for consolidated financial statements of public listed companies. On April 1, 2012, 4 Japanese listed companies adopted IFRS, while about 30 Japanese listed companies adopted United States (U.S.) GAAP.

Table 6**International Comparability and Its Relevant Concepts**

	Comparability		Capital Markets		Transparency		Total	
	positive	negative	positive	negative	positive	negative	positive	negative
CON	0	3	3	1	4	0	7	4
LIB	3	0	7	0	8	0	18	0
OTH	1	0	2	0	0	0	3	0

Note: CON: Conservatives (*Kokunai-ha*); LIB: Liberalists (*Kokusai-ha*); OTH: Others.

Table 7
Number of Statements by Conservatives (*Kokunai-ha*), Liberalists (*Kokusai-ha*), and Others

	Conservatives			Liberalists			Others			Total
	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	
Q1. Does the board member agree with the opinion that Japanese contextual factors should be reflected in the decision of the BAC concerning the adoption of IFRS?	31	3	30	5	7	12	0	1	7	96
Q2. Does the board member agree with the opinion that Japanese GAAP are superior for Japanese companies (<i>Monodukuri</i>) compared to IFRS?	31	2	31	1	9	14	0	0	8	96
Q3. Does the board member agree with the mandatory adoption of IFRS?	11	9	44	11	0	13	0	0	8	96
Q4. Does the board member agree with convergence toward IFRS?	15	0	49	3	0	21	1	0	7	96
Q5. Does the board member agree with the opinion that Japanese authorities should maintain the triangular legal system and/or a close relationship between financial reporting and taxable calculation?	16	1	47	0	3	21	0	0	8	96
Q6. Does the board member agree with the separation approach?	16	3	45	10	1	13	0	0	8	96
Total	120	18	246	30	20	94	1	1	46	576

Note: Neutral: a neutral stance or no statement.

Notes

- ¹ Convergence is defined in this study as the process that eventually results in the adoption of IFRS.
- ² The Business Accounting Council (BAC) took over in 1952 from the Investigation Committee on Business Accounting Systems (ICBAS), which was established in 1948 to prepare a set of accounting standards as the first public accounting standard-setting body in Japan. Since the Accounting Standards Board of Japan (ASBJ) was established in 2001 as a private accounting standard-setting body, the BAC has concentrated on preparing auditing standards and policymaking concerning the adoption of IFRS.
- ³ The BAC publishes all minutes in the form of PDF files (in Japanese). Available at: http://www.fsa.go.jp/singi/singi_kigyuu/top_gijiroku.html.
- ⁴ These numbers are calculated by the authors using data from MOF (2010), JICPA (2011), and MIAC (2011).
- ⁵ Three laws, namely, the Financial Instruments and Exchange Act, the Companies Act, and the Corporation Tax Law, have considerable effect on the accounting practices in Japan. These laws relate systemically to each other. This style of accounting regulation is called the “triangular legal system.”
- ⁶ Two coders were involved in the data collection process. As suggested by Krippendorff (2013, p. 277), the reliability of the analysis has been tested by computing agreements and Krippendorff’s alpha. The inter-coder reliability between a researcher and the research assistant in percentage ranged from 96.9% to 99.0% (Q1: 96.9%, Q2: 97.9%, Q3: 97.9%, Q4: 97.9%, Q5: 96.9%, Q6: 99.0%). The average score of Krippendorff’s alpha was 0.949. These results show high levels of reliability in the coding process of the study.
- ⁷ These cases were also expressed in the “Comments on Requests for Views, Agenda Consultation 2011” as a formal opinion of a wide variety of stakeholders in Japan (ASBJ, 2011).