

# IFRS FLASH REPORT

## Toward Finalizing the Roadmap of IFRS Application in Japan

Optional application may start for the fiscal year ending March 2010 – mandatory application may begin in 2015 or 2016

June 19, 2009

On June 11, 2009, the Japanese Financial Service Agency (FSA) Business Accounting Council (BAC) held its 16<sup>th</sup> Planning and Coordination Committee (Committee) meeting. BAC had previously issued a roadmap for IFRS application on February 4, 2009. This roadmap is officially known as *Draft Interim Report: Application of International Financial Reporting Standards (IFRS) in Japan* (the Exposure Draft). On April 6, 2009, FSA ended its public consultation comment period. The June 11 meeting was the first Committee meeting since the expiration of the comment period. As a result of the June 11 meeting, FSA issued a revised Interim Report on June 16. There are no major differences between this revised Interim Report and the Draft Interim Report.

A summary of the Interim Report is available on the FSA website at <http://www.fsa.go.jp/en/news/2009/20090612-3.html>. This Flash Report is based on information published on the FSA website and summarizes the direction the FSA is taking to finalize the IFRS application roadmap. The roadmap is expected to be finalized at the next General Meeting of the BAC. Therefore, the summary below does not necessarily reflect the BAC's final decisions.

There are four major revisions from the prior Exposure Draft. The four main areas of modifications are as follows.

- Clarification of optional application timing
- Clarification in the scope of companies for which optional application is permitted
- Defining mandatory application timing
- Discussion of mandatory application by the phase-in approach

These four areas are discussed further below.

### Clarification of Optional Application Timing

The Exposure Draft stated that while the optional application timing may possibly be as early as the fiscal year ending in March 2010, the decision on timing is subject to the progress of governance reform by the International Accounting Standards Committee Foundation and other international developments. However, the amended Interim Report now states, "It is appropriate to allow optional application on the fiscal year ending March 2010." This unqualified statement

emphasizes Japan's strong intention to move forward with optional application, regardless of international developments. Also, the statement may, to an extent, be a reaction to what appears to be a softening of the U.S. Securities and Exchange Commission's commitment to the timing of IFRS convergence in the United States.

### **Clarification in the Scope of Companies for which Optional Application is Permitted**

Per the Exposure Draft, IFRS was to be allowed to be used for "the consolidated financial statements of large-scale companies whose financial activities are conducted internationally or are well recognized in the [Japanese] market." However, the amended Interim Report includes "the consolidated financial statements of companies (and their listed consolidated subsidiaries) with financial activities conducted internationally." The reference to "companies [that are] large-scale [and] are well recognized in the [Japanese] market" was removed. FSA will determine whether to expand the scope of optional application to these companies based on subsequent IFRS developments and the evaluation of Japan's investors and other interested parties.

### **Defining Mandatory Application Timing**

The Exposure Draft stated that the mandatory application timing will be decided in 2012; however, the timing itself is not defined yet. Many people commented on their need to know the timing of mandatory application in order for them to plan for the application. Since the implementation may require approximately three years to complete and the FSA's final decision will not be made until 2012, the timing of mandatory application was determined to be either 2015 or 2016. This determination will provide companies a basis for planning.

### **Discussion of Mandatory Application by the Phase-In Approach**

The Exposure Draft stated that "IFRS should be introduced simultaneously for the consolidated financial statements of all listed companies." However, public comments suggested a phased-in approach such as the one under consideration in the United States. The Exposure Draft was then revised to say "mandatory application will be introduced either simultaneously or as a phased-in approach and will be discussed after assessing the status of optional application." Thus, a phase-in approach could be used. Even if such a phase-in approach is adopted, it will be completed in three years at most. Therefore, the first mandatory adoption may start in the fiscal year ending in March 2015, and the last adoption may start in the fiscal year ending in March 2017.

To illustrate, let's assume your company has a March fiscal year-end and is required to adopt IFRS under the mandatory application for the fiscal year ending March 31, 2015. In that case, you will need to prepare the consolidated financial statements under IFRS for the years ending March 31, 2014, and March 31, 2015, since comparative financial statements are required. Also, you will need to prepare the consolidated balance sheets as of March 31, 2013, since the beginning balance of the March 31, 2014, fiscal year has to be confirmed. Thus, you will need to start maintaining the books and records using IFRS during the year ending March 31, 2013. This requirement means you have only three more annual periods of non-IFRS reporting (the years ended March 31, 2010 (the current year), March 31, 2011, and March 31, 2012).

Companies often hear that IFRS application does not merely impact accounting policies and practices, but also affects IT systems, business strategy assessments and the company as a whole. However, the accounting department may still take the lead in IFRS conversions. The March 2009 fiscal year was the first year to adopt the Quarterly Reporting under the Financial Instruments and Exchange Act and Internal Control over Financial Reporting (J-SOX) requirements for Japanese public companies. If management looks back at last year's adoption of J-SOX, they may be able to estimate how much time they need to allocate to IFRS conversions in the coming years. The message is that companies have limited time available if they view the conversion process as a multi-year effort. That limited time is further reduced if a company decides to delay the conversion process until IFRS becomes mandatory.

In order to use the available time effectively, companies will need to analyze how the IFRS conversion process would impact them, develop a specific action plan based on the expected impacts and issues, and execute the plan based on the planned schedule. For many Japanese companies, the most significant impact is expected to be revenue recognition. Revenue recognition is a part of daily business and built into the underlying business processes. Thus, the impact is not on the financial statements only. IFRS conversion will also affect business decision-making, business processes and internal control over financial reporting. Financial instruments and fixed assets are other areas in which there may be a significant impact for Japanese companies. Management should perform a diagnostic to evaluate the impact of adopting IFRS before they develop a specific conversion plan.