[Article]

Development of International Accounting Standards in Japan

Masato Kikuya

Contents

Ⅰ Introduction

Accounting has been influenced by the legal, political, social and economic variables. Just as nations have different histories, values, and political systems, they also have different patters of financial accounting development (Mueller, Gernon and Meek, 1994, p. 1). The evolution of accounting and financial reporting in various nations has inevitably led to various practices and regulations. Accounting is formed, developed and changed by the environment in which it operates. Factors which are seen as influencing accounting development include the disparate legal systems, the prevalent providers of finance, the influence of taxation, the strength of accountancy profession, the inflationary experience, the accounting theory, and the accidents of history (Nobes and Parker, 1995, pp. 11-20). As the economic, social and legal systems and conditions vary from one nation to another, so do the approach to accounting and financial reporting .

Among the fully matured post-industrial countries, there are two contrasting systems of setting mandatory accounting rules: the Napoleonic Code background in which the rules are set entirely in prescriptive law or statutory regulation, and the common law background in which mandatory accounting rules are not generally set in the law (ASC, 1981, para. 8. 7.). Whereas code law countries tend to define financial reporting requirements in their national laws, common law nations tend to be permissive until rulings are made regarding actions that cannot be taken, such as those proscribing fraudulent financial reporting. Mueller, Gernon and Meek (1994, p. 11) classified the Japanese accounting as the Continental Model (code law country) that financial accounting is legalistic in its orientation, the practices tend to be highly conservative, and moreover it is usually designed to satisfy such government-imposed requirements as computing income taxes or demonstrating compliance with the national government's macroeconomic plan.

The International Accounting Standards Committee (IASC) was founded on 29 June 1973 by the leading accounting bodies of Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the UK and Ireland, and the US. The IASC is an independent private sector body, which consists of 119 members and 6 associate members in 88 countries as at January 1997. Japan made an effort to achieve harmonisation with IASs after the formation of the IASC. Nonetheless, Japanese common practices were often quite different from IASs modelled on British-American accounting standards (common law country). Accounting conventions and customs, economic, social and cultural environments in Japan have hindered the international harmonisation of accounting standards or the full compliance with IASs. However, the concept should be reviewed as a result of the move to globalisation of securities market with the advance of Japanese economic power worldwide.

In this article, influence of IASs on Japanese accounting standards and some issues on international harmonisation in Japan will be explored in comparison with the developments of IASs and Japanese accounting standards.

II Development of International Accounting Standards (Committee)

The objectives of the IASC, as set forth in its Constitution (para. 2), are (a) to formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance, and (b) to work generally for the improvement and harmonisation of regulations, accounting standards and procedures relation to the presentation of financial statements. Prior to the formation of the IASC there were frequently differences of form and content between the published accounting standards of most countries. The IASC takes cognisance of exposure drafts, or of accounting standards already issued on each subject and in the light of such knowledge produces an International Accounting Standard (IAS) for worldwide acceptance (IASC, 1983, para. 9). Since the formation, the IASC has issued 33 IASs, of which 31 remain in force, in order to harmonise as far as possible the various accounting standards of different countries.

Reviewing the history of the IASC, as Epstein and Mirza (1997, p. 10) also analyze, it is possible to identify three stages through which it has passed in its evolution as a global standard-setting body. These are, respectively, (1) the early years of attempting to demonstrate attention to all the major accounting issues; (2) the middle period of consolidation, when allowable alternative treatments were reduced as part of the effort to improve international comparability; and (3) the current era, when the core set of standards necessary to obtain the support of the international capital markets is being completed. The stages through which the international standard-setting process has developed are indicated by the history of IASs that have been issued to date.

In the first stage, the IASC attempted to establish a common body of accounting standards on major topics, such as accounting for inventories, for depreciation and plant assets, for research and development costs, and for foreign currency translation. Actually, all the mainstream treatments used in any of the major countries were introduced and standardized as IASs. This approach resulted in the publication of a number of IASs that permitted the application of various accounting policies to similar transactions and events. For example, the prerevised IAS 21 provided that unrealised exhange gains and losses on long-term foreign currency monetary items should normally be recognised in income for the period in accordandce with the generally accepted accounting principles in the US, but might be deferred and amortised systematically to income over the remaining lives of the items in accordance with the accounting standards in Australia and Canada. The lack of conceptual framework for financial statements resulted in the diverse accounting principles or the free choices of accounting treatments.

In the second stage in the IASC's evolution, the range of the acceptable accounting treatments for similar transactions and events was narrowed to improve comparability by setting out proposals for the removal of free choices of accounting treatments. The stage was marked by the Comparability and Improvements Project which started with the publication of *Exposure Draft 32 "Comparability of Financial Statements"* (E32) in 1st January 1989, and ended with the approvement of 10 revised IASs by the IASC Board in November 1993 that came into effect in January 1995.

In 1981, the IASC established an international Consultative Group that includes representatives of international organisations of preparers and users of financial statements, standards-setting bodies and intergovernmental organisations. In particular, it is important to international harmonisation of accounting practices that representatives of the European Commission, the Financial Accounting Standards Board (FASB) in the US and the International Organisation of Securities Commissions (IOSCO) attend IASC's Board meetings as observers. Moreover, the IOSCO which is an organisation of securities regulators from more than 40 countries (e. g. the SEC in the US, the Ministry of Finance in Japan) has recently given increased support to the need for improved global accounting standards. The IOSCO is looking for the IASC to provide mutually acceptable IASs for use in multinational securities offerings.

In order to meet such a need, the IASC published E32 that proposed to remove the free choices of accounting treatments permitted by IASs. E32 dealt with 29 accounting issues where the choice of acceptable alternatives in IASs may have a material effect on the definition, recognition, measurement and presentation of financial statements items. The objective of E32 is to eliminate all except one required treatment when the different treatments represent a free choice for similar transactions and events. In some cases, E32 proposed the retention of two accounting treatments particularly when the application of the different criteria supports the use of different treatments. In these circumstances, E32 indentified one treatment as the preferred treatment and the other as an allowed alternative treatment. Where a free choice has been identified, the following criteria in deciding which alternative treatments should be required, preferred or eliminated (IASC, 1989, paras. 18-19).

(a) current worldwide practice and trends in national accounting standards, law and generally accepted accounting principles.

(b) conformity with *the Framework for the Preparation and Presentation of Financial Statements* (which was in Exposure Draft form at the time when E32 was issued).

(c) the views of regulators and their representative organisations, such as IOSCO.

(d) consistency within an IAS and with other IASs.

The IASC received over 160 comment letters on E32 by 30 September 1989. The Board has reconsidered the proposals in E32 in the light of the comment letters and its discussions around the world. *The Statement of Intent "Comparability of Financial Statements"* was approved in June 1990 for the publication in July 1990 after reviewing the comments received on E32. In this Statement of Intent, the Board had decided that:

(a) twenty one of the twenty nine proposals in E32 should be incorporated in revised IASs without substantive change,

(b) three of the proposals in E32 require substantive change and should be reexposed, and

(c) reconsideration of five of the proposals should be deferred pending further work.

The Board has used the term "benchmark" instead of the proposed term "preferred" in those few cases where it continues to allow a choice of accounting treatment for similar transactions and events (IASC, 1990, para. 10). In 1991, the IASC issued Exposure Drafts, *E37 "Research and Development Activities"*, *E38 "Inventories"* and *E39 "Capitalisation of Borrowing Costs"* with regard to the above (b) three issues. Following reconsideration of the issues in *the Statement of Intent* in the light of the comments on E37, E38 and E39, the Board re-approved the decisions subject to two changes. In 1992, the IASC also issued Exposure Drafts of all the other revised IASs in order to allow IASC's constituency to comment on the implementation of *the Statement of Intent* changes and the other revisions. The Board approved ten revised standards (IASs 2, 8, 9, 11, 16, 18, 19, 21, 22 and 23) in Novemver 1993 and issued *"Comparability of Financial Statements : Revised International Accounting Standards 1993"*, which became operative for financial statements covering periods beginning on or after 1 January 1995. This completed the work of the Comparability and Improvements Project.

The project was a qualified success, as indeed the number of acceptable alternatives was reduced, although perhaps too many alternatives still remain. This experience reveals the very difficult task faced by the IASC (Epsten and Mirza, 1997, p. 10.). For example, in taking up the question of inventory accounting , which had been dealt with by IAS 2, which had permitted free choice among the FIFO, LIFO, weighted-average, and base stock methods, *the Statement of Intent* eliminated LIFO and base stock methods. However, in a number of countries including Japan and the US, LIFO is popular and depends on conformity between financial reporting and tax reporting. The IASC Board eventually had no choice but to accept the continued existence of LIFO, which was relegated to altenative treatment, with FIFO and weighted-average methods becoming the benchmark treatments.

The IASC may currently be said to be stepping in the third major stage of its existence. In July 1995, the agreement made with the IOSCO will lead to completion of the core set of IASs by early 1998. In 1993, the IOSCO already agreed a list of core standards (for example, accounting for inventories, depreciation, income taxes, financial instruments and investments, intangible assets, segment reporting, retirement benefit costs, presentation of financial statements, provisions and contingencies, research and development costs) for use in financial statements of companies involved in cross-border capital raising and listing purposes in all global markets. The IOSCO has endorsed *IAS 7 "Cash Flow Statements*", and has indicated to the IASC that 14 of the existing IASs do not require additional improvement, providing that the other core standards are successfully completed (IASC, 1997, p. 14).

The IASs setting process has developed through three stages and is now poised on the brink of achieving wide-spread legitimacy, which may result, over time, in the IASC's becoming the premier accounting standard setter. If both parites to the IASC-IOSCO agreement in 1995 abide by their respective commitments, by the end of this century the globalisation of accounting standards may well be in sight (Epstein and Mirza, 1997, p. 14).

Ⅲ Characteristics of Accounting and Financial Reporting in Japan

Based on the Continental Model that financial accounting is oriented toward the protection of creditors, the first Commercial Code was promulgated in 1890 and amended in 1899. The Commercial Code dominated financial reporting in Japan until the end of the Second World War.

After the acceptance of the Potsdam Declaration in 1945, as Baxter (1976, p. 433) also states, the US economic support was important in the reconstruction process and it was no surprise that the MacArthur regime used the US systems as its social and economic model. Under the control of General Headquarters of Allied Nations, the Zaibatsu (financial combines) began to be dissolved in 1946 in order to reduce their power and the shares were sold to the public in an attempt to develop a sound securities market. In 1947 the Law Concerning the Prohibition of Private Monopoly and Preservation of Fair Trade (usually referred to as the Anti -Monopoly Law) was promulgated with the purpose of protecting general consumer interests by facilitating effective enforcement of free and fair competition. The Law prohibits private monopolies, unfair trade and anti-competitive arrangements.

In order to protect investors' interests, the Securities Transaction Commission was established in 1947 (and abolished in 1952, when its role was transferred to the Finance Bureau of the Ministry of Finance) and the Securities and Exchange Law (which was based on the Securities Act of 1933 and the Securities Exchange Act of 1934 in the US) was promulgated in stages in 1947 and 1948. Furthermore, the Investigation Committee on Business Accounting Systems of the Economic Stabilization Board, predecessor of the Business Accounting Deliberation Council (BADC) was formed as an accounting standards-setting body in 1948. The BADC is an advisory body to the Ministry of Finance whose members consists of representatives from the Japanese Institute of Certified Public Accountants (JICPA), academicians, government officials, and business and industry. In 1949, the BADC published "The Business Accounting Principles" (and subsequently amended in 1954, 1963, 1974 and 1982) with the aim of uniformity in financial accounting standards. The Principles are modelled on "*A Statement of Accounting Principles*" written by Sanders, Hatfield and Moore in 1938. The Business Accounting Principles published by a public sector should be recommended as a practical guideline for adoption whenever existing Laws are changed or new laws are promulgated, even when new regulations are compulsory (Kikuya and Cooke, 1991, p. 4).

According to the provisions of the Commercial Code, every Kabushiki-Kaisya (K. K.) which is similar to the public limited company in the UK, has to prepare a balance sheet, a profit and loss statement, a business report, a proposal relating to the appropriation of retained earnings or accumulated deficits and supporting schedules as the individual accounts. These accounts should be audited by the statutory auditor (s) before a general meeting of shareholders. A balance sheet, a profit and loss statement and a proposal relating to the appropriation of retained earnigns (or accumulated deficits) should be approved at the shareholders' general meeting. Besides the internal audit by the statutory auditor, all large KKs whose share capital is ¥500 million or more, or whose total liabilities are ¥20, 000 million or more, are required to provide an audit report by a CPA (s) or by an audit corporation independent of the company. The audit by an independent external auditor began under Section 2 of the Law Concerning the Special Case of Commercial Code for the Audit of a Kabushiki-Kaisha which was promulgated in 1974.

In addtion to the requirements for accounting and financial reporting under the Commercial Code, the following companies must comply with the requirements of the Securities and Exchange Law.

(1) companies whose shares are listed on the Stock Exchange
(2) companies whose shares are traded in the over-the-counter market
(3) companies that publicly offer securities amounting to ¥500 million or more
(4) companies that already had a public offering of securities amounting to ¥500 million or more

The above companies must submit the annual securities report (or the registration report in case of (3)), which includes the individual financial statements (whose formats are more detailed than those prepared in accordance with the Commercial Code) approved at the shareholders' general meeting, to the Ministry of Finance with the purpose of the fair and appropriate trading in securities and the protection of investors and the public by disclosing the business results and financial position of the company. Accordingly, individual financial statements (which consist of a balance sheet, a profit and loss statement, a statement of appropriations of retained earnings and detailed supporting schedules), should be audited by the independent external auditor and filed with the Ministry of Finance. Preparation of consolidated financial statements became a requirement from the financial year beginning on or after 1 April 1977. As McKinmon (1984, pp. 18-19) has noted, the introduction of consolidated financial statements is traceable to three separate but reinforcing stimuli : the entry of Japanese corporations into foreign capital markets in the early 1960s ; the bankruptcy of Sanyo Special Steel Company in 1965 ; and the entry of foreign corporation into Japanese capital markets in the early 1970s.

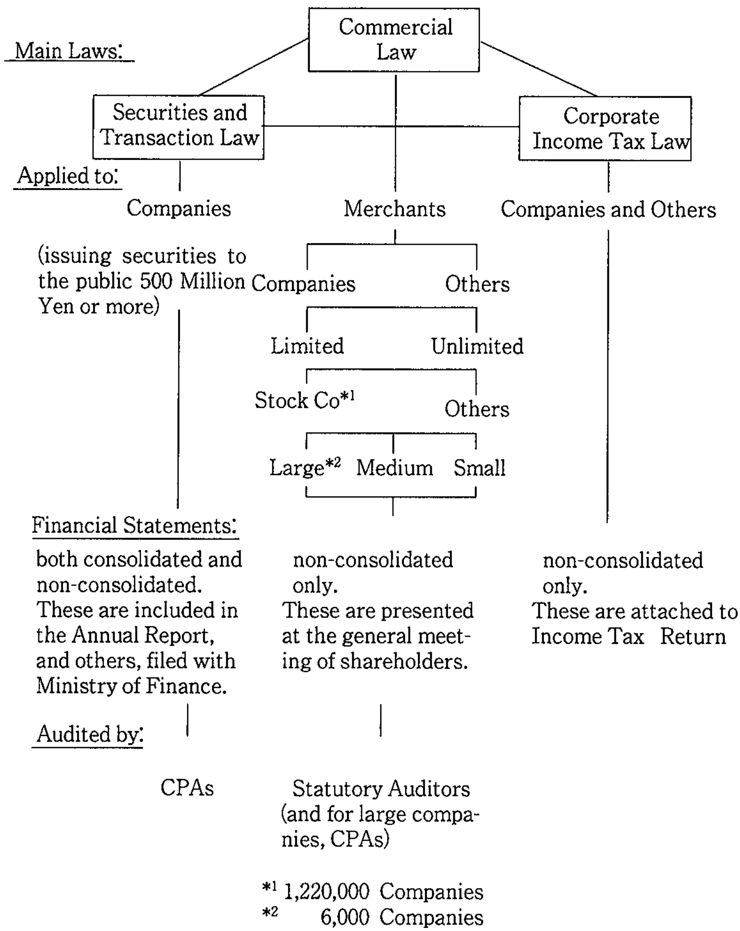
As mentioned above, the Commercial Code and the Securities and Exchange Law have had by far a great influence on financial accounting and reporting in Japan after 1948 when the latter was promulgated under the control of General Headquarters of the Allied Nations. The main objective of reporting under the Commercial Code, which is administered by the Ministry of Justice, is principally to protect creditors. Consequently, accounting rules of the Code place great emphasis upon asset valuation or determination of net worth in order to enable creditors to appraise the solvency of the company. On the other hand, underlying objective of financial statements prepared in accordance with the Securities and Exchange Law, which is administered by the Ministry of Finance, is to provide the useful information for the protection of general investors. The accounting rules of the Law place emphasis on income determination and full disclosure in order to enable investors to estimate distributable income and to know appropriately the business result and financial position of the company. In Japan, there are two different regulations in financial reporting. Therefore, all companies subject to the provisions of the Securities and Exchange Law must prepare two different formats of financial statements under two different laws in order to submit to the shareholders' general meeting and the Ministry of Finance. A unique feature of the post-war financial reporting in Japan is its dual nature in which these companies produce one set of financial statements based on the requirements of the Commercial Code and a second set based on the requirements of the Securities and Exchange Law. As Wakasugi (1992, p. 111) points out, the institutional peculiarity that there exist two different standards on financial reporting is very wasteful and irrational.

In addition to these laws, there are tax laws and regulations which have had a significant impact on financial reporting. The main laws imposing corporation tax are the Corporation Tax Law 1965 and the Special Taxation Measures Law. The Income Tax Law (including the provisions of corporation tax) was first introduced in 1899 (the original law was issued in 1887) and the Corporation Tax Law was independently promulgated in 1940 and revised substantially in 1947 and 1965. The Special Taxation Measures Law was issued in 1957 in order to provide tax advantages to certain industries, businesses or regions from the viewpoint of political and economic policies. The preferential treatment of taxation under this Law proved to be very useful in the economic development of many companies (Kikuya and Cooke, 1991, p. 126). All companies have to prepare the tax return in conformity with the Corporation Tax Law (and the Special Taxation Measures Law, if applicable). Deductions for expenses and the deferral of income allowed in determining the limit of taxable income are strictly regulated by the tax laws.

In Japan, the bureaucracy is the strongest influence on accounting development and effectively controls the profession. Initiatives on financial reporting have come from the bureaucracy and there has always been concern for Japan's post-war economic development. The statutory control by the bureaucracy is one of the main characteristics in Japanese financial reporting.

As described above, there exist basically three different laws concerning accounting treatments of a company. Arai (1994, p. 5) calls this Japanese accounting system a Triangular Legal System. The Commercial Code, the Securities and Exchange Law and the Corporation Tax Law work neither separately nor independently, rather they are closely tied and interact with the Commercial Code in the center. Income reported on financial statements which have been approved at the general meeting of shareholders, is determined in accordance with the computation rules regulated under the Commercial Code, and taxable income stipulated in the Corporation Tax Law

Figure 1 Outline of Business Accounting System in Japan



Source: K. Arai, *Accounting In Japan*, Tokyo: Waseda University, 1994, p. 37.

is calculated in conformity to the income reported on the financial statements under the Commercial Code. In the financial statements prepared under the Securities and Exchange Law, assets, liabilities, revenues and expenses are recognised and measured in accordance with the computation rules of the

Commercial Code. Therefore, net income shown on the profit and loss statement for the Securities and Exchange Law meets with net income reported in the corresponding profit and loss statement under the Commercial Code (Arai and Shiratori, 1991, p. 3). However, it sometimes happens that the provisions of the Corporation Tax Law and the Special Taxation Measures Law conflict with the Business Accounting Principles or the Commercial Code because the tax laws are affected by political considerations. In general, almost all companies adopt an accounting practice that is designed to minimize tax, rather than one that would more accurately reflect economic reality (Campbell, 1985, p. 9). Although all companies in Japan must prepare financial statements in accordance with the Commercial Code, in some respects the Code is vague and therefore choice made by companies may affect the tax assesed. It is one of the characteristics of institutional accounting in Japan that the Corporation Tax Law affects financial reporting to the extent that it specifies accounting procedures.

Moreover, in reality, the cross-shareholdings between business corporations, or financial institution and business corporation are mainly employed in order to maintain the business or financial relations and to stabilise their business administration. Through the cross-shareholdings, there are some cases where they form a corporate group. The cross-shareholdings function as the means of business combination. Among a corparate group alignment, directive (s) in one company or bank is (are) usually sent to another company. The multiple directorship often facilitates and strengthens the management control among a business group (Kikuya, 1990, p. 134). In Japan, the cross-shareholdings and the multiple directorships result in mutual low dividend. Despite of the postwar influence of the US, Japanese accounting practice continues to follow the conservative Continental Model closely. In practice, Japanese companies tend to prefer the conservatism (which emphasizes a cautious measurement approach in dealing with uncertain future events) to the optimism (which is characterized by laissez-faire and risk-taking).

Ⅳ Influence of IASs on Japanese Accounting Standards

Prior to the release of E32 in 1989 and Statement of Intent in 1990 or the agreement in 1995 made with the IOSCO as a public sector, Japanese companies had little interest in IASs published by the IASC as a private sector. IASs was nothing but an object of some academic study within the universities. It is no exaggeration to say that Japanese industrial circles have never paid attention to IASs at all (only Sasebo Heavy Industry presented an English version of its financial statements, prepared in accordance with IASs).

Nonetheless, it is generally agreed that Japan is one of the most vital countries with the advance of Japanese economic power worldwide so far as international harmonisation of accounting standards is concerned. The BADC has made very effort to acquire and harmonise its rules and regulations with IASs since the formation of IASC in 1973 and has established various accounting standards with the objective of improving financial disclosure under the Securities and Exchange Law, even in the triangular legal system.

For example, it has published the accounting standards or opinions for consolidated financial statements in 1975, interim financial information in 1977, foreign currency translation in 1983, cash flow in 1986, business segments in 1988, futures, options and marketable securities in 1990, leases in 1993. These standards or opinions principally deal with disclosure requirements for certain financial information and, accordingly, do not infringe on the computation rules stipulated in the Commercial Code (Arai and Shiratori, 1991, p. 5).

The Opinion on Disclosure of Segment Information was published by the BADC in May 1988 and became effect under the Securities and Exchange Law in April 1990. In Japan, relatively little segmental information was required to be published except that a breakdown of sales by products and by geographic area for exports only must be shown in the securities report required under the Securities and Exchange Law. There was no requirement for companies to disclose disaggregated data regarding profits, new capital investment, capital employed, assets or employees (Campbell, 1985, p. 40). According to the survey published in 1988 by the Fair Trade Commission, the restructuring of business strucure in Japanese companies, such as the conglomerates or the diversification of main business, has been increasing with the advance of innovation, the maturity of main business, the friction of foreign trade or the rise in the value of Japanese yen and the overtaking by the developing countries. As an information reflected upon the status of diversified management, segment information has been requested to be disclosed in foreign countries because Japanese companies have begun to shift its emphasis from conventional exports to prodution abroad in order to redress the imbalance in trade and to aviod the possibility of retaliation. In particular, the SEC in the US demanded the disclosure of more detailed segment information from the Japanese Research Group of Disclosure System in Europe and US in 1985 (Kikuya, 1990, pp. 141-142).

Superficially or essentially, Japan is sensitive to international criticism or external pressures (Cooke and Kikuya, 1992, p. 250). International presssures by external public sectors resulted in the promulgation of the Opinion on Disclosure of Segment Information. Consequently, the Opinion is similar to *IAS 14 "Reporting Financial Information by Segments"* modelled after British-American accounting standards. External pressures seem to be one of significant factors for harmonisation or change of accounting standards in Japan.

The BADC has recently directed its efforts to actively revise the existing accounting standards in order to harmonise with IASs or cope with the external pressures such as the IASC-IOSCO Agreement in 1995. For example, accounting standards for foreign currency translation and consolidated financial statements were revised for the sake of international harmonisation.

On 26th June 1979, the BADC published "The Accounting Standards for Foreign Currency Transactions, etc.," in order to establish a comprehensive accounting standard for foreign currency translation. However, Japanese accounting standard was quite different from *IAS 21 "The Effects of Changes in Foreign Exchange Rates"*. For example, foreign currency monetary items at the balance sheet date, irrespective of short or long term, should be translated at the closing rate according to IAS21 (para. 11) whereas long-term monetary items should be translated at the historical rates. Consequently, there was no exchange difference with respect to long-term monetary items in Japan. It would seem that such an accounting treatment stems from the ultra-prudence in Japanese practice which unrealised gains should not be recognised. The IASC adopts the situational approach to foreign currency translation that the closing rate method should be used for the financial statements of a self-sustaining foreign entity and the temporal method should be used for financial statements of an integrated foreign operation. In Japan, the temporal method should be used for financial statements of a foreign branch provided that long-term monetary items are translated at the historical rates. A modified temporal method was used for financial statements of a foreign subsidiary or associated company provided that long-term monetary items were translated at the historical rates. Under the modified temporal method, net income and retained earnigns were translated at the colsing rate and exchange differences resulting from the translation of balance sheet items were charged or credited to assets or liabilties. As Campbel (1985, p. 170) also stated, the Japanese approach might be appear unusual to Anglo-Saxon accountants.

On 26th May 1995, the BADC revised "The Accounting Standards for Foreign Currency Transactions, etc." In the revised standard, long-term monetary items may be translated at the closing rate only when the amount of exchange loss is significant. Furthermore, the closing rate method should be normally used for financial statements of a foreign subsidiary or associated company provided that long-term monetary items are translated at the historical rates. Switching the modified temporal method to the closing rate method might be a remarkable advancement from the viewpoint of international harmonisation. However, there still remain some differences. Exchange differences should be charged or credited to assets or liabilities as exchange adjustment account and income statement items may be translated at either the closing rate or the average rate during the period whereas the exchange differences should be taken to shareholders' interest and income statement items should be normally translated at transaction rate in accordance with IAS 21 (para. 30).

According to the provisions of "The Accounting Principles for Consolidated Financial Statements" published by the BADC in June 1975, a parent company was a company that owned substantially more than 50 per cent of the votes in another company. A subsidiary company was a cpmpany, in which more than 50 per cent of the votes was owned by a parent company. The criterion of control over the composition of the board of directors could not be adopted in Japan whereas it may be applied by IAS 27. The IASC permits consolidation in the following cases where the control also exists even when the parent owns one half or less the voting of an enterprise (IAS 27, para. 12).

(a) power over more than one half of the voting rights by virtue of an agreement with other investors;

(b) power to govern the financial and operating policies of the enterprise under a statute or an agreement;

(c) power to appoint or remove the majority of the board of directors or equivalent governing body; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body.

In June 1997, the BADC issued the revised Accounting Principles for Consolidated Financial Statements, which will partly take effect in stage in 1998 and 1999. The revised standard permits criterion on control over the composition of the board of directors as well as the provision of IAS 27.

Moreover, industrial circles gradually have paid attention to IASs because the IOSCO as a public sector began to support IASs published by the IASC as a private sector. In fact, several general constructors switched the completed contract method to the percentage of completion method because IAS 11 eliminated the former method although the latter method had never been adopted for financial reporting in Japan. Nonetheless, there are still some differences between Japanese accounting regulations and IASs, most of which are modelled on British-American standards. As Arai (1994, pp. 99-100) points out, the fundamental causes of differences are that the importance is placed on such accounting characteristics as verifiability, objectivity, realisability and conservatism under the Japanese concept while the IASs attach importance to relevance or usefulness to investors, timeliness and comparability, etc. The main issues relating to the differences are, for example, as followings (excluding the above).

(1) IAS 2 (para. 6) requires the valuation at the lower of cost and net realisable value with ragard to the measurement of inventories whereas either the cost method or the lower of cost and market value (net realisable value or replacement cost) method may be used in Japan.

(2) According to the provisions of IAS 8 (paras. 34 and 38), the amount of

the correction of a fundamental error that relates to prior periods, (a) as benchmark treatment, should be reported by adjusting the opening balance of retained earnings and restating prior years' statement (unless comparative information is impracticable), or (b) as alternative treatment, may be included in the determination of net profit or loss for the current period. Only (b) is applied in Japan.

(3) IAS 9 (paras. 15-17) requires that research costs should be charged in the year in which they are incurred but development costs may be deferred in exceptional circumstances. On the other hand, research and development costs may be deferred and should be amortised over a period not exceeding five years under the provision of the Commercial Code in Japan.

(4) IAS 11 (para. 22) requires the percentage-of-completion method for the recognition of contract revenue and contract costs associated with the construction contract. In Japan, the completed-contract method may be also used.

(5) IAS 15 (paras. 21-25) requires disclosure of the adjusted amount for changing prices on depreciation, cost of sales, monetary items and the overall effects of such adjustments as supplementary information. In Japan, there is no equivalent standard although the Opinion on Disclosure of Financial Information for Changing Price Level Accounting was issued in 1980 by the BADC.

(6) IAS 16 (para. 30) allows for tangible fixed assets to be carried at the revalued amount as a remeasurement subsequent to initial recognition. However, the Commercial Code, the Securities and Exchange Law and the Corporation Tax Law in Japan prohibit for property, plant and equipment to be revalued as a general rule.

(7) Although the useful life of an item of property, plant and equipment

should be reviewed periodically according to IAS 16 (para. 52), there is no equivalent requirement in Japan. The useful lives regulated by the Corporation Tax Law are mostly used for financial reporting by Japanese companies.

(8) Whereas the government grants related to assets should be accounted for either as deferred income or as deduction related assets in accordance with IAS 20 (para. 24), the grant may be accounted for as deduction from the these assets in Japan.

(9) In accordance with IAS 21 (para. 36) and IAS 29 (paras. 33 and 38), the restate-translate method should be used for the financial statements of a foreign entity that reports in the currency of a hyperinflationary economy. There is no equivalent requirement in Japan.

(10) IAS 25 (paras. 19 and 23) requires valuation at either (a) market value or (b) the lower of cost and market value for the current investments, and at either (a) cost, (b) revalued amounts or (c) in the case of marketable equity securities, the lower of cost and market value for the long-term investments. In Japan, securities are normally carried in the balance sheet at cost provided that marketable securities other than share in subsidiaries may be valued at the lower of cost and market value. However, the carrying amount in balance sheet, the current value and the revaluation difference of marketable securities should be normally disclosed in the footnote of financial statements under the Securities and Exchange Law.

It may be significant issue on international harmonisation for Japanese accounting regulations to eliminate or reconciliate these differences. The achievement of harmonisation depends in part on the efforts of the BADC which is a standard-setting body, the Ministry of Finance which administers the Securities and Exchange Law and the Ministry of Justice which administers the Commercial Code.

V Concluding remarks

As Someya (1996, pp. 17-18) states, Japan has experienced two accounting revolutions, one in the latter half of the 1800s, and the second after the Second World War. During the latter half of the 1800s there was increased influence over Japanese accounting from the West because of the voluntary introduction of Western-style double-entry bookkeeping and the Commercial Code, which subsequently served as the foundation upon which the modern capitalist economy of Japan could develop. The second accounting revolution in the middle of this century changed the style of financial reporting and involved a shift in emphasis in all facets of accounting practices and institutions from stewardship-oriented accounting directed towards public investors because of the mid-compulsory introduction of the Securities and Exchange Law under the control of General Headquarters of Allied Nations.

Today, it seems that Japan is encountering the third accounting revolution or external pressures. The BADC and the Ministry of Finance have been continuing their effort to work for improvement and harmonisation of accounting standards. Japan is moving ahead by revising the existing accounting standards in order to establish the internationally acceptable and understandable standards. At least, the BADC and the Ministry of Finance should harmonise Japanese accounting standards with IASs only in the preparation of consolidated financial statements which would be employed for cross-boarder securities offerings, by detaching the Securities and Exchange Law from the triangular legal system. Otherwise, a conciliation statement or notes should be attached to the conslidated financial statements prepared in accordance with the existing standards. Measures taken to make progress towards harmonisation with IASs are the clearest indication of third wind of change blowing through Japanese financial reporting.

References

Accounting Standards Committee (1981), *Setting Accounting Standards.*

Arai, K. (1994), *Accounting In Japan*, Tokyo: Waseda University.

Arai, K. and S. Shiratori (1991), "*Legal and Conceptual Framework of Accounting in Japan*", Paper prepared for Presentation at a Conference of National, Regional and International Standard Setting Bodies organized by IASC and FEE, Brussels, Belgium, June 16-18, 1991, Tokyo: JICPA.

Baxter, W. T. (1976), "Accounting in Japan", *The Accountant's Magazine*, November.

Cooke, T. E. and M. Kikuya (1992), *Financial Reporting in Japan: Regulation, Practice and Environment*, Oxford: Blackwell.

Epstein, B. J. and A. A. Mirza (1997), *IAS 1997 : Interpretation and Application of International Accounting Standards*, New York: John Wiley & Sons, Inc.

International Accounting Standards Committee (1983), *Preface to Statements of International Accounting Standards.*

International Accounting Standards Committee (1989), *Exposure Draft 32 "Comparability of Financial Statements".*

International Accounting Standards Committee (1990), *Statement of Intent: Comparability of Financial Statements.*

International Accounting Standards Committee (1993), *International Accounting Standard 2 (revised 1993) "Inventories".*

International Accounting Standards Committee (1993), *International Accounting Standard 8 (revised 1993) "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies".*

International Accounting Standards Committee (1993), *International Accounting Standard 9 (revised 1993) "Research and Development Costs".*

International Accounting Standards Committee (1993), *International Accounting Standard 11 (revised 1993) "Construction Contracts".*

International Accounting Standards Committee (1994), *International Accounting Standard 15 (reformatted 1994) "Information Reflecting the Effects of Changing Prices".*

International Accounting Standards Committee (1993), *International Accounting Standard 16 (revised 1993) "Property, Plant and Equipment".*

International Accounting Standards Committee (1994), *International Accounting Standard 20 (reformatted 1994) "Accounting for Government Grants and Disclosure of Government Assistances".*

International Accounting Standards Committee (1993), *International Accounting Standard 21 (revised 1993) "The Effects of Changes in Foreign Exchange Rates".*

International Accounting Standards Committee (1994), *International Accounting Standard 25 (reformatted 1994) "Accounting for Investments".*

International Accounting Standards Committee (1994), *International Accounting Standard 27 (reformatted 1994) "Consolidated Financial Statements and Accounting for Investments in Subsidiaries".*

International Accounting Standards Committee (1994), *International Accounting Standard 29 (reformatted 1994) "Financial Reporting in Hyperinflationary Economies".*

International Accounting Standards Committee (1997), *International Accounting Standards 1997.*

Kikuya, M. (1990), "Consolidated Financial Statements in Japan", *Accounting Research (Keiri Kenkyu),* No. 34.

Kikuya, M. and T. E. Cooke (1991), *Accounting in Japan: An International Perspective,* Tokyo: Teihan.

McKinnon, J. L. (1984), "Application of Anglo-American Principles of Consolidations to Corporate Financial Disclosure in Japan", *ABACUS*, Vol. 20, No. 1.

Mueller, G. G. , H. Gernon and G. K. Meek (1994), *Accounting: An International Perspective,* Richard D. Irwin, Inc.

Nobes, C. and R. Paker (1995), *Comparative International Accounting Fourth Edition,* Prentice Hall.

Someya, K. (1996), *Japanese Accounting: A Historical Approach,* Oxford: Oxford University Press.

Wakasugi, A. (1992), "Japanese Accounting System (Nippon no Kaikei-Seido)", in A. Wakasugi (ed.) *International Comparison of Accounting System (Kaikei-Seido no Kokusai-Hikaku),* Tokyo: Chuo-Keizai Sha.