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**AZ IFRS ÁTÁLLÁS JAPÁNBAN, A JAPÁN GAAP-RÓL AZ IFRS-RE
VALÓ ÁTTÉRÉS FŐ KOCKÁZATAI, ÉS AZ EZZEL JÁRÓ
KÖLTSÉGEK, ELŐNYÖK**

**THE ADOPTION OF IFRS IN JAPAN, THE MAIN RISKS INVOLVED
IN THE TRANSITION FROM JAPANESE GAAP TO IFRS AND THE
INHERENT COSTS AND BENEFITS**

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1. Introduction

The use of IFRS in Japan is an ongoing concern for companies, that are preparing consolidated financial statements. Many listed companies have interest and subsidiaries overseas, but they were not able to compare their financial data with global competitors, because they did not have the chance to use a corresponding accounting framework. The introduction of voluntary application of IFRS in Japan made it possible for companies to choose their respective accounting framework from several options and deliberate, which choice carries the best possible future for the entity.

For companies, that are largely connected to and invested in overseas markets, the possibility of using IFRS contains several advantages. The use of IFRS makes the comparability the financial information easier, which contributes to the company in the form of new, overseas investors and more connections to the international markets.

However, in Japan, the generally used accounting standard is Japanese GAAP (J-GAAP) and the use of IFRS has only been permitted around 2010, for companies, that meet the prescribed criteria. Since the voluntary adoption of IFRS has become possible, more and more listed and unlisted companies are transitioning from Japanese GAAP. Although the number of companies have been steadily increasing in recent years, there are also those, that are still only considering the adoption. Every company has to contemplate various factors before their decision is made in terms of the adoption. They must assess all cost and benefits of the process, the possible rewards or demerits and consequences as well.

Arriving at the decision to adopt IFRS is a long and complicated process for any company. There are many materials and researches existing for the help of companies, however there is no complete research on the whole process. My goal is to create a critical assessment for companies still considering IFRS adoption, to summarize the potential obstacles in the transition, beginning with the differences between the generally used Japanese GAAP and IFRS and continuing with examples of other adopting companies concerns and expectations.

First, I will introduce the current accounting environment in Japan, including the possible choices of domestic companies. I will also cover the history of the introduction of IFRS in Japan and assess the current status of adoption.

Secondly, I will review some existing researches and surveys on the topic of IFRS adoption in Japan to summarize the perceptions and experiences of companies, that already adopted

IFRS. I will include what adopting companies considered as possible benefits and inherent cost of the adoption.

Lastly, I will make a comparison between the two frameworks in question to highlight the problematic parts of the transition, and exhibit any foreseeable differences in the financial statements after the adoption of IFRS. I will also include some practical examples of the changes discussed.

2. The current accounting system of Japan and the usage of IFRS

In Japan, the Financial Accounting Standards Foundation (FASF) is the main organization responsible for the development of financial practices. Its main body is the Accounting Standards Board of Japan (ASBJ). The ASBJ's prime responsibility is the improvement of the accounting standards, both domestic and international. The ASBJ is dependent on the Financial Services Agency (FSA), the relevant Japanese government agency.

All domestic companies in Japan are required to adhere to the following key accounting pillars:

- true and fair reporting
- orderly system of bookkeeping
- distinction between earned and capital surplus
- clear disclosure
- consistency
- prudence
- in accordance with reliable accounting records and facts

In Japan, the fiscal year is different from the European, which is often similar to the calendar year. The usual fiscal year for domestic companies starts from the 1st of April until the next year 31st of March. (EU-Japan Centre for Industrial Cooperation Report, n.d.)

IFRS is one of four different accounting standards in Japan, that listed companies are permitted to use. The four frameworks are the following (IFRS Foundation, 2020):

- *Japanese GAAP*: These standards are issued by the ASBJ and designated by the FSA. Three types of accounting standards can be issued in accordance with the “Rules on the Due Process for the Development of Japanese GAAP and Japan’s Modified International Standards (Due Process Rules)”. Firstly, Accounting Standards, the main guidelines for accounting. Secondly, Implementation Guidance for easier understanding and guidance in the implementation of rules. Lastly, Practical Solutions which cover problematical areas and questionable situations in accounting. (Accounting Standards Board of Japan, n.d.)
- *IFRS Standards*
- *Japan’s Modified International Standards (JMIS)*: The JMIS accounting standards consist of IFRS base with other modifications by the ASBJ. The

modifications are related to two main topics: the accounting of Goodwill and Other Comprehensive Income. It was first issued in 2015 as a means to further endorse IFRS Standards. (Accounting Standards Board of Japan, n.d.)

- *US GAAP*: The use of US GAAP is permitted for companies, that can match the following criteria: either registered as US Securities and Exchange Commission (SEC) companies, or have been using US GAAP since 1977 for their consolidated financial statements. (Sanada & Tokuga, 2019)

Although IFRS is only one of four choices in Japan, each year it becomes more relevant and the number of companies adopting it or considering the adoption is increasing steadily.

2.1. Designated IFRS

The applicable IFRS Standards in Japan is called 'Designated IFRS' and is authorized by the FSA. Each and every standard, that is listed or updated has to be made effective by the FSA through a formal process. (Japanese Institute of Certified Public Accountants, n.d.) Based on the current regulations, there are some criteria, that companies need to meet to be able to adopt IFRS. The use of the IFRS is only permitted to listed and unlisted companies, that prepare consolidated financial statements for listing purposes. (IFRS Foundation, 2020)

In 2015, an endorsement system was created to support the use of IFRS standards. Pursuant to this mechanism, all standards must be reviewed by the Commissioner of FSA. Amendments are also applied to unique cases present in Japan. (Ernst & Young ShinNihon LLC, 2016) The reviewed standards are translated to Japanese by the IFRS Foundation. The translations are also inspected by a committee and after this process, they can be published by the FASF. (IFRS Foundation, 2020)

According to the IFRS Foundation, the criteria of the voluntary adoption are the following:

- “The company discloses, in its Annual Securities Report, information regarding specific efforts to ensure that the consolidated financial statements will be prepared in accordance with Designated IFRS; and
- The company allocates executives or employees with ample knowledge about Designated IFRS, and puts in place a structure to ensure that the consolidated financial statements will be prepared properly in accordance with Designated IFRS.” (IFRS Foundation, 2020, p. 2)

When transitioning from J-GAAP to Designated IFRS, the companies also need to disclose some information of the process. For the current and immediately preceding years companies are required to present their financial data not only in accordance with IFRS, but also J-GAAP as well. Furthermore, the major differences between the two frameworks and their impact needs to be included for the above-mentioned years. (IFRS Foundation, 2020)

2.2. Historical background

After the European Union's (EU) regulations for the mandatory use of IFRS, other countries also started to adopt the accounting standards more frequently. Japan also felt the need to comply to the global trend. It became essential for multinational companies to improve their comparability in the global market and make their financial statements more transparent to foreign investors.

The first discussions about the convergence to IFRS started in the middle 2000s. The International Accounting Standards Board (IASB) and the relevant Japanese organization, the ASBJ worked together for several years to bring the two accounting frameworks closer and reduce the differences between them. However, the ASBJ had a more conservative view in reforming the Japanese standards, so many major differences have remained intact until today. (Gray, Nagata, Nakamura, & Ozu, 2017) In 2007, the "Tokyo Agreement" was announced as the result of the process. The agreement's main goal was to accelerate the convergence between J-GAAP and IFRS from 2008 and achieve it by 2011. (Accounting Standards Board of Japan, 2007)

As a next step, in 2009, an advisory body of the FSA, the Business Accounting Council (BAC) issued the "Opinion on the Application of International Financial Reporting Standards in Japan (Interim Report)". Based on the Interim Report, the voluntary use of IFRS was approved for listed companies, that fulfilled the prescribed criteria from the financial year end of the 31st of March. It also included a roadmap to introduce the process of mandatory IFRS adoption. (Gray, Nagata, Nakamura, & Ozu, 2019)

After the economic recession, caused by the Great East Japan Earthquake in 2011, Jimi, the Minister of Financial Services at the FSA announced the postponement of the mandatory application of IFRS. (Sato & Takeda, 2017) The decision was strongly influenced by other circumstances as well. Firstly, numerous Japanese leading companies were requesting the postponement of the mandatory adoption. Secondly, the Japanese Trade Union Confederation

opposed the idea. Furthermore, the adoption of IFRS standards was also postponed in the USA. (Tsunogaya, Hellmann, & Scagnelli, 2015)

Subsequently, the BAC issued two reports, which aimed at the promotion of voluntary IFRS application. In 2012, the “Previous Discussion Summary for the Consideration on the Application of IFRS in Japan (Discussion Summary)”, and in 2013, “The Present Policy on the Application of the International Financial Reporting Standards (Present Policy)”. (Financial Services Agency, 2015) The Present Policy eased some of the application criteria so more companies would be able to choose IFRS. Out of three conditions, two were eliminated. These are the following:

- Only listed companies can adopt IFRS.
- The company needs to have at least one subsidiary overseas, that is capitalized over 20 million yen. (Gray, Nagata, Nakamura, & Ozu, 2019)

In 2014, the “Japanese Revitalization Strategy (Revised in 2014)” was issued as the next step in promoting IFRS. It is important, because this was the first announcement by the Cabinet, that aimed to increase the number of applicants. The strategy also declared the conduction of a survey in 2015, called “IFRS Adoption Report”. The purpose of the inspection is to provide references for companies currently considering the adoption of IFRS. The topic of inquiries and questions are about the challenges companies had to face while transitioning, how they overcame them and the advantages they gained afterwards. (Financial Services Agency, 2015)

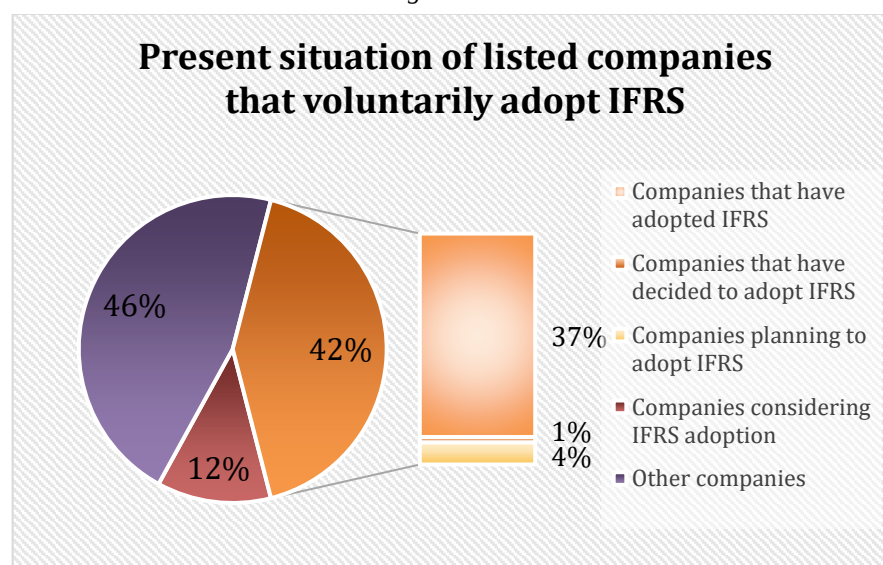
The Cabinet issued a new version of the Japanese Revitalization Strategy in 2016, thus becoming a principal influencing factor in the increase of voluntary IFRS adoptions. To encourage companies, the early adopters’ experiences are shared in the strategy. As well as presenting various interpretations about IFRS and promoting the Japanese Institute of Certified Public Accountants (JICPA) to train people with adequate skills for auditing IFRS based financial reports. (Gray, Nagata, Nakamura, & Ozu, 2019)

2.3. Current status of adoption

The use of IFRS has been steadily increasing since the voluntary adoption became possible in Japan. The Tokyo Stock Exchange (TSE) keeps track of the companies already using IFRS and any possible adopters. TSE also makes a detailed yearly analysis of the matter which is disclosed on its website. (Tokyo Stock Exchange, Inc., 2020)

The latest analysis of TSE (2020) made in 2020 includes 3,671 companies whose fiscal years ended by the 31st of March. As shown in Figure 1, 234 listed companies have already adopted, decided, or planning to adopt IFRS. This number amounts to approximately 42% of the market capitalization of all the TSE listed companies, which is 255 trillion Japanese yen (see Table 1). Within this, 37% already presented their consolidated statements in IFRS by the 20th of June 2020. Also, 12% of the companies have been considering the adoption of IFRS.

Figure 1



Note: Adapted from the analysis of Tokyo Stock Exchange Inc. (2020)

Table 1: The present situation of listed companies in Japan, and the rate of the IFRS adoption

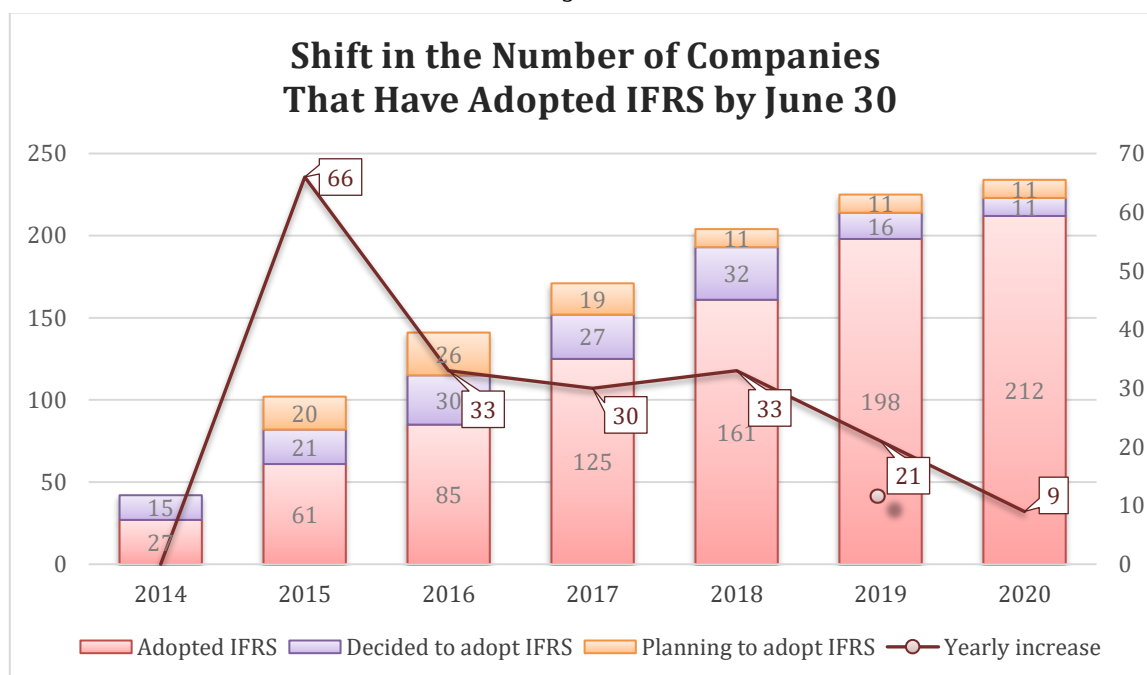
<i>Company categories</i>	Number of companies	Number of companies (%)	JPY in trillions	Market capitalization (%)
<i>Adopted IFRS</i>	212	5.8%	223	36.5%
<i>Decided to adopt IFRS</i>	11	0.3%	6	1.0%
<i>Planning to adopt IFRS</i>	11	0.3%	26	4.3%
<i>Considering IFRS adoption</i>	172	4.7%	75	12.3%
<i>Other companies</i>	3265	88.9%	281	46.0%
<i>All TSE-listed companies</i>	3671	100%	611	100%

Note. Adapted from the analysis of Tokyo Stock Exchange Inc. (2020)

It is clearly noticeable in Table 1, that even though the number of companies, that adopted IFRS is only 6% of all TSE listed companies, their market capitalization is around 37%. It means, that the IFRS adopting companies are much more substantial ones than the remaining others.

The TSE have been keeping track of the companies' intentions regarding the adoption of IFRS since 2014. Each year, the number of companies adopting IFRS is increasing (see Figure 2). However, in recent years the rise seems to have eased. Compared to the years from 2016 to 2018, when around +30 was the increase in adopting companies, it is only +21 for 2019 and even less, +9 for 2020.

Figure 2



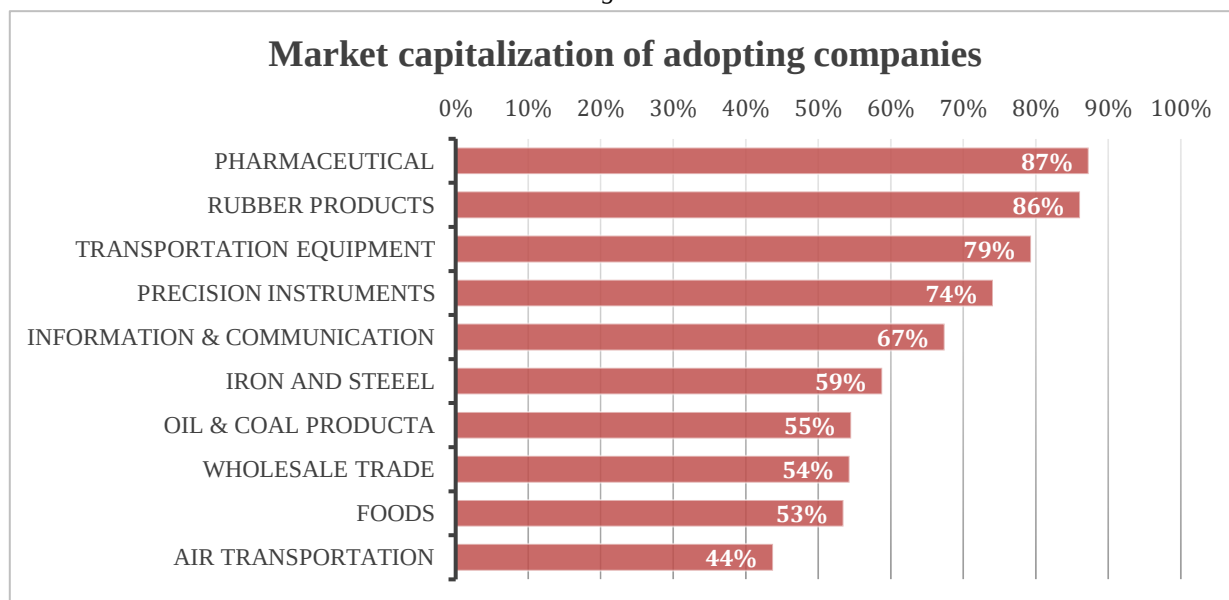
Note: Adapted from the analysis of Tokyo Stock Exchange Inc. (2020)

In Appendix A, the industrial coverage of the IFRS adopting companies are shown. Out of 33 industries, only 7 has no companies using IFRS, the other 26 includes at least one adopting company. The average market capitalization of the adopting companies is 37%, which varies from 1% to 87%.

TSE has ranked the listed companies based on their market capitalizations per industry. This ranking system is called the “JPX-Nikkei 400”. As the name suggests, the ranking consist of 400 TSE listed companies, which could be particularly appealing for investors. The JPX-Nikkei 400 are selected through a thorough process and strict criteria, including scoring based on quantitative indicators and qualitative factors. Among the 26 industries, where IFRS using companies are present, 21 includes at least one, that is ranked in the first 3 places. It is considered a general trend, when one of the high-ranking companies in an industry adopts IFRS, it influences all others, and more companies tend to follow. (Financial Services Agency, 2015)

The industries, where the adoption of IFRS is the most significant, are Pharmaceutical (87%), Rubber Products (86%), Transportation Equipment (79%) (see Figure 3). Out of these three, the first and third sector was also included in the leading industries in the IFRS Adoption Report from 2015 and has been a decisive influence on other industries. (Financial Services Agency, 2015)

Figure 3



Note: Adapted from the analysis of Tokyo Stock Exchange Inc. (2020)

3. Challenges of the adoption – the inherent costs and benefits

In the past few years, numerous companies have adopted IFRS. Each one of these companies went through the difficult process of changing their accounting framework and also experienced all the problems and uncertainty of their decision. In addition to their concerns and work, they could see the outcome of the adoption as well. All these experiences could help other companies, that are still considering the adoption, could provide an answer for their questions and make their decision easier.

In this section, I explored what additional challenges are involved in the adoption of IFRS. My objective is to give answers for important questions regarding the thought process of management when considering the IFRS adoption for their company. For instance, what are the main concerns about the adoption, what costs are to be expected, what are the anticipations and what goals they seek to achieve.

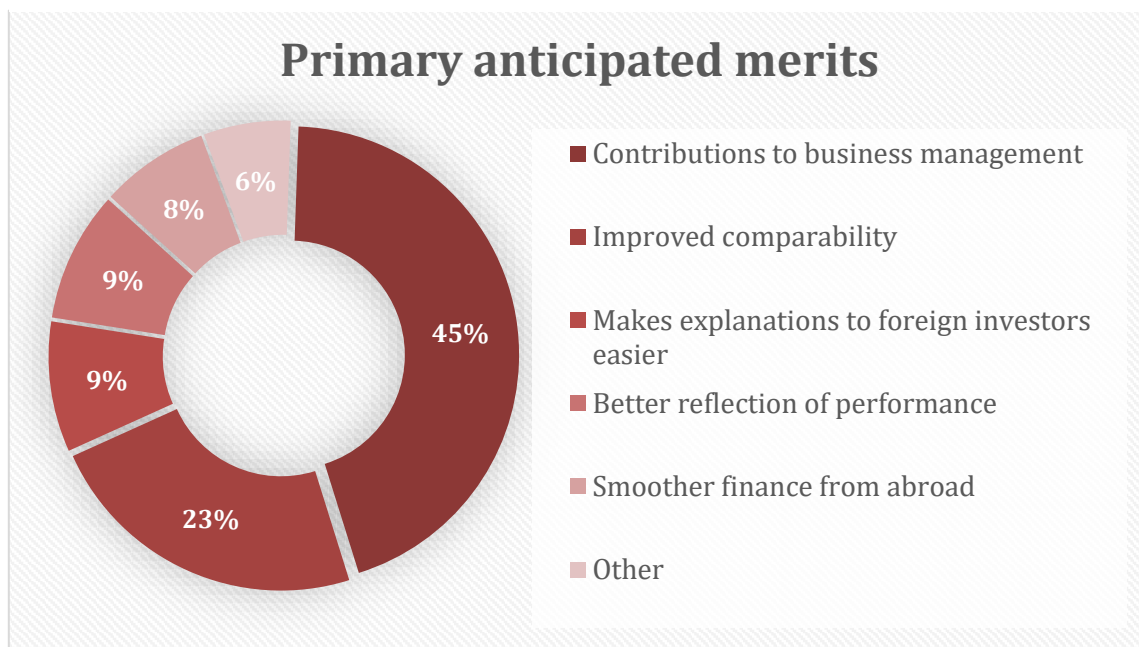
I used some existing researches and inquiries to reveal the main prospects of the adopting companies and determine the uncertainties. These researches were focused on companies, that have already adopted IFRS, asked them about their experience and observation before and throughout the process. I highlighted some topics and results of these surveys based on the answers and relevance of the adopting companies' perceptions.

3.1. Expected benefits and results of the adoption

The first aspect of the decision-making is the expected benefits of the transition. Several studies exist to determine, what were the expectations of companies, when they adopted IFRS. Even the FSA, a Japanese accounting authority conducted research on this topic to help promote the IFRS to more and more Japanese companies.

One of the main topics of the research of the FSA was the companies' reason for adopting IFRS. What benefits they were anticipating from it. In Figure 4, you can see the distribution of answers for this question.

Figure 4



Note: Adapted from the FSA report (2015)

In result, FSA highlighted, that many companies considered the ‘contribution to business management’ as the main benefit of the adoption. This result highlighted, that companies with multiple overseas subsidiaries have a need for a common measure for the enhancement of their internal transparency. With IFRS, they are able to evaluate the efficiency of their operations more precisely and improve their management accounting. It means, that not only the change of the accounting principles and its comparability to investors and external parties can be considered as benefits, but the sophistication of the company’s business management would also be a major contribution. (Financial Services Agency, 2015)

As expected, the improved comparability of financial information is also an important merit, thus it received many votes in the questionnaire. The answering companies explained that their international comparability was necessary because their company shares are held by foreign investors and it makes their communication about the business more apparent. Or because their largest competitors are based in the EU. It is also one of their reasons, that they remain comparable to their domestic competitors, that already adopted IFRS before. (Financial Services Agency, 2015)

A different study on the perceived benefits of IFRS adoption arrived at similar results. It concluded, that for the adopting companies, four items were the most important prospects. The increase in comparability of financial information with other companies internationally was clearly the most important. The other three included the higher possibility to gain international shareholders, followed by the increase in transparency of their financial information and the improved quality information accessible to shareholders. However, this study also concluded, that these benefits show only moderate results for most companies. Only large companies with overseas subsidiaries perceived substantial benefits from the adoption of IFRS. (Gray, Nagata, Nakamura, & Ozu, 2017)

Based on another research by the same authors, the companies, that are more likely to adopt IFRS voluntarily are aiming for the following benefits: to improve the communication with international market participants, to improve the company's financing ability, also to decrease other costs as a result of IFRS implementation. The study also states, that the decision to adopt IFRS is more feasible, when there is foreign investor ownership in the company, as well as high overseas sales. Furthermore, the results of this research also conclude, that the companies expecting favorable economic consequences are more likely to adopt IFRS. Such expectations include improving market valuation and credit ratings. (Gray, Nagata, Nakamura, & Ozu, 2019)

Lastly, a research from 2019 (Giner, Merello, Nakamura, & Pardo, 2019) made a detailed statistical analysis of the voluntary adoption of IFRS. It tests four hypotheses with several variables. As a result, it concludes, that IFRS adopters are more international, having more foreign subsidiaries, shareholders or listed abroad. They benefit greatly from the common language, that IFRS offers. It is also an important discovery, that adopting companies are commonly audited by Big 4 companies. It also mentions, that larger sized companies increase the probability of adopting IFRS, however younger firms decrease it. This study also considers a contagion effect, which occurs, when firms tend to follow a leader in the same industry, which is one of the most influential variables in the overall results.

3.2. Inherent cost of the transition

Opposing to the expected benefits, it is also important to know, what costs are involved in the transition and how much does it affect a company's decision.

In the survey conducted by the FSA (2015), two of four important conclusions were related to the inherent costs of IFRS adoption.

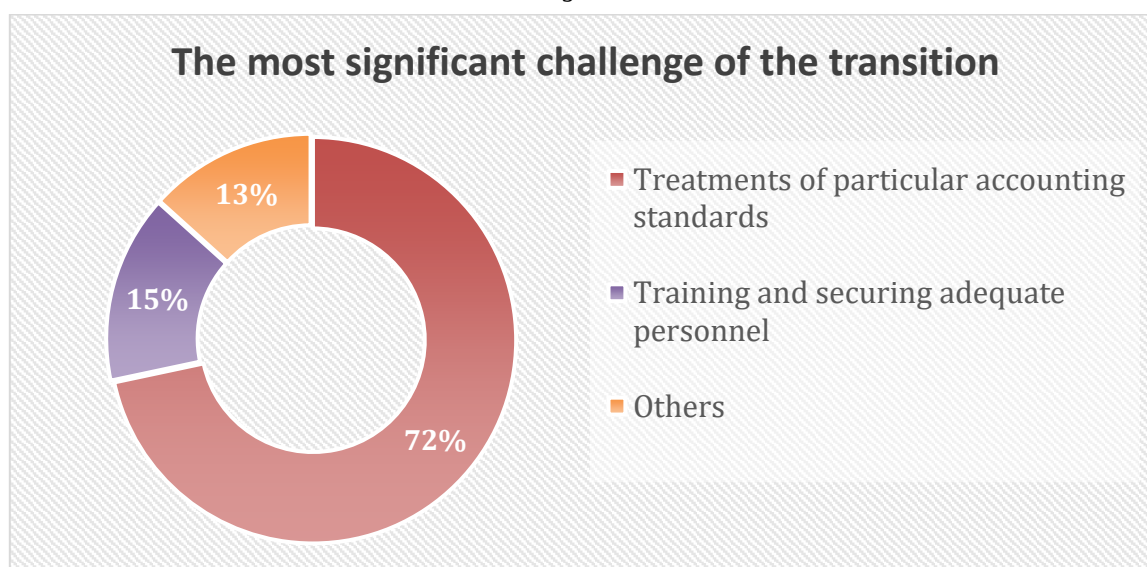
Firstly, they concluded that, there is a connection between the extent of inherent costs and a company's size. Companies with only a single line of business or few subsidiaries were able to adopt IFRS with much lower costs. Furthermore, it also indicates a relation between a company's policy for IT system development. The adoption of IFRS could trigger a total upgrade of the company's IT systems depending on the aim of the company, which also means longer transition process. (Financial Services Agency, 2015)

Regarding the transition process, the companies had a common opinion. The process demands a company-wide involvement of all business units. It is generally divided to three steps. The first one includes action plans and impact studies by a small group of the accounting department. The second stage starts involving various business units to develop the accounting policies, modify IT systems and prepare a draft group accounting policy manual. In the third stage, the IFRS based financial statements are prepared. (Financial Services Agency, 2015)

The research also states, that there were almost no cost other, than the ones forecasted before transition. The results indicated, that some aspects, where the companies expected problems were much less troublesome, for example the reclassification from Japanese GAAP to IFRS. (Financial Services Agency, 2015)

Secondly, FSA states (2015), that companies must expand the number of experts in IFRS. This point is directly related to a question about the most significant challenges is the transition (see Figure 5).

Figure 5



Note: Adapted from the FSA report (2015)

A huge number of adopting companies responded that, the 'treatment of particular accounting standards' is one of the greatest challenges in the adoption. Some items listed as

part of this answer included the depreciation method and estimates of an asset's useful life, revenue recognition, capitalization of development costs, impairment of assets and fair value measurement of financial instruments. The report concluded, that companies lack the necessary expertise in IFRS for their changing accounting treatments and particularly, in case of high degree estimates. They also have more problems with securing personnel with the fundamental knowledge in IFRS. (Financial Services Agency, 2015)

A different study researched what items are considered as the major difficulties in the accounting transition. The research showed, that companies generally found similar topics difficult as the result of FSA has shown. For example, the IT system configuration, technical knowledge, and staff training. On the top of the list were the uncertainty concerning the interpretation of the new accounting standards. In regards to specific accounting topics, the revenue recognition were considered highly difficult, and such as the financial statement presentation, retrospective application or impairment were also in the top few results. However, these results varied based on the companies' size or interests. Larger companies and those listed in overseas market found it less difficult to cope with the differences between J-GAAP and IFRS. (Gray, Nagata, Nakamura, & Ozu, 2017)

4. Risks in the transition, a comparison between IFRS and J-GAAP

Japanese GAAP and IFRS have been found equivalent by the European Union and Japanese authorities long before the actual implementation of the new accounting standards option. But equivalence doesn't mean these two frameworks are identical. There are many differences between J-GAAP and IFRS. Minor ones, that doesn't make much difference in the financial statements, as well as major and problematic differences, that can change the decisions of potential investors.

In 2004, the FSA created a pamphlet about J-GAAP written in English. Its aim was to reach out to overseas investors and any other interested parties. The document also includes a small comparison about the overall accounting treatments of J-GAAP, IFRS and US GAAP. The published comparison of Japanese GAAP and IFRS is comprised in Table 2. (Financial Services Agency, 2004) You can see the highlighted items, which were not considered consistent. It is important note that, some items of this comparison table are already outdated, but even now, most major issues with the transition process are related to the items indicated here and they can cause considerable variations in the financial statements of a company.

Table 2: International Comparison of Accounting Standards-Overview of Major Japanese GAAP, IAS/IFRS

Accounting Standards	Items	Japanese GAAP	IAS/IFRS
Financial Instruments	<i>Measurement of securities</i>	Fair value or amortised cost (bonds) depending on category	Fair value or amortised cost (bonds) depending on category
	<i>Estimating potential credit losses/impairment</i>	Discounted future cash flows	Discounted future cash flows
	<i>Derecognition of financial assets</i>	Legal isolation required (Financial-components approach)	Legal isolation not required (Primarily risks and rewards approach)
	<i>Measurement of derivatives</i>	Fair value	Fair value
	<i>Hedge accounting</i>	When hedging criteria are met	When hedging criteria are met
Business Combinations	<i>Basic method</i>	Purchase method	Purchase method
	<i>Pooling of interests method</i>	Exceptionally used only when strict criteria are met	Purchase method only
	<i>Goodwill</i>	Strictly amortised with impairment	Not amortised, impairment only
Impairment of Assets	<i>Grouping</i>	Lowest level (smallest identifiable group of assets) for which cash flows are largely independent of cash flows of other assets	Lowest level (smallest identifiable group of assets) for which cash flows are largely independent of cash flows of other assets
	<i>Indication of impairment</i>	Assessed	Assessed
	<i>Recognition test</i>	Undiscounted future cash flows	Recoverable amount (Higher of net selling price and value in use)
	<i>Measurement</i>	Recoverable amount (Higher of net selling price and value in use)	Recoverable amount (Higher of net selling price and value in use)

	<i>Reversal of impairment loss</i>	Prohibited	Reversed (excluding goodwill)
Retirement Benefits	<i>Recognition of liability</i>	Retirement benefit obligation adjusted for unrecognised actuarial gains/losses and past service cost, minus plan assets	Retirement benefit obligation adjusted for unrecognised actuarial gains/losses and past service cost, minus plan assets
	<i>Actuarial gains/losses</i>	Strictly amortised without corridor	Corridor amortisation
	<i>Recognition additional minimum liability</i>	Not recognised	Not recognised
Income Taxes	<i>Basic method</i>	Asset liability method	Asset liability method
	<i>Recording of deferred tax assets</i>	Based on recoverability/realizability	Based on recoverability/realizability
Research & Development	<i>Development costs</i>	Expensed when incurred	Capitalised
Consolidated Financial Statements	<i>Scope of subsidiaries</i>	Based on control	Based on control
	<i>Presentation of minority interests</i>	Between liability and equity	Equity
Investment Property	<i>Measurement</i>	Cost	Fair value or cost

Note. Adapted from the FSA pamphlet (2004)

In this section, my goal was to highlight some differences between the two frameworks, deliberate the effect of the transition and determine the major risks involved. In the settings of this study, it is simply impossible to study all of the differences, so I focused only on a few topics here. I organized the differences in sections depending on what part of the accounting standards are affected, based on my judgement and in some cases with the help of Table 2.

I also raised practical examples from a transitioning company, the Olympus Corporation (2018) for further explanation of these effects. The company has adopted IFRS starting from the fiscal year ended on the 31st of March, 2018. Its transition date is the 1st of April, 2016. The Reconciliation prepared for the transition between IFRS and Japanese GAAP, that I used for the examples is from the fiscal year ended on the 31st of March, 2017. The balances included in the practical examples are presented in Millions of Japanese yen.

4.1. IFRS 1: First-time adoption of IFRS

Although IFRS 1 is not a comparison of the two accounting frameworks, it is important to mention in case of a newly adopting company. This standard lays out the procedures for companies to follow, when they are adopting IFRS. It serves as a guide for an effective and efficient transition.

The statement clarifies which companies can be first-time adopters. It states what are the required conditions and disqualifying factors. (Deloitte, n.d.)

At the date of transition, the entity must provide an opening IFRS statement of financial position. It is crucial to indicate the beginning of subsequent accounting under IFRS. The transition date must be the first day of the company's financial year, at which the full period is presented under IFRS. (Croner-i Navigate, n.d.)

In the opening statement, the entity must put down some fundamental information and changes:

- Must recognize all assets and liabilities, that IFRS requires.
- Must exclude any items from the assets and liabilities, if it is not permitted by IFRS
- Reclassify any items, including assets, liabilities and equity, that belongs to a different type or category under IFRS
- All items must be measured according to IFRS.

IFRS 1 also includes exemptions from some requirements of IFRS. An entity is able to choose one or more of these exemptions. (Croner-i Navigate, n.d.)

A first-time adopter entity needs several additional disclosures in their financial statements. IFRS 1 requires entities to analyze and demonstrate the changes, that occurred in their financial statements and records due to the transition. These disclosures involve the followings (Deloitte, n.d.):

- Reconciliation of equity from formerly used J-GAAP to IFRS in two versions: one at the date of the transition, and one at the last day of the period, where the reporting was done under J-GAAP.
- Reconciliation of total comprehensive income to IFRS for the last fiscal year, where J-GAAP was used.

- Explanation for any material adjustments made to the entity's financial statements in regard to the adoption of IFRS.
- Any errors detected in the previously used J-GAAP during the transition process needs to be disclosed separately.
- Any impairment losses recognised or reversed in the preparation of IFRS must be disclosed.
- If any exemptions permitted under IFRS 1 are used in the transition process, an explanation is required for the items.

For the practical examples shown in the following sections, I used the reconciliations of some Japanese companies to show the effect of the discussed issue.

4.2. Financial assets – Classification, measurement and derecognition

IFRS 9 Financial Instruments is the standard which contains the regulations for recognition, derecognition, measurement, impairment and hedge accounting. (Deloitte, n.d.) This standard includes several differences compared to Japanese GAAP, one of which is the conditions for derecognition of financial assets highlighted in Table 2.

4.2.1. Derecognition

The derecognition criteria under IFRS and J-GAAP is fundamentally different. While under IFRS, it is necessary to evaluate whether all the risks and rewards of ownership are transferred substantially. If the ownership is not transferred nor retained substantially to the new owner, but they have the practical ability to sell the asset, the derecognition is acceptable. Otherwise, if the transferee does not have the practical ability to sell the asset, the entity must continue to recognise the asset to the extent of their involvement in their financial statements. (PwC Japan Group, 2020)

In comparison, J-GAAP requires the total, including legal control over the asset to be relinquished, in accordance with the Financial component approach. Japanese GAAP prescribes the following three conditions in relation to the derecognition. The derecognition is allowed only if all three criteria is met (PwC Japan Group, 2020):

- The contractual rights of the financial asset are legally transferred from the entity to the transferee.
- The transferee is able to savor all contractual rights over the asset in an ordinary manner.
- The entity does not have the right or obligation to repurchase the asset before its maturity date.

4.2.2. Classification and measurement

In terms of classification, under J-GAAP, financial assets are classified based on their legal form. For example, securities, receivables, derivatives etc. In case of securities, further classifications are required, such as securities held for trading, bonds held to maturity based on their holding purposes. In comparison, IFRS 9 requires classification based on the financial instruments' measurement. Debt instruments are classified to one of three possible categories:

- Amortised cost
- Fair value through other comprehensive income (FVOCI)

- Fair value through profit or loss (FVPL)

As for equity instruments, measurement at fair value through profit or loss (FVPL) is general, but it is also possible to elect measurement through other comprehensive income (FVOCI). In this case, the choice is irrevocable, IFRS 9 prohibits subsequent reclassification of the measurement. Subsequently, the different accounting method will bring forth additional differences after initial recognition. (PwC Japan Group, 2020)

In Table 3 below, you can see an example for the different classification of a financial instrument under IFRS. The item is categorized as available-for-sale security under Japanese GAAP. IFRS presentation for financial assets allows the measurement through other comprehensive income. This greatly affects the Total other comprehensive income in the entity's statements even though it also includes a few other, smaller variances. As a result, the treatment of this asset affects the Comprehensive income of the company. For the complete reconciliation please see Appendix B.

Table 3: Difference in the classification and measurement of a financial instrument

Presentation under J-GAAP	<i>Effect of the transition</i>	Presentation under IFRS
Net unrealized holding gains (losses) on available-for-sale securities, net of taxes	<i>Recognition and measurement difference</i>	Financial assets measured at fair value through other comprehensive income
(15,391)	16,526	1,135
Total other comprehensive income		Total other comprehensive income
(26,221)	18,454	(7,767)

Note. The above data is disclosed by the Olympus Corporation. The complete version is included in Appendix B. Adapted from the reconciliation of the Olympus Corporation (Consolidated Financial Results for the Fiscal Year Ended March 31, 2018 <under IFRS>, 2018)

4.3. Non-financial assets

The accounting for non-financial assets is not primarily different for IFRS and Japanese GAAP, but the detailed application of the two system's requirement includes potentially significant variances for a transitioning entity.

4.3.1. Intangibles and Goodwill

The recording and measurement of intangible assets can cause differences in the financial statements of the entity, because under Japanese GAAP there is no comprehensive guidance on these assets. While IFRS includes a definition of intangible assets and criteria for its recognition, J-GAAP has no general definition of intangible assets in it, only examples of goodwill, patents, rights etc. are listed in it.

Table 4: Variances in relation to the measurement of intangible assets

Presentation under J-GAAP	Effect of the transition	Presentation under IFRS
Goodwill	<i>Recognition and measurement difference</i>	Goodwill
86,664	8,904	95,568
Intangible assets (Others)	<i>Reclassification, recognition and measurement difference</i>	Intangible assets
44,426	31,432	75,858

Note. The above data is disclosed by the Olympus Corporation. The complete version is included in Appendix B. Adapted from the reconciliation of the Olympus Corporation (Consolidated Financial Results for the Fiscal Year Ended March 31, 2018 <under IFRS>, 2018)

In Table 4 above, you can see two cases, where the recognition of intangible assets causes a variance after the transition. In the first row, Goodwill is treated differently in the two accounting frameworks. J-GAAP requires the amortisation of goodwill over its useful life up to 20 years on a straight-line method, while it is not amortised under IFRS 3 Business Combinations. (PwC Japan Group, 2020) In this case, the amortisation of goodwill was discontinued on the date of transition (Olympus Corporation, 2018), which causes the increase in its value. From this point onward, an impairment test is to be performed in each period.

The topic of goodwill is a major concern of the Japanese authorities and companies. It is a critical factor for companies in the decision to adopt IFRS, which is supported by a recent research as well. According to it, companies with larger goodwill tend to adopt IFRS. (Giner, Merello, Nakamura, & Pardo, 2019) The amortisation of goodwill is also included as a modification in the relatively newly introduced IFRS based accounting framework applicable

in Japan, the JMIS. The ASBJ even conducted a research in relation to the amortisation of goodwill. Its aim was to initiate a global discussion on the topic and promote the view they stand for. (Deloitte, 2015)

As for the Intangible assets in Table 4, the variance is mainly caused by the treatment of development expenses. Under Japanese GAAP, all internally generated research and development costs are generally expensed. IFRS however, allows expenditure generated during the development process to be capitalized after the recognition criteria for the intangible asset is met. (PwC Japan Group, 2020) The above mentioned research also determined a positive correlation to the adopting companies and the size of a their R&D activities. (Giner, Merello, Nakamura, & Pardo, 2019) Furthermore, the capitalisation of development expenses also affects the Comprehensive income of the entity.

4.3.2. Impairment of assets

IFRS and Japanese GAAP are largely similar in the handling of impairment of fixed assets. The assets are grouped based on their generated cash flows and impairment testing is required only in case there is an indication, that an identifiable group or asset is impaired. However, there are some differences beginning at the testing phase.

Based on the impairment test under IAS 36, the 1 step method is used, which means, that the impairment loss is recognised when the asset's recoverable amount is below the carrying amount. In comparison, J-GAAP uses the 2-step method, which includes one more requirement before the impairment loss can be recognised. The undiscounted total future cash flow is below the carrying amount, then the recoverable amount is below the carrying amount, which step is the same as indicated in IFRS. (PwC Japan Group, 2020)

There are differences in the two accounting frameworks, in the recognition of the impairment loss. Both IFRS and J-GAAP recognises the impairment loss in profit and loss. But IAS 36 also specifies, that in this case the loss of asset is measured by the cost model, while Japanese GAAP uses the Recoverable amount, as indicated in Table 2. However, if under IAS 36, the impairment loss for the asset is measured by the revaluation model, the revaluation surplus should be reduced first, and the residual amount can be recognised in profit or loss.

The reversal of impairment loss is also treated differently. Japanese GAAP simply prohibits the impairment loss reversal for all assets. In contrast with J-GAAP, IAS 36 permits the reversal. If there is indication, that the previously recognised impairment loss possibly decreases or no longer exist, the entity should assess the recoverable amount. The reversal of

impairment loss in case of goodwill is prohibited in IAS 36, as it is under J-GAAP. (PwC Japan Group, 2020)

4.3.3. Investment property

The measurement of investment property is a significant matter for entities adopting IFRS. The entity is able to choose, how to measure its investment property under IFRS. Based on its choice, the effect of the transition differs.

Under Japanese GAAP, for the subsequent measurement of investment and rental property is only allowed with the cost model, cost less accumulated depreciation. Also, information on the property's fair value needs to be disclosed.

However, under IAS 40, not only the cost model is applicable. The entity can elect to use the fair value model as well. It is also required to disclose its choice in its accounting policy, and apply the same policy for all of its investment properties, with exceptions for certain cases. (PwC Japan Group, 2020)

4.4. Revenue recognition

The IASB issued the standard for revenue recognition, IFRS 15 in 2014. IFRS 15 Revenue from Contracts with Customers aims to achieve a consistent application for revenue recognition with a contract-based, well-regulated, individual model. (PwC Japan Group, 2020)

The core principle of IFRS 15: “An entity recognises revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” (IFRS Foundation, 2021)

The revenue recognition process consists of the following 5 steps (Croner-1 Navigate, n.d.):

Step 1. Identify the contracts with a costumer: A contract is an agreement between entities, that creates rights and obligations enforceable by the law. (Deloitte, n.d.)

Step 2. Identify all the performance obligations in the contracts: A performance obligation is an agreement, a promise between the parties, that the seller will transfer to the customer the distinct goods, services (or the series of them) in the manner included in the contract. (Deloitte, n.d.) A good or service is distinct only when the buyer can enjoy its benefits on its own or together with readily available resources, and the good or service can be identified separately from other goods or services agreed upon in the contract. (Croner-1 Navigate, n.d.)

Step 3. Determine the transaction price: The transaction price in the contract is the amount, which the seller expects to be entitled, subsequent to the transfer of promised goods and services to the customer, excluding any amount collected from third parties. (Deloitte, n.d.) The costumer consideration may be a fixed or variable amount, and also can be in a form other than cash. In case, the consideration is variable, the parties estimate a price to be included in the contract which is highly probable. (Croner-1 Navigate, n.d.)

Step 4. Allocate the transaction price for each and every performance obligation promised in the contract: The allocation is typically done based on the basis of the stand-alone selling prices available for the distinct goods or services. If it is not observable, an estimation is necessary for the specific good or service. It is also possible to apply a discount or variable amount of consideration for one or

more performance obligations promised, but not to all of them. (Croner-1 Navigate, n.d.)

Step 5. The revenue is recognised when/as the entity satisfies a performance obligation: The performance obligation is satisfied, when the entity delivers the promised goods or services, and the customer takes control of them. It can be satisfied at a point of time, usually for the transfer of goods, or over time, for promised services. If a performance obligation is satisfied over time, the entity needs to select an appropriate measurement method for the progress of the promise. (Croner-1 Navigate, n.d.)

On the other hand, Japanese GAAP recognises revenue upon the sale of goods or rendering of services based on the realisation principle and revenue is also recognised on a realisation basis. However, there is no general comprehensive guidance for revenue recognition, nor for any specific issue considered in IFRS 15, which can cause significant differences in the treatment and accounting of revenue. The issues, where there is no specific guidance under J-GAAP involve such as the collectability of revenue, identifying performance obligations, contract modification, differentiation between principal/agent considerations, the timing of revenue recognition, accounting guidance for various possible considerations etc. Each of these topics are strictly regulated under IFRS. (PwC Japan Group, 2020)

As a solution for the recently appeared problem, the ASBJ issued a new revenue standard under Japanese GAAP in 2018. The standard, Accounting Standard for Revenue Recognition is largely based on IFRS 15. It took on the core principle of IFRS 15 and the five step model for the application of the principle. But this does not mean, that the two standards have become identical. Although the ASBJ have incorporated all IFRS 15 into the standard, they also considering additional, alternative ways for the treatment of revenue. Their aim was to make an easier application of revenue recognition for entities reporting under J-GAAP and increase their international comparability. (Deloitte, 2018) The standard is effective for annual reporting from the period starting on or after 1st of April, 2021. The ASBJ also published proposed amendments for this standard in October 2019, called the “Exposure Draft: Proposed amendments to Accounting Standard for Revenue Recognition, etc.” and issued the amendments in March 2020. (PwC Japan Group, 2020) The effect and result of the introduced standard and its amendments are yet to be seen.

5. Conclusion

In this study, my objective was to create a critical assessment, that can help Japanese companies in their decision-making in relation to the adoption of IFRS. The issue of adopting IFRS have been a major concern for companies aiming for or connected to international markets. The application of IFRS benefits the transparency of financial statements, makes the comparability easier between competitors. It also can invite possible overseas investors and raise interest in the company internationally.

My thought process was the following:

I introduced the current accounting system, the historical approach on IFRS and the current status of the adoption, which conveyed the significance and presence of the problem regarding IFRS adoption. It also shows, that the issue is still an ongoing matter and requires further attention for the sake of companies, that are still considering the conversion to IFRS.

In the next section of my study, I introduced and compared the results of some researches and questionnaires around the topic of IFRS adoption. The studies included were not only from external researchers and interested personnel, but also from relevant accounting authorities in Japan.

My aim in this section was to display the thoughts and concerns of companies about the adoption, thus help the companies that are still considering. I concentrated on two major topics in the studies, the expected benefits, and the inherent cost.

In case of the benefits and expectations of companies, I found, that most of the companies, that adopted IFRS were aiming for similar gains. The most important prospect of companies is to increase the comparability of financial statements internationally, thus improve the connection to overseas markets. The aspect of improving the entity's business management and transparency of financial statements is also important and connected to the future development of a company. Last, but not least, the companies were also aiming for overseas investors by using a common accounting language and increasing their capital by coming closer to international markets.

The inherent cost of IFRS adoption were also based around some major topics. One of which is the concerns relating to the transition of the entity's financial statements to IFRS, the necessary understanding, application difficulties and the shortage in expertise to help the company through the process efficiently. However, there were results, when the companies

stated, that the expected difficulties about the transition were not so troublesome in reality. There were also concerns relating to the internal IT processes and staff trainings, which could involve significant costs to the entity. All in all, the results indicated, that the cost revolving around the adoption of IFRS were not exceeding any forecasted expenses and overall, the companies benefited from it.

However, it is important to notice, that many of these results were largely dependent on the size and sales of the company. Larger companies, companies with more overseas subsidiaries or more international sales were giving different answers based on their aims and had varying concerns about the adoption of IFRS. Each entity, debating the adoption of IFRS needs to consider these elements as well, before making their decision

In the last section, I focused on the differences between IFRS and Japanese GAAP, which is the general choice for Japanese companies. Based on my findings on this topic, I concluded, that although the equivalence of IFRS and Japanese GAAP was determined over a decade ago, there are several major differences between the treatment of specific topics between the two accounting framework and most of these are still existing problems.

I used comparisons and reports from some Big 4 companies to make the comparison between Japanese GAAP and IFRS, however the extent of all differences is too high to be included in this study. Instead, I highlighted a few issues based on the equivalence report, as well as new significant matters, which included the First-time adoption of IFRS, the classification and measurement method of financial assets and their derecognition and included practical examples of a company's reconciliation of financial data on the topic. I also specified some differences in relation to non-financial assets.

Lastly, I highlighted the matter of revenue recognition, which has been a major concern for companies, however due to recent developments, this topic remains a continuing problem. After the issue of IFRS 15, the relevant Japanese authorities also found it necessary to comply to the new statement, however not entirely. As the newest adjustments to Japanese GAAP in relation to revenue recognition are applicable from the period starting on the 1st of April 2021, the effects of this are yet to be seen.

As a future research direction, the assessment of JMIS appealing. The accounting standards introduced in 2015 are an IFRS based framework, with a few modified standards, that remained similar to the J-GAAP standard. The opinions on its effectiveness in terms of the comparability of financial statements are varying. I would be an interesting topic to explore in the future.

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Appendix A. The IFRS adoption rate by industrial sectors

<i>Industrial Sectors</i>	<i>Adopting companies</i>	<i>Ratio of adopting companies</i>	<i>Highest ranked adopting company</i>	<i>Market capitalization ratio of adopting companies</i>
<i>Pharmaceutical</i>	18	27%	1.	87%
<i>Rubber Products</i>	5	26%	1.	86%
<i>Transportation Equipment</i>	19	20%	1.	79%
<i>Precision Instruments</i>	7	13%	1.	74%
<i>Information & Communication</i>	30	6%	1.	67%
<i>Iron and Steel</i>	3	7%	1.	59%
<i>Oil & Coal Products</i>	1	9%	1.	55%
<i>Wholesale Trade</i>	12	4%	1.	54%
<i>Foods</i>	13	11%	1.	53%
<i>Air Transportation</i>	1	20%	2.	44%
<i>Chemicals</i>	15	7%	2.	36%
<i>Services</i>	29	6%	1.	36%
<i>Electric appliances</i>	26	11%	3.	36%
<i>Textiles & Apparels</i>	2	4%	1.	31%
<i>Nonferrous Metals</i>	2	6%	2.	29%
<i>Other Financing Business</i>	6	18%	2.	28%
<i>Machinery</i>	14	6%	4.	26%
<i>Glass & Ceramics Products</i>	3	5%	2.	23%
<i>Retail Trade</i>	12	3%	1.	23%
<i>Metal Products</i>	4	4%	2.	14%
<i>Securities & Commodity Futures</i>	2	5%	3.	15%
<i>Other Products</i>	3	3%	3.	8%
<i>Real Estate</i>	3	2%	5.	5%
<i>Land Transportation</i>	2	3%	9.	1%
<i>Electric Power & Gas</i>	1	4%	18.	1%
<i>Insurance</i>	1	7%	10.	0.4%
<i>Mining</i>	0	0%	—	—
<i>Fishery, Agriculture & Forestry</i>	0	0%	—	—
<i>Marine Transportation</i>	0	0%	—	—
<i>Pulp & Paper</i>	0	0%	—	—
<i>Warehousing & Harbour Transportation Services</i>	0	0%	—	—
<i>Banks</i>	0	0%	—	—
<i>Construction</i>	0	0%	—	—

Note: The "Adopting companies" includes companies, that already adopted, decided, or planning to adopt IFRS.

Adapted from the analysis of Tokyo Stock Exchange Inc. (2020)

Appendix B. Olympus Corporation – First-time adoption Reconciliation

The following screenshots are from the Olympus Corporation's Financial Results
(Consolidated Financial Results for the Fiscal Year Ended March 31, 2018 <under IFRS>)
Reconciliation of profit or loss and comprehensive income for the Fiscal year ended March 31, 2017

(Millions of yen)

Presentation under Japanese GAAP	Japanese GAAP	Reclassification	Differences in recognition and measurement	IFRS	Note	Presentation under IFRS
Net sales	748,050	(3,148)	(4,345)	740,557	A	Revenue
Costs of sales	256,708	2,468	2,895	262,071	A, B, D, F	Cost of sales
Gross profit	491,342	(5,616)	(7,240)	478,486		Gross profit
Selling, general and administrative expenses	414,855	(5,616)	(11,542)	397,697	B, C, D, F	Selling, general and administrative expenses
		(1,253)	–	(1,253)		Share of profit (loss) of investments accounted for using equity method
		29,508	(23,858)	5,650	G	Other income
		14,323	(329)	13,994		Other expenses
Operating income	76,487	13,932	(19,227)	71,192		Operating profit
Non-operating income	3,998	(3,998)	–			
Non-operating expenses	18,336	(18,336)	–			
Extraordinary income	27,757	(27,757)	–			
Extraordinary losses	8,220	(8,220)	–			
		2,247	(81)	2,166		Finance income
		10,980	(103)	10,877		Finance costs
Income before provision for income taxes	81,686	–	(19,205)	62,481		Profit before tax
Total	3,471	–	16,200	19,671	E	Income taxes
Net income	78,215	–	(35,405)	42,810		Profit
Net income attributable to owners of the parent	78,191	–	(35,408)	42,783		Profit attributable to: Owners of parent
Net income attributable to non-controlling interests	24	–	3	27		Non-controlling interests
Net income	78,215	–	(35,405)	42,810		Profit
Other comprehensive income						Other comprehensive income
Net unrealized holding gains (losses) on available-for-sale securities, net of taxes	(15,391)	–	16,526	1,135	G	Items that will not be reclassified to profit or loss Financial assets measured at fair value through other comprehensive income
Remeasurements of defined benefit plans, net of taxes	1,169	–	1,550	2,719	F	Remeasurements of defined benefit plans Items that may be reclassified to profit or loss
Foreign currency translation adjustments	(12,020)	–	(762)	(12,782)		Exchange differences on translation of foreign operations
Net unrealized gains (losses) on hedging derivatives, net of taxes	7	–	1,140	1,147		Cash flow hedges
Share of other comprehensive income of associates accounted for using equity method	14	–	–	14		Share of other comprehensive income of associates accounted for using equity method
Total other comprehensive income	(26,221)	–	18,454	(7,767)		Total other comprehensive income
Comprehensive income	51,994	–	(16,951)	35,043		Comprehensive income
Comprehensive income attributable to owners of the parent	51,981	–	(16,955)	35,026		Comprehensive income attributable to: Owners of parent
Comprehensive income attributable to non-controlling interests	13	–	4	17		Non-controlling interests

Reconciliation of assets as of March 31, 2017

(Millions of yen)

Presentation under Japanese GAAP	Japanese GAAP	Reclassification	Differences in recognition and measurement	IFRS	Note	Presentation under IFRS
Assets						Assets
Current assets						Current assets
Cash and time deposits	199,431	–	34	199,465		Cash and cash equivalents
Notes and accounts receivable	137,924	34,889	(15,344)	157,469	A	Trade and other receivables
Lease receivables and lease investment assets	35,338	(35,338)	–			
		1,158	460	1,618		Other financial assets
Merchandise and finished goods	51,257	72,807	1,255	125,319		Inventories
Work in process	21,830	(21,830)	–			
Raw materials and supplies	50,977	(50,977)	–			
Deferred income taxes	36,729	(36,729)	–			
Other current assets	25,226	(25,226)	–			
Allowance for doubtful accounts	(5,720)	5,720	–			
		5,831	(685)	5,146		Income taxes receivable
		12,965	(63)	12,902		Other current assets
Sub-total	552,992	(36,730)	(14,343)	501,919		Subtotal
	–	3,828	–	3,828		Non-current assets held for sale
Total current assets	552,992	(32,902)	(14,343)	505,747		Total current assets
Fixed assets						Non-current assets
Property, plant and equipment	171,352	(4,427)	(7,190)	159,735	A, B	Property, plant and equipment
Goodwill	86,664	–	8,904	95,568	C	Goodwill
Intangible assets (Others)	44,426	1,693	29,739	75,858	D	Intangible assets
Investments and other assets						
Investment securities	28,946	(28,946)	–			
Net defined benefit asset	24,762	–	(218)	24,544		Retirement benefit asset
Other assets	66,994	(66,994)	–			
Allowance for doubtful accounts	(10,016)	10,016	–			
		51	–	51		Investments accounted for using equity method
		46,150	(27,847)	18,303	A	Trade and other receivables
		37,599	296	37,895		Other financial assets
Deferred income taxes	24,942	36,729	(20,234)	41,437	E	Deferred tax assets
		1,031	(137)	894		Other non-current assets
Total fixed assets	438,070	32,902	(16,687)	454,285		Total non-current assets
Total assets	991,062	–	(31,030)	960,032		Total assets