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International accounting standards

Future adoption of IFRSs in Japan and the Japanese accounting system

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Abstract

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Title: International accounting standards: Future adoption of IFRSs in Japan and the Japanese accounting standards

Background and problem: With the globalization of financial and capital markets, the internationalization of accounting standards has inevitably become a trend. Over time Japanese accounting standards have been harmonized and converged towards IFRSs. The remaining question at the moment is whether Japan should adopt IFRSs or not.

Aim: To depict and analyze the developments in Japanese accounting standards in order to evaluate the potential direction of Japanese accounting standards in near future and assess any changes among Japanese business environment in a practical context in relation to IFRSs.

Limitation: The scope of this thesis is to perceive the developments in Japanese accounting standards in a more general context such as accounting traditions and historical causes etc, without any further comparison between the Japanese GAAP and IFRSs in details.

Methodology: Two interviews with Japanese professors have been performed. The empirical material has been analyzed on the basis of the theoretical framework regarding the background and development of Japanese accounting standards in relation to the internationalization of accounting standards.

Result and conclusion: The adoption of IFRSs is assessed to be finalized in Japan in very near future, based on the analysis of the postmodern history of Japanese accounting and the accounting situation in Japan. Concerning potential effects of IFRSs in relation to a series of factors such as Japanese market infrastructure and business environment, Japan is suggested to carefully choose a proper adoption approach while implementing IFRSs.

Recommendation for further research: A similar study would be conducted about few years from now in order to obtain a more accurate and deep insight into the impact of IFRSs on both Japanese accounting standards and companies. Another study group such as accounting companies could contribute a new perception on the issue from different perspective.

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1. Introduction

In this chapter, a background regarding the emergence of the international accounting standards and to which extent this incurrence can affect the Japanese accounting system is introduced. Subsequently derived from the background, a problem statement and an aim of this thesis will be presented. In the end, there is a presentation of the disposition of the thesis.

1.1 Background description

Due to increasing integration of international markets, companies around the world are in need of accomplishing their business in a manner to coincide with the international corporate activities (PWC, 2008), which results in multinational stakeholders and investors than only domestic ones. In other words, the stakeholders and investors are no longer limited in their selection of companies and investment opportunities to search for the best portfolio. (Tafara, 2008) Accordingly a higher level of comparability and quality of financial statements is required because of an increased international audience and their unfamiliarity with different national domestic accounting standards that the financial statements are produced under. (Choi, 2005) If the investors and stakeholders are not able to obtain an adequate and transparent view on the selected companies, extra costs in form of lost potential capital or investment opportunities will occur as a result of lack of confidence in the companies. (PWC, 2008)

The above statements are only a few of these potential problems caused by the diversity of accounting standards posed to users of financial information. In 1973, Japan, USA and seven other countries established the International Accounting Standards Committee (IASC), which was later replaced by the International Accounting Standards Board (IASB) in 2001. The primary goal of IASB is to develop and promote "*a single, high quality language for financial reporting that is accepted throughout the world's capital markets*". (IASC, 2007) The single and high quality language as stated by the International Financial Reporting Standards (IFRSs), contains standards, interpretations and frameworks. Many of these standards are known by the former name of International Accounting Standards (IAS). (IASB, 2009) One of the significant changes in accounting standards with IFRSs is that assets in a larger extent will be valuated at fair value instead of acquisition value. Another example is increased demand of supplementary information since IFRSs put more emphasis on assumptions than just reports. The modifications are aimed to enhance transparency in financial disclosures. (SOU 2003:71)

Even though the ultimate goal of IASB is to create one single international standard, at the current stage the expressions of international accounting "harmonization" and "convergence" of IFRSs standards are more appropriate. Accounting harmonization is referred to a process that institutes accounting regulations at an international level to reduce contradictory accounting practices and principles between different national accounting standards used in financial disclosures. Meanwhile international convergence is related to a process where both domestic General accepted accounting principles (GAAP) and IFRSs moving toward a mutual goal with minor difference between them to further adopt IFRSs fully in near future. They are both aimed to strive for increased comparability between companies across borders and improved accountability. Additionally, adopting IFRSs would increase involvement of all the stakeholders to engage in advocating accounting standards. (Chand and Patel, 2008)

Until 2008 there are more than 100 countries adopting or in planning phase of adopting IFRSs in the world such as Australian, Hong Kong, European countries and U.S.A. etc. Canada and Indian among others have announced their intention to convert to IFRSs in 2011. (Nippon Keidanren, 2007)

Among the countries adopting IFRSs to their accounting standards, there are different approaches used for the adoption, in forms of full adoption immediately, full adoption with time lags, selective adoption and national standards developed on basis of IFRSs. Moreover, the approaches may differ because of the variation of the way to enforce accounting standards between countries. (Chand and Patel, 2008) Some examples are that EU and Australia have adopted IFRSs with amendments from 2005 (IAS Plus, 2005; 2009); Singapore selectively adopted the international standards from 2002; Papua New Guinea has performed full adoption of IFRSs since 2000. (Chand and Patel, 2008)

The differences among the above approaches concern "*national and international accounting standard-setters, regulators, auditors and financial statement users*". Despite of the advantages of IFRSs, the view of uniform international standards is criticized by some researchers considering the practicability, since it has been shown that the remaining differences of important accounting standards between countries are still very large, as are the differences between international corporate financial reporting. (Chand and Patel, 2008)

In line with Chand and Patel (2008), there are arguments against the fundamental conception of harmonized accounting standards, which states that the conception should not be assumed as an assurance of "*harmonized accounting practices and comparable financial reports*". One of the difficulties of the harmonization and the convergence of accounting standards lie in the huge differences between national accounting standards in different countries. (Nobes and Parker, 2006) A reason behind the differences appears to be the unique historical developments in accounting system in respective country epitomized with the continental- or the Anglo-Saxon tradition. The continental tradition is outlined with a firm connection between accounting and laws, while the Anglo-Saxon tradition emphasizes a spirit of "true and fair" in accounting standards. (Smith, 2006) Other reasons can be in relation to one country's culture, connection between accounting and tax regulation, accounting professions and the economic and politic environment. (Nobes and Parker, 2006) However there is presumptions that indicate inappropriate objectives behind some countries' action of adopting IFRSs in aim to for example gain " *instant respectability or to serve as "politically correct substitute" for their own accounting standards* " without giving a direction of reporting incentives and applying proper manners for complying with the international standards. (Chand and Patel, 2008)

Realizing the complications of – and willing to achieve the adoption of IFRSs, there have been many international organizations and institutions behind IASB's development of international accounting standards. (Thorell, 2004) Some of them are the IOSCO, assisting the IASB to achieve widespread adoption of IFRSs, and the IFAC, focusing on issues associated with the practice of auditing and accounting education at an international level. (IAS Plus, 2009)

However an intriguing question remaining at the moment is whether IFRSs as a matter of fact can capture the underlying economics of a company in a way that can be useful for both the company and its users. Otherwise applying the international standards would be meaningless if the users cannot reach relevant investment decisions based on the information presented in the financial statements. (Kim, 2007)

1.2 Problem description and analysis

In 2009, all non-European companies listed in Europe will be required by the European Commission (EC) to practice consolidated financial statements based on IFRSs or other standards equivalent to IFRSs. The Japanese GAAP was regarded as inferior to IFRSs and was under pressure to meet "equivalence assessment" posed by EC (IASplus, 2009; Saitou, 2007). This gave the final push on Japan to consider convergence.

Despite of the increased interest in IFRSs because of the urgent adoption, there are still very few Japanese companies using IFRSs while disclosing their financial statements. This has been seen as a problem for the Japanese investments of fund-raising in Europe. As the Japanese Financial Services Agency listed, there was a rapid decline in the number of Japanese fund-raising companies in Europe from 83 to 26 between January 2002 and September 2006. (Saitou, 2007)

The reasons behind the downward tendency can be analyzed in three major topics according to Saitou (2007). First of all, the main market for the Japanese fund-raising companies is still the domestic one. The European markets are in a much less attractive position than before because of the additional costs caused by adopting IFRS into the companies' accounting principles. Secondly, a perception regarding that the Japanese accounting standards is on par with the international accounting standards is relatively accepted by both Japanese and foreign investors. Additionally financial statements based on the U.S. GAAP are accepted in Japan. Finally, a rapid growth of foreign investments in transactions on the TSE during 2006 and 2007 has proposed a strong argument against the theory of the withdrawal of foreign investors from the Japanese markets unless the Japanese accounting standards is converged. This indicates that as long as investors believe that they have enough information for investment decisions and the returns on risk are reasonable, they will not retreat from the markets. Given these facts, despite the growing concern from EC, IFRSs are not yet acknowledged among Japanese companies and investors. (Saitou, 2007)

There are however two aspects initiating a push for change. The first one is that the Japanese GAAP in certain respects has come under increasing criticism. From an international perspective, Japanese companies appear to be closed and secretive to the rest of the world in relations to the choices of their corporate policy and financial disclosure practices to the public. In the 1990s, the Japanese economy was afflicted severely with business scandals and bad loans. (Rimmel and Chitoshi, 2007) The second one is the benefits and efficiency in international trade provided by preparing financial statements in accordance with international accounting standards. (IAS Plus, 2009)

In January 2005, a joint project was launched by ASBJ (Accounting standards board of Japan) and IASB to "*reduce differences between Japanese accounting standards and ...IFRSs*" (ASBJ, 2005). The "ultimate and desirable goal" of the project is convergence to IFRSs and a series of continuous improvements of the Japanese accounting standards was announced immediately afterward. (ASBJ, 2009) Later the topic of the adoption of IFRSs had gradually appeared among the subjects and discussions of accounting in Japan. The Business Accounting Deliberation Council (BADC) as an advisory body to the Minister of Finance has been designated to issue the adoption while ASBJ continues with the convergence. (Saitou, 2007)

In spite of the efforts from the standard-setters, skeptical attitude has arisen from Japanese company leaders towards the adoption of IFRSs. (Rimmel and Chitoshi, 2007) Already in 1999, there was a warning regarding the rigid attitude within the Japanese companies to accommodate changes in the accounting standards. (Kim, 2007) In this case, accompanied with the complexity of Japanese corporate structure, which is dominated by the main-bank system and keiretsu (former zßaibatsu), it would be a long-term and difficult path for Japan to converge and adopt the Japanese GAAP with IFRSs without revolutionary changes within the Japanese system. (Kim, 2007)

1.3 Problem statement and aim of the thesis

Until the time of writing, it has been approximately four years since the convergence project was introduced in Japan. Over time the Japanese accounting standards have been going through a set of attempts of modifications in aim to accomplish the convergence and move further towards the adoption. Therefore on the basis of the above problem description and analysis, I find that it would be interesting to assess the developments that have taken place and the current accounting situation in Japan on purpose to find the underlying reasons behind these attempts and possible tendency in the future. For this purpose it has led to the following questions:

1. Towards which direction is Japan moving now in relation to IFRSs?

2. Are there any potential changes within Japanese business environment and companies in terms of the internationalization of accounting standards?

1.4 Limitations of the thesis

In this thesis, there will not be a presentation of the differences between the Japanese GAAP and IFRSs discussed in details with specific examples. The focus is to form an overall perception of the developments of the Japanese accounting standards with general information such as accounting traditions and historical causes. At same time, I am more interested in which way, not in which extent Japanese accounting standards have been reformed in order to fulfill the requirements set by globalization.

1.5 Disposition

The thesis begins with an introductory chapter, which describes the background of the emergence of IFRSs, to further carry on a discussion about the problems and importance of the convergence and the adoption in Japan. Thereafter the aim of the thesis will be explicated and followed by two main questions, which will help me to stay on the topic throughout the thesis.

In chapter two the approaches and methods regarding the gathering of empirical and theoretical material will be described. This chapter will give an account of the procedure of the interviews and the selection of interviewees. In the end of the chapter concerns about reliability and validity, as well as critique to references will be discussed. The third chapter demonstrates the relevant theoretical framework to the thesis, starting by discussing advantages and disadvantages of IFRSs. Subsequently, the reasons behind the complex accounting situation in Japan in relation to the convergence and the adoption will be explained. In the end, a study regarding the reaction from the Japanese managers will be presented.

The fourth chapter starts with a presentation of the interviewees and their comments. Eventually a summary of the gathered empirical material will be presented and constantly reflect back to the theoretical part.

In the fifth chapter the empirical material and theories will be analyzed and explained in accordance with the problem statement. The sixth and last chapter goes back to the aim of the thesis by answering the two main questions. The chapter will end with a conclusion of the topic and recommendation for further researches.

2. Methods and data

This chapter begins with an introduction of the methods used for gathering empirical material. Thereafter it gives account for the choice of the subject and interviewees, followed by a discussion and explanation of the choices. In the end of the chapter an evaluation of the quality of the empirical and theoretical material will been presented.

2.1 Qualitative method and qualitative interview

The choice of methods depends mainly on the subject and purpose of a study. (Merriam, 1994) The purpose for this thesis is to depict the movements of the Japanese GAAP in relation to IFRSs over the time. The aim of the material I gathered is to be able to illuminate the developments with notification of any possible changes within Japanese business environment in relation to the convergence and the adoption. In order to explain and interpret the phenomenon, a thorough understanding of the initiation of international accounting standards is required. It is also my personal preference to gain knowledge from individual experiences with this phenomenon through the interviewees' perspectives. The numbers of interviewees is limited to two since I have no intention to neither examine a large population, nor concentrate on quantities. Therefore it fell naturally for me to opt a qualitative method, which is characterized by the features stated above. (Trost, 1993)

This type of approach is built on a closer exchange between researchers and research-objects in a form of deep-going interviews. (Lundahl and Skärvad, 1999) Interviews were performed by asking open questions with a non-pre-determined order so the interviewees could have more influence over the structure of their answers, which also gave me an opportunity to constantly follow up the answers and the interviewees' reviews. My interviews are characterized with a low degree of standardizations. In other words, I accommodated the interviews to the situation and interviewees. The questions were asked in the order that was appropriate and attendant questions were directed by earlier answers. (Trost, 1993)

I believe that a qualitative interview fulfills the purpose of the thesis in the most appropriate way and provides flexibility in the implementation in the thesis, as well as a possibility for a more advanced analysis regarding the problem statement.

2.2 Research process

The gathering of relevant and useful information is initiated by studying literature and thereafter composing it with the interviews. The information can be divided into two categories as secondary- and primary data.

2.2.1 Literature review

Secondary data is information collated by other researchers, in forms of reports and articles etc. (Jacobsen, 2002) As a supplement to the literature, I have tried with various combinations of search-words as "harmonization", "convergence", "adoption", "Japanese accounting standards/ system/ principles/ practice/ traditions", “management” and “international accounting standards /IFRSs” on the Internet in purpose to find recent updates and further information regarding the subject. The websites of authorities such as IASplus, ASBJ, and Japanese organizations such as Nippon Keidanren, JICPA, as well as accounting firms such as PriceWaterHouseCoopers, were considered to be reliable sources to obtain information from. Databases such as Science Direct, Emerald and Academic search elite were used in the search for scientific articles.

2.2.2. Interviews and selection of interviewees

Primary data is the part of the information that researchers obtain through his/her own experience during the research. (Jacobsen, 2002) In this thesis the primary data will be collected from qualitative-oriented interviews.

To my selection of interviewee, I have chosen to interview Japanese professors with specialty in accounting since I considered my study requires recent updates of the developments in Japanese accounting standards and there is a lack of such information with an academic background in other forms of data resources.

To my choices of Japanese professors, I have reflected on that the subject of accounting is integrated with a great amount of involvements of one country’s own culture, traditions of businesses and the historical developments in accounting system. (Choi, 2005) Bearing this in mind, I considered that the opinions from Japanese researches would be more interested. However I am aware that the selection of only Japanese professors can reduce the degree of comparability and transparency of my study.

In addition I am conscious about a possible lack of reliability because of the small number of interviewees. But it does not need to be a problem on account of my choice of qualitative methods. In other words, I do not have to be concerned about quantities. Furthermore the interviewees are the leading researchers in their field with substantial knowledge of the subject; therefore I presumed that their answers would be fairly representative for other researchers. I have performed interviews with each interviewee once with approximately two hours’ duration.

The interview questions are derived partly from the research of “*Accounting harmonization and diffusion of international accounting standards: the Japan case*” (Rimmel and Chitoshi, 2007) and partly from other literature. The research by Rimmel and Chitoshi (2007) explored the effect of the convergence in a practical context by sending questionnaire to the 150 largest Japanese companies listed in Tokyo Exchange Stock (TES), to further study the reaction from Japanese companies to the adoption of IFRSs. Based on the data in the research, it indicates that the majority of Japanese senior managers do not have positive view on the incident because of potential costs caused by adapting the new accounting principles. Very few believe that the benefits significantly outweigh the costs. (Rimmel and Chitoshi, 2007)

The interview is divided mainly into three sections with questions issuing the interviewees’ background, their views about the globalization of the international accounting standards and the potential adoption of IFRSs in Japan.

The purpose of the questions regarding the interviewees' background is to give a general concept of the interviewees' educations and researches in order to sustain a high reliability. The correct background and the amount of time devoted on the subject may ensure the relevance and quality of information and knowledge acquired from the interviewees.

The questions regarding the interviewees' views on the globalization of accounting standards is about to reveal how the interviewees see on the strengths and weakness that they have experienced with the phenomenon. Included in this category are also for examining the overall opinions from the Japanese leading researchers towards the convergence and the adoption since the success of implementing the international accounting standards certainly needs support from opinion-leaders. (Rimmel and Chitoshi, 2007)

The final questions relates the potential future adoption of the international accounting standards in Japan in order to demonstrate any positive movements in the procedure over the passed four years from the interviewees' perspective and how they perceive the future of the Japanese accounting standards.

2.3 Validity and reliability

The interviews were formed with standardized questions. The advantages with standardization are, first of all that standardized questions could help to institute a structure during the interviews so the interviewees will not lead the subject away to sidetrack. Secondly the questions are in an open character, which means that they are not addressed to a specific incident but only trying to direct the interviewees to relate the topic to their own experiences. The reason behind the features of the questions, as stated before, is to illustrate and receive a better understanding of each interviewee's personal view on the subject. Indeed my choice to perform interviews in such way may reduce the degree of comparability and transparency in the study. (Rosengren and Arvidsson, 2001)

The interviews are conducted in the form of personal interviews in face-to-face meetings. One of the disadvantages with personal interviews is that interviewer and interviewee unconsciously have an influence on each other. This can result in a situation that the interviewee for instance feels which answers are expected from him or her. In that case it will affect the validity of the study. (Hellevik, 1977)

Moreover language should be taken into consideration as another factor that can cause misunderstanding and misinterpretation during the interviews, as well as while reading articles or documentation obtained from Japanese sites since they are written in Japanese. The interviews were done in English, which is neither the professors' nor my mother tongue. This can easily lead to mistakes in interviews to certain respect and possible incorrectness while interpreting the answers. In hope to reduce the risk of misinterpretation, I have chosen to record the interviews so that I can render the interviewees' answers on a more reliable way by listening to them more than once.

Still there can be shortage in reliability since the answers were constructed only by me.

2.4 Critique of references

The purpose of criticizing cited references is to verify whether the references are valid or not (Holme, 1997). It is difficult for the researchers to completely take exception from involving their own opinions in their works. I tried to deal with the information as objective as possible on purpose to remain a high degree of validity and reliability in my study. In addition, it is also necessary to sustain a critical view on original sources in the chosen references in terms of whether they are biased by different interests or not.

In the theoretical framework, there is information obtained from Japanese private organizations and accounting agencies. Regarding this type of information, there is an underlying risk that it can be weighted to highlight the organizations and agencies' interest and attitude to a subject. Despite of the risk, the information from the organizations and agencies was utilized in the study since they have important knowledge of the subject. Furthermore scientific articles are also included in the references. The benefits with scientific articles are that they are ensured with high quality because of comprehensive reviews over the articles by the reputable journals before publishing.

3. Theoretical framework

In this chapter, an overview of the reasons, advantages and disadvantages of the internationalization of accounting standards will be presented. Thereafter the chapter will briefly cover Japanese accounting including postmodern history, business environment, accounting traditions and reforms. Eventually the possible obstacles and the attitude of Japanese management towards the adoption of IFRSs will be illustrated and discussed.

3.1 Reasons behind international differences in accounting standards

The prerequisites of different conditions in each country have created friction to the process of creating a uniform set of accounting standards across nations. In general, the structure of accounting standards originates from the requirements of investors and stakeholders in terms of financial information. The requirements can vary much between companies and countries. As considered in the introduction, the design of one country's accounting standards is firmly tied to a complex composition of various factors such as culture, economy, legal and politic environment where the company is engaged. (Choi, 2005)

In terms of cultural influence, Hofstede defined a set of cultural societal values, which have motivated the institutional form and practice. The societal values are included in four dimensions such as "individualism vs. collectivism", which addresses the degree of independence among individuals and relationship to group; "power distance", which addresses the degree of acceptance of uneven power distribution in a society; "uncertainty avoidance", which addresses in which way and to which extent members in a society deal with uncertainty; "masculinity vs. femininity", which addresses the extent that a society allocate social roles of man and woman. (Hofstede, 1984) Derived from Hofstede's societal values, Gray (1988) proposed a theory of potential significance of culture over accounting practice in four accounting sub-cultural values. The first one is ”professionalism vs. statutory control” which relates to accounting profession based on individual judgment and self-regulation in contrast to accounting profession complied with legislative regulations and controls. The former is comprised for countries such as UK and USA. The latter is applied by European countries. The second one, ”uniformity and flexibility”, indicates a preference for standardized or varying accounting practice between companies over time. The third one is "conservatism vs. optimism". Conservatism is reflected in a sense of prudence, which is strongly emphasized for instance in the German accounting, and optimism is aimed for a fair presentation which can be seen for example in the U.S. accounting. The last one, ”secrecy vs. transparency”, is in terms of a preference of minimal information disclosure or full disclosure with openness. Countries with stakeholders in concentration of family operated and institutional entities prefer secrecy. These accounting sub-cultural values according to Gary (1988) will have effect on the development of accounting system in respective country at a national level. (Gary, 1988)

From a historical perspective an accounting system is considered a result of historical developments governed by the continental- and an Anglo-Saxon tradition at an international level. The continental tradition is comprised by the West, except the UK, Ireland and the Netherlands, which belongs to the Anglo-Saxon tradition with the USA and the British Commonwealth. These two traditions are derived from essences of different civil laws across the countries. (Smith, 2006)

In the Anglo-Saxon tradition, accounting practice and standards are not based on statute laws but case law that in other words refers to common laws with supplementation of court precedents. In these countries, a proper disclosure should provide a ”true and fair” picture of the reality with possible exceptions from regulations. In contrast, the continental tradition is based on code law, which indicates that the accounting practices and standards is in compliance with legislations and more regulated in the continental tradition than in the Anglo-Saxon tradition. (Smith, 2006)

The main difference between the continental- and the Anglo-Saxon tradition is outlined with the purpose of accounting, which in turn depends on different financing environment in respective countries. Major European companies have a long-term bank-financing background in their corporation histories, while private capital markets with risk capital have been the main financing source for the USA and the UK. Therefore requirements of the information on financial reports can vary much between companies and countries. (Nilsson 2005). Accounting in accordance to the Anglo-Saxon tradition is designed to provide full disclosure to investors and stakeholders since majority of them are in private sectors and do not have access to intern information. On the opposite the continental tradition is strongly associated with taxation and has a main focus on to protect creditors’ interest, which relates to a lesser degree of openness in disclosures because creditors such as banks and other institutional entities have already full access to companies’ information. The continental tradition is also characterized by a predominating principle of conservatism. (Smith, 2005)

3.2 Advantages with internationalization of accounting standards

The starting point of development of IFRSs is to create a set of global accounting standards that can contribute to transparent, understandable and high quality financial reports to users of financial statements over the world. (IASB, 2009) For investors and stakeholders, the uniform standards of accounting increase comparability and transparency in financial statements, which in turn improve investment decisions in terms of fewer misunderstandings and less risk for errors. (Choi, 2005; Rodrigues and Craig, 2006) Subsequently adopting uniform accounting standards can remove barriers to cross-border trading in capital market and leads to a more effective allocation of capital. (Hail et al, 2009)

Besides the above stated advantages, the most significant benefit of the adoption of IFRSs is reduction of capital cost. In general, companies with business activities around the world are in need to translate their financial reports in different national accounting languages, which will induce cost for example of employing financial employees with these competences. Additionally the translation of financial statements is evidently a time-consuming procedure and have tendency to cause errors. To corporations with affiliated companies around the world, the reduction of capital cost comes in forms of centralization of accounting departments and the ability to move financial employees freely across borders, which at same time improves internal control in the corporations. (Nobes and Parker, 2006)

Reducing capital cost is especially crucial for investment companies because of increased competition due to the globalization of capital markets. However it is too early to state the positive effect of adopting IFRSs in this category since the transformation to IFRSs in the capital markets such as New York Exchange Stock (NYES) and TES is relatively young. (PWC, 2008)

3.3 Disadvantages with internationalization of accounting standards

The convergence of accounting standards has been criticized to be a too easy solution to an extremely complex problem. (Choi, 2005) Critics argued whether the international standards are flexible enough to cope with all the differences of accounting practices and standards between countries. The conception of enhanced comparability of financial reports and liquidity of capital markets will only be proven true, in the case the new set of accounting standards will be adopted in the time the cultural, politic and economic factors in one country are also changing for the adoption. (Hail et al, 2009) Another view on the issue is whether it is a new strategy for large international accounting companies to expand their markets since their competence in IFRSs practice will be necessary for others. (Choi, 2005)

Furthermore the new way to disclose financial statements requires evidently more account information than before, thus the implementation is expected to demand more efforts from concerned companies. The accumulated efforts are including for example annual reevaluation of certain assets, immediate education approaches, external expertise and quick revision of accounting procedures. (Jermakowicz and Gornik-Tomaszewski, 2006) Within the current economic situation, it will be disinclination for many companies to confront these costs. (Hail et al, 2009)

Another arising question to IFRSs regards the usability of the new valuation method that valuation of assets is suggested to be calculated in fair value as restated as market value. Considering delivering the most relevant information about adjustment in companies' economy to stakeholders and analysts, the new method of valuation seems to be logical from a theoretic perspective. However in a practical context, this makes it more difficult for external partners to perceive a clear overview of actual underlying changes in the economy of a company. Considering the shifts of changes are likely augmented from year to year, it may cause withdrawal of investors. In countries with the continental tradition, early regulations allowed assessment on assets to be valued in acquisition value, which resulted in fewer fluctuations. (Precht, 2007)

Given the factors of social, economic and cultural diversity, there were concerns about the appropriateness of IFRSs for *all* companies without consideration of size and benefits in relation to implementation costs. Reports from many countries indicated that "*IFRSs are too complicated and expensive for SMEs—especially standards dealing with financial instruments, fair value accounting and impairment*", especially when SMEs (small and middle sized entities) are not deemed for international competitions. After several years of working on the issue, IASB has announced the proposal of "differential reporting" in 2005. The "differential reporting" system means that IFRSs will include full IFRSs and IFRSs for SMEs. Which standards will be applied by SMEs depends on the decisions of each national jurisdiction. Although there is already an argument regarding a need for conducting three particular IFRSs for SMEs in consideration with an additional category, which is the smaller ones versus larger SMEs with external users. Hence the development indicates that accounting legislation needs to continuously modify simpler accounting standards that correspond the need of smaller companies. (Rodrigues and Craig, 2006)

Nevertheless, Tweedie, the chairman of IASB encourages a consistent discussion of issues arising from different way of thinking. He believes that one of the major pitfalls that occurred during the setting-up of IFRSs is the failure to include the distinction between the cultural background and the specific conditions of the business activities in each country. In the end, Tweedie suggests a uniformity of three functional elements in order to put international accounting standards into function. The three elements are good revision, sensible standards and supervision. (Precht, 2004)

3.4 Accounting in Japan

3.4.1 Postmodern history of Japanese accounting

After the Meiji restoration, the Japanese government was eager to improve the Japanese accounting system. From that time, the Japanese GAAP was advanced by BADC. The primary purpose of the BADC is to issue accounting and audit standards. (Gordon, 1999) In 1890 the Commercial Code was enacted and the Corporation Tax Law in 1947. Both of the regulations were based on the continental German system. Later the Securities and Exchange Act was enacted in 1948. Together these three legislations composed so-called "Triangular legal system" in order to regulate financial reporting in Japan. (Shizumi, 2003; Saitou 2007)

The Commercial Code regulates financial reports from all companies, including limited companies, with different requirement depending on the size of organizations. The Code has more emphasis on protection of creditors than shareholders. The Securities and Exchange Act requires stock-listed companies in Japan to file consolidated and parent-only financial statements with financial regulators half-yearly and annually. (Shizumi, 2003; Kim 2007) Financial reports according to the Commercial Code and the Securities and Exchange Act are regarded "*to be similar and consistent to each other*". (Kim, 2007) The Corporation Tax law requires the principle of conservatism applied in financial disclosures, for example reporting earnings instead of reporting the income in fair value. (Shizumi, 2003; Kim 2007)

Eventually, the emergence of the liberalization of corporate financing, the collapse of the "Bubble" and requirement of investor protection had initiated the Japanese version of the Big Bang in November 1996 on order to revitalize the Japanese financial market on a par with the international markets such as New York and London. (Shizumi, 2003) Since then a series of reforms in the areas of business combination, impairment of fixed assets, financial instruments, retirement allowances and consolidation policies has been conducted so that Japanese accounting standards would be more comparable to the Western ones. Still there were some substantial differences between Japanese and Western accounting standards in accounting measurement and disclosure practices because of distinctions in economic environment, corporate structure, management style and legislative regulations. (Saitou, 2007)

Over time the increasing importance of globalization have laid much pressure on Japan to harmonize its accounting standards according to the international standards. In 2001, a new accounting standard-setting body known as ASBJ was formed in the private sector to develop domestic accounting standards and is expected to contribute to international harmonization or convergence of accounting standards. In 2002, ASBJ adjusted the regulation regarding acknowledgement of financial statements in accordance with the U.S. GAAP. In 2004 ASBJ joined a convergence project with IASB as EC announced the convergence of accounting standards in European countries with IFRSs. (Saitou, 2007)

As of 2007 ASBJ encouraged accounting professions to participate actively in the setting-up of accounting standards. In that way, the standards can satisfy both the need of the market and the demands for convergence. (ASBJ et al, 2004) According to Saitou it is a social experiment in its new way to involve a private sector to take a decisive role in the development of public regulations. Especially it is revolutionary for Japan, since the Japanese accounting standards lack in flexibility on account of strong obstructive circumstances caused by the legislations. (Saitou, 2007)

So far ASBJ has enhanced and developed the standards in such areas as quarterly disclosures, stock options, presentation of net assets, and finance leases. The first two reforms are in terms of adjustments to the Commercial Code. The third reform relates to the Securities and Exchange Act, while the last one is associated with the Corporate Tax Law. Some other reforms, which have been carried out, are in standards of related party disclosures, measurement of inventories, and unification of accounting policies applied to foreign subsidiaries. Beside that, ASBJ also put focus on issues concerning disclosure of financial instruments, scope of consolidation, and asset retirement obligations etc. (Saitou, 2007)

In 2007 the U.S. Securities and Exchange Commission (SEC) had announced that there would not be a need of reconciliation if foreign companies listed in the American market prepare their financial statements based on IFRSs. At the same time, the U.S. SEC also proposed a roadmap for transition of the U.S. GAAP to IFRSs, which leaves Japan as the only country that has not officially indicated their choice of adoption of IFRSs among the major capital markets. In correspondence to these announcements, Japan has accelerated the convergence process. Hence Nippon Keidanren, Japanese federation of senior management, suggests an urgent discussion regarding the future direction of accounting standards in Japan and a setting-up of a roadmap as soon as possible. (Nippon Keidanren, 2008) Now in 2009, the most concerning question for Japan is the adoption of IFRSs. By the year of 2010, Japan is expected to determine the direction of Japanese accounting standards. However from 2010 it will be voluntary for listed companies to apply IFRSs in their financial statements. Mandatory use of IFRSs will be under discussion after reviewing the effect of voluntary adoption of IFRSs among Japanese companies. (IAS Plus, 2009)

3.4.2 Japanese business environment

In order to be able to understand the nature of Japanese accounting standards and practice, it is necessary to acquire an insight into Japanese corporate structure and major financing systems. (Kim, 2009)

3.4.2.1 Corporate Structures – Zaibatsu and Kieretsu

The rise of zaibatsu can be traced back to the period of 1920 to 1950 when Japan was in need of an expansion of its economy. Four families were chosen and supported by the Meiji government to start new businesses in different branches. The families were Mitsubishi, Mitsui, Sumimoto and Yasuda. The families formed business conglomerates with a singular holding company in the center, which in turn owned the majority of shares in other companies. Each conglomerate was financed by one single bank. In return the bank took over one part of the shares in different companies within the same family. (Kim, 2007) Most of the workings within zaibatsus were secretive. There were little incentives to share financial information to the public. (Rimmel and Chitoshi, 2007)

After a forced dissolution of zaibatsus during the American occupation, keiretsu was emerged as a product of zaibatsus' reorganization. Keiretsu refers to a structure formed by a set of companies horizontally integrated across many industries, but they would also supply each other in terms of vertical integration. The major keiretsus are organized around one bank within conglomeration as zaibatsus did. Instead of shares of majorities, keiretsus is marked with shares of minorities, in other words cross-holdings. In Japanese context cross-holdings is an ownership structure to separate Japanese companies from non-Japanese companies, when there is shareholders between banks and companies, as well as between companies. This structure was considered to be very stable and be an effective way to protect Japanese companies from hostile takeovers. Because of the solid and interlocking relationship between owners and investors, financial reports to external users is not important considering that intern information can be easily accessed by any company within the business group. (Kim, 2007)

3.4.2.2 Main-Bank System

Beside the corporate structure, the other factor that causes a weak external financial report is the main-bank system. The main-bank system in Japan is referred to a company's financing and control system, which is involved with an informal set of practice and institutional arrangements. (Kim, 2007) The uniqueness in the Japanese model lies in the role of banks to companies as a monitoring entity to have control of the clients' management and income, as well as emergency entity to rescue its clients from winding-up in form of reconstruction and merger. The main-bank generally is the largest creditor and shareholder among others to its clients. It offers cheaper financing in terms of bank loans and obtains access to all information of its clients, to enhance the credit risk evaluation and supervise its clients. The relationship is not based on a juridical contract but on an agreement, expectations, accumulation and trust, also reputations. (Hugh, 1994)

When it comes to external financial reports, the main-bank system prefers to limit the level of disclosure to the public to a minimum. In addition a close relationship between supervisory authorities and banks has restrained the degree of openness of financial statements. Since the authorities already have full information in their hands or in the case of insufficient information they would simply ask companies. Therefore it leads to a situation where there is no need to perform improvement of the quality and manners of external financial reports. (Hugh, 1994)

3.4.3 Traditions in Japanese accounting

One of the factors which shape reporting incentives of a company is business and governance practices (Hail et al, 2009) In Japan, companies' accounting principles and practices are under influence by the rule-based continental tradition, which also implies a close association to the Japanese legal institution. (Saitou, 2007) Other additional social circumstances should also be included, such as corporate structure and main-bank system. (Hail et al, 2009)

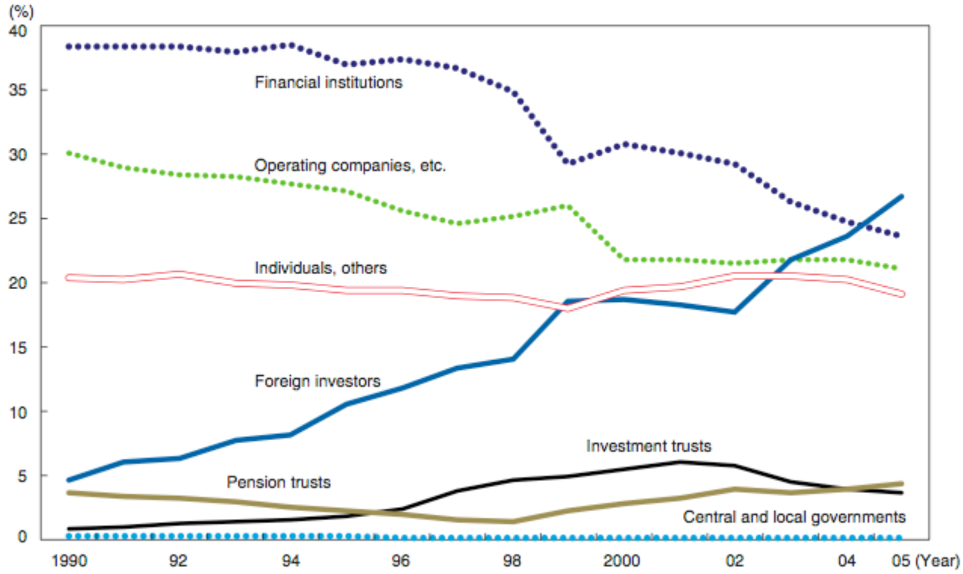
The predominant principle in the Japanese GAAP is the principle of conservatism, which is a result from the early adoption of the German accounting systems. A preference of short estimated lives for depreciable assets in Japanese companies is one example of the application of this principle. (Rimmel and Chitoshi, 2007) Six other general principles are respectively True and Fair View, Orderly bookkeeping, Distinction between capital and earnings, Clear presentation, Continuity and Consistency. Out of the seven principles, the conservative tradition is in conflict with IFRSs since IFRSs is inspired by the Anglo-Saxon tradition with less conservatism in focus. Nevertheless the principle of conservatism has been criticized for distortion of neutrality in accounting because of its unilateral bias on earnings in unfavorable sense. Otherwise influence of tax law, which is characterized by German accounting, is also deeply embedded in the central features in financial statements in Japan. (Kim, 2007; Saitou, 2007)

In a typical Japanese company, about 70 percents of the shares are held by other institutions and corporations, about 20 percents by individuals and the remaining 10 percents by foreign investors. (Rimmel and Chitoshi, 2007) In other words, Japanese companies depend significantly on the funds provided by banks and institutional investors. Even though TSE was founded 1878, large companies such as zaibatsu have rarely raised their capital through the market. In contrast to the Japanese financing structure, the main stream of capital for American and British companies is acquired from well-developed stock with strong and widespread private investors and stakeholders, Thus high quality of disclosure is demanded by the public and it is an inevitable condition for companies to fulfill in order to obtain capital from them. (Kim, 2007) It also explains why Western investors generally base their investment decisions on financial goals. To Japanese investors, an investment decision is drawn on establishment of a good business relationship. For companies, it is conveyed that a long-term and interactive relationship can help companies to gain competitive advantages. For investors, it would mean full access to internal information depending on the type of investors in terms of institutional or private ones. (Rimmel and Chitoshi, 2007)

Given these factors, some of the reasons behind the phenomenon that Japanese investors and stakeholders lack interest in improvement of financial disclosures can be proven. The first reason concerns the conservative tradition. The German Commercial Code as a basis for Japanese Commercial Code is derived from French Commercial Code, which requires a stock-check every two years to obtain detailed information regarding assets and liabilities in order to protect creditors. Subsequently, Japanese Commercial Code had an emphasis on creditor-orientation already at the beginning. Another reason is the highly developed and intensive relationship between companies and stakeholders. For example main banks have access to all financial information within companies, since Japanese companies rely more on internal rather than external financing sources. Hence institutional shareholders whom already secure channels to desirable information through the relationships with the board, cross-holdings and directorships, had little motivation to improve the manner and quality of financial disclosures. (Kim, 2007) In this business environment, a tradition of full disclosure of underlying economy in a Japanese company is considered to be economically unnecessary, which can imply great information asymmetry between internal and external users. For external users, the incomplete information in financial reports will not be able to illustrate the underlying economy in a company. (Rimmel and Chitoshi, 2075) Consequently from an international view it will cause less transparency in Japanese financial statements compared to American and British companies. A deficient disclosure standard in turn can reduce the ability for Japanese companies to flexibly exploit the international capital markets. (Kim, 2007)

However the situation in Japan concerning the financing structure appears to be going through significant changes after a series of successful launches of new regulations and reforms in the Japanese accounting standards. A study by Taki, Nishino and Konuma (2006) for Nomura research institution in Japan has demonstrated the shifts in equity ownership ratio by investor based on monetary basis. According to their data, in 1990 financial institutions counted for around 38 percent of the shareholders in Japan, operating companies for 30 percent, individuals for 21 percent and foreign investors for below five percent. In 2005 the share of financial institutions decreased significantly to around 25 percent while investment from foreign investor increased to 27 percent. In other words, foreign investor exceeds the share of equity ownership of Japanese institutional investors. (Taki et al, 2006) This indicates the importance of a market infrastructure, which complies with international standards in order to increase the reliability and attractiveness of Japan's financial and capital markets. (Nippon Keidanren, 2008) Even though the institutional factor still plays an important role in shareholding in Japan, the changes in foreign investors shareholding may be a trigger towards a solution of the general poor disclosure environment in Japan. The shares of operating companies has slightly sloped to around 22 percent while shares of individuals remain constantly over time around 20 percent as in 1990 (Taki et al, 2006)

Changes in Equity Ownership Ratios by Investor (on Monetary Basis)



Note: Investment trusts and pension trusts are not included in the figures for financial institutions.
Source: "Stock distribution survey for fiscal 2005 (summary version)," Tokyo Stock Exchange, etc., June 2006.

(Reference: Taki et al, 2006)

3.4.4 Reforms in Japanese accounting system

In Japan a view on the reforms of Japanese accounting system as an initiation of transition in accounting theories and practice is a sequence of changes within the internal environment. The Japanese accounting is considered to not necessarily follow the path of American and European ones. There are two revolutionary incidents that has challenged and reformed the Japanese accounting systems with forces from the external world. (Kim, 2007)

The first major force was inducted to the Japanese system in the middle of 1880s as result of Japan reopening the border to foreigners. When the Meiji government came to the power in 1868, a strong emphasis was placed on developing and reconstructing the politic, economic and social entities of that time. Successively the western double-entry bookkeeping system was immediately adopted without any resistance. What was so fascinating about this case was that the process of the adoption was effective and quick. (Kim 2007)

The second major reform was the adoption of accounting standards and practice with investor-orientated direction in financial reports. The phenomenon did not occur until the middle of 1920s, which was more imposed than adopted voluntary in Japan. Under the American occupation after Second World War, USA attempted to institutionalize new systems with democratic features in Japan, including new accounting regulations. The Securities and Exchange Act that was enacted later in 1948 derived exceedingly from the American version, which put emphasis on investors' interest and aim to present a "true and fair" picture of reality in the financial disclosure in order to provide correct and useful information to investors for the first time in Japan. The late investor-oriented character in financial reports was also weighed up with negligible function of stock markets to raise capital and with company ownership in form of zaibatsu, which had control over significant parts of the Japanese industrial and financial business from the Meiji period. Therefore accounting as a way to present financial information to external investors was completely irrelevant in Japan. (Kim, 2007)

In the study of "*Japan's Movement towards Adoption of IFRSs: Cosmetic or Economic Convergence?",* Kim (2007) mentioned that Someya, a professor from Waseda University has expressed that reforms underlie in the correspondence to the need of changes in social and economic structure in one country. According to him, there are two factors in terms of potential forces that initiate revolutions in Japanese accounting system. The first one is level of economic growth, which relates to the first incident when Japanese economy was behind West. Another factor depends on the external force, which imbue new political, economical and cultural substances into the old system, which is referred to the second incident. (Kim, 2007)

However, Kim (2007) argued in agreement with Someya about the adoption of western accounting principles in Japan is not only a pure result of adoption but also a natural reaction of a nation when lagging behind other nations and tries to catch-up in order to reduce differences between itself and other more developed nations. The Japanese accounting system today is in deep doubt whether the system can keep up with Japan's economic growth. The concern at the moment is whether adoption of Western accounting systems can be a solution for Japan this time in accordance with the first factor since the Japanese economy is already commensurate with the West at the current stage. Concerning the other factor, it is an interesting question if IASB is eligible to be regarded as an external source as Occupation Forces after World War II or the West in 1800s. (Kim, 2007)

3. 5 Possible obstacles of adoption of IFRSs in Japan

The adoption of the American systems on the former German ones has taken nearly a half-century for Japan to finalize it after going through a series of attempts and errors. In aligned with Saito (2007), it is difficult to implement a foreign system in an already well-developed system. Regarding to IFRSs, he argued about that the maximum benefits in terms of low transformation cost will only appear on countries with less advanced systems or a market that is trivial and lack an incentive to maintain its own system. However, Japan is not in this situation. (Saitou, 2007) Further more, Hail et al (2009) state in their study that other factors than accounting standards should not be neglected when considering an adoption of new standards, since the local standards are a product of a country's legislations, demand of financial information from existing investors, market competition, and company's business and their accounting practice.

One of the other potential factors that hinders the adoption of IFRSs in Japan, is the structure of the "Triangular legal system", which is constituted by the Securities and Exchange Act, Commercial Code and Corporate Tax Law. This system retards effectively efforts from the Japanese standard-setters to completely converge Japanese accounting standards with IFRSs, because of the essential characters derived from cultural, social and politic aspects in the country, which is required by Japanese companies when preparing financial reports. The "Triangular legal systems" describes the business accounting regulations, which must be complied with in a literal sense. In other words, if there is not any specification indicated in the laws, then companies are presumed to perform in any way they want. (Kim, 2007)

An important element in the U.S. GAAP and IFRSs is to have ”true and fair” disclosures. But in Japan, the meaning of the principle of "true and fair" is not obvious, since the Japanese accounting is strictly followed by the continental tradition. In other words, the system is in absolute compliance with laws and regulations than seeking an image of ”true and fair” beyond the law. This has led to a potential opportunity for Japanese companies to make use of the scope existed because of lack of specification or modified principles. (Kim, 2007) Beyond all means, if the above mentioned factors are not going under tremendous changes as a foundation for adoption of IFRSs, the shift in accounting standards will not have any effect on companies’ reporting incentives and practices, hence can not result enhanced comparability. It has also been proven that companies apply IFRSs in different ways and they tend to consider their previous local GAAPs when deciding the choice of accounting principles and practices. (Hail et al, 2009)

3.6 Attitude of Japanese management towards IFRSs adoption

Until 2005, there were merely two of 123 large listed companies in Japan adopting IFRSs. One more company indicated that IFRSs adoption was in progress, but had not finalized yet. For rest of the companies it remained unclear if and when they were going to adopt the international standards. It was one of the results from the survey included in the study of “*Accounting harmonization and diffusion of international accounting standards: the Japan case*” by Rimmel and Chitoshi (2007) in order to assess the Japanese business community’s attitude towards the adoption of IFRSs.

In the study, there are several reasons subtracted from the survey that reflect to the late acknowledgement of IFRSs for Japanese companies. (Rimmel and Chitoshi, 2007) The mission of IFRSs is to enhance quality and manner of financial statements conducting by companies around the world, on purpose to increase reliability, transparency and comparability. (IASB, 2009) In other words, a heavy weight of a company’s operations should be included in the international markets and for multinational investors. In contrast, for Japanese companies domestic stock market is the main focus, followed by domestic bond market, overseas bond market and overseas stock market. Sequently overseas investment was none of the priorities for the companies in relation to all their securities investments. Hence domestic investors with emphasis on institutional investors were regarded as the most important one to the companies’ business while overseas private investors were extremely low-rated. In turn, it formed a different attitude of the Japanese companies towards domestic and international users of financial statements and it indicated a lack of the attention to external users of financial statements. (Rimmel and Chitoshi, 2007)

However the majority of the Japanese companies responded in the survey expect the increased use of IFRSs in Japan in five years from 2005. In the report of “Future directions of accounting standards in Japan” (2009), Japanese federation of senior management (Nippon Keidanren) proposed a use of IFRSs by all listed companies in Japan in the future (Nippon Keidanren, 2008), by recognizing the potential benefits from adopting one single financial reporting language in forms of easier entries to international market, enhanced international fund-raising and increased international status for Japanese companies. (Rimmel and Chitoshi, 2007) Unexpectedly the cited benefit in terms of reduction of capital cost as mentioned in 3.2, is not important regarded by the responded companies. Thus the majority of the respondents considered that the cost would exceed the benefits. Hail et al (2009) assessed that the overall impact of the adoption of IFRSs would result between the one-time costs and the modest but recurring benefits, but it depends completely on a company's evaluation of the future benefits in relation to the current costs.

Even though, the primary concern to the adoption of the international standards in Japan is the lack of accounting professions with corresponding competence in IFRSs, not the high costs of transition of accounting standards. (Rimmel and Chitoshi, 2007) Proper education system of IFRSs is stated as the most urgent goal to accomplish in order to prepare the adoption of the new standards. (Nippon Keidanren, 2008) However, there is almost none form of official support from the government and any related organizations in Japan to facilitate the process of adoption for the Japanese companies and management. Japanese institution of certificated public accountant (JICPA, 2009) is the only organization at the time of writing, known for promoting IFRSs to the public, providing seminars and training programs to their members. (JICPA, 2009) According to Rimmel and Chitoshi (2007), the path towards adoption of IFRSs for Japan would be more effective and smooth if organizations such as JICPA would cooperate with large companies and obtain support from the government. Hence strong opinion leaders in leading companies, accounting profession organizations and the media are necessarily essential. (Rimmel and Chitoshi, 2007)

Even though Japan possesses its own accounting standards already as equivalent to IFRSs, the Japanese senior managers found that there still are some significant differences between the Japanese GAAP and IFRSs in such areas as business combinations and goodwill etc. (Rimmel and Chitoshi, 2007) As conclusion, Rimmel and Chitoshi (2007) indicates the importance of support from Japanese management in order to carry out the adoption of IFRSs efficiently.

4. Empirical study

This chapter will start with a brief presentation of the interviewees. Thereafter a summary of the interviews will be followed and presented into two main categories regarding the internationalization of accounting standards and the future adoption of IFRSs in Japan.

4.1 Presentation of interviewees

Chitoshi Koga is one of leading researchers in the field of international accounting in Japan. He obtained professional education from University Illinois in Accounting Science, Kobe University in Business administration and also from New York University. At the time he was staying in New York, he became a certificated accountant. After graduation, he worked with auditing and international taxation in COPEA and Arthur Young & Co. (former Ernst & Young). Furthermore, he has long-term experience in teaching courses related to international accounting and finance management at Kobe University, Kyoto University and Doshisha University etc for more than 25 years until now. His research is covers several fields including international accounting, financial instruments and intellectual capital accounting. Since the start of internationalization of accounting standards, Chitoshi has done a number of studies in relation to the Japanese accounting systems in co-authorship with other researchers. A recent work in 2005 with Gunnar Rimmel[1] has presented some views for and against accounting harmonization in the context of the accounting situation in Japan at that time and an analysis of attitudes within Japanese company managements.

Toshio Ohno is a professor of accounting in Kobe Gakuin University. He first graduated from Hitotsubashi University and thereafter obtained doctor degree from Kobe University in subject of American and German accounting theories. Afterwards he went to Germany in order to research for the suitability of the German accounting systems in modern accounting situation. When he came back to Japan, he began to teach accounting-related subjects in Kobe Gakuin University for almost 30 years. Over time Toshio has published books and paper in focus of human information processing in relation to accounting and intellectual capital accounting. Regarding international accounting, he expressed that the subject is integrated with intellectual capital accounting. Hence he has not done any separate researches on that.

4.2 Internationalization of accounting standards

In line with Chitoshi, harmonization means a reduction of contradictory differences between national and international accounting standards, while convergence is one step further than harmonization and brings national standards closer towards IFRSs by narrowing differences to a minimum. The Japanese GAAP is nearly converged with IFRS according to Chitoshi at the time of writing. In terms of adoption, he referred to a process of nearly word-for-word implementation of IFRSs into national accounting standards. In addition, he pointed out that full adoption in today's sense is strenuous

[1] Gunnar Rimmel: Associate professor at Department of Business administration in the School of Business, Economics and Law.

to achieve. Toshio asserted harmonization as a goal to harmonize diversity of domestic accounting standards across countries, while convergence is perceived merely as a process for him without any outcomes. He explained that convergence refers to a process that engages everyone to join. Concerning adoption, Toshio stated that a full adoption is virtually not possible to occur without any modifications to the Japanese accounting situation.

Regarding potential advantages of adopting IFRSs, Chitoshi expressed that it could result in easier access to international markets, increased international image and status for Japanese companies. Furthermore he indicated that the financial statements regulated under uniform standards will facilitate the comparison between companies across nations and it will become a competitive disadvantage if Japanese companies do not prepare their financial statement based on IFRSs while all other companies in the world do. In terms of other advantages, Chitoshi considered that it is too early to identify any confirmed effects of them. Toshio Ohno believed that IFRSs could stimulate Japan to be more engaged into the process of globalization with possibility of easy access to international markets for Japanese companies. Concerning the matter of comparability, Ohno stated that enhanced comparable financial information leads to more user-oriented financial statements. But he pointed out that it needs to be taken into consideration with to whom and in which extent comparable financial statements are used so not only those with accounting background would acquire benefits from it.

In consideration of disadvantages, Chitoshi asserted that the overall perception of convergence and adoption obtained by Japanese companies is that transition cost would exceed the benefit. Another significant disadvantage according to him is elimination of accounting tradition and social institutions such as cultural, economic and politic backgrounds because of adoption of IFRSs. He explained that on purpose to achieve uniformity in financial statements, differences between national GAAP have to be removed. Consequentially by reducing these differences, Chitoshi argued that it would eliminate all these factors, which can expose fairly true incentives of a company's financial statements under certain business environments, hence it could not be possible to illustrate a completely "true and fair" view in relation to IFRSs. Also the principle of "true and fair" is originated from the Anglo-Saxon tradition, which implies an irrelevance to Japanese accounting practices.

For Toshio, the predominant disadvantage of adoption of IFRSs is problem of time, not cost. Considering other disadvantages, he expressed that the adoption of IFRSs is a result of politic pressure and accounting reforms influenced by politic decisions are generally not thoroughly reviewed. They are determined without a theoretical basis, and therefore they can lead to an undesirable consequence. Besides that, Toshio did not think that adoption of IFRSs could increase the quality of "true and fair" view, particularly related to Japanese business environment. He described that in Japan there are neutral and reliable transactions between companies and companies to banks, because of the corporate structure such as main-bank system and keiretsu. The close relationships between partners result in unwillingness to disclose extensive financial information to the public. In addition, Toshio affirmed that this type of relationship is not classified as parent-affiliate relation, thus these transactions will not be included in usual consolidated financial statements. In turn the principle of "true and fair" view will not be practicable in Japanese context.

Concerning the appropriateness of the adoption of IFRSs for Japanese companies in terms of scales and types, Chitoshi considered IFRS as the best option for limited companies in order to enhance comparability of information in financial statement, while for unlimited companies such as SME, there would be a great possibility of segregation of accounting standards that SME could continue with domestic standards in the future. He explained the strategy on the basis of two factors. The first one is that the benefits of IFRS do not satisfy SME's needs. The second one is that incentives of consolidated and non-consolidated financial statements are different.

Toshio stated that theoretically the international accounting standards should be applied by all companies if IFRSs are assessed to be competent to improve accounting practices and principles. In this circumstance according to Toshio, the matter of sizes and types of companies should not be concerned. In line with him, the dependence of SME on large companies as Toyota and Sony has been broken off due to the globalization. The substantial change in business structure forced SME to alter their business style by following a direction along with large companies and find partners outside of Japan. Toshio emphasized the importance of international business relationship for SME in order to survive and develop because of demographic changes in the Japanese domestic market. In this case, he concluded that it is pertinent for SME to adopt IFRSs. Furthermore he pointed out that the adoption should be carefully evaluated and properly performed in consideration with unique situations in each country.

In the subject of the adoption, Chitoshi asserted that the announcement of a roadmap from U.S. SEC implying the adoption in USA has led much pressure on the Japanese standard-setters. He claimed that Japan tends to consider the adoption of IFRS following U.S. action on the issue. According to Toshio, adoption is caused by politic pressure, which is accepted because Japan is in need of a set of generally accepted accounting standards to keep up with today's global business situation. He suggested that Japan should have more influence over the setting process of IASB in international accounting standards.

4.3 Future adoption of IFRSs in Japan

Chitoshi considered that the most significant changes within Japanese accounting standards were accounting for consolidated financial statements in 1997 and for financial instruments in 1999 because of globalization of international financial and capital markets. Through the harmonization and the convergence until the ongoing adoption of IFRSs, he stated that the closer Japanese accounting standards are approaching to IFRSs, the more Anglo-Saxon tradition has influence over the Japanese GAAP. In other words, the Continental tradition derived from German accounting standards is being eliminated day by day. Chitoshi assessed a need of a firm guideline during this procedure, since the Japanese GAAP differs in certain extent to IFRS. He specified in examples as that in principle-based standards such as IFRSs it is much more strict and requires more estimate for evaluation of assets and inventory, in contrast to the Japanese accounting principles and practices.

Toshio identified the most predominant change as user-orientation with alterations, for example in accounting for consolidation and financial instrument etc since the adoption of U.S. system on the Continental accounting system after Second World War when the structure of Japanese securities markets became key issue. He asserted that the senior accounting professors still believe the effects of the German accounting standards remains in Japanese accounting standards, while younger generation of professors has contradictory opinions.

According to Chitoshi, large Japanese companies are now ready for the future adoption of IFRSs by providing seminars for their employees and offering advice to their client companies. He referred to a report conducted by Nippon Keidanren (2008) that Japan should sooner or later to adopt IFRSs for all listed companies. Additionally he mentioned that among the leading accounting organization the JICPA is the only one actively promoting IFRSs to the public and providing training programs, for example, to its members, etc at the moment. However there are still very few Japanese companies adopting IFRS at the time of writing without any increase compared to few years ago. A reason to this as stated by Chitoshi would be that preparing financial statements based on IFRSs is not required by the legislations yet. Moreover, he explained that since the adoption is not officially declared, there is no formal support in Japan from standard-setters and leading accounting organizations. Subsequently approximately 30 Japanese companies confused the U.S. GAAP with IFRS and had preparation for adoption of the U.S. GAAP. Chitoshi indicated that Japanese standard-setters need to clarify IFRSs with other widely used generally accepted standards.

Toshio expressed that Japanese companies have prepared themselves before the adoption. According to him, Japanese companies could still manage the changeover on their own whether official support from any institutions and the government is available or not. In addition he pointed out that in the beginning of 2009 the government has introduced a new tax policy regarding reduction of tax on expense in human resources in forms of training program etc for all companies. In turn, Toshio believed that transition cost would not be so tremendous as it was supposed to be for Japanese companies in terms of necessary educational cost. Concerning any increase in the numbers of Japanese companies adopting IFRSs, Toshio had not noticed any tendency of the adoption yet.

To the question regarding the main reason for accounting reforms in the Japanese GAAP, Chitoshi affirmed it as influence from external factors as Japanese financial statements have been criticized not being open and fair for a long time, and also because of globalization and pressure from other nations such as European countries and USA. Consequently, these factors impact Japanese traditional business structure characterized by shareholdings. In turn changes in business structure successively alters the infrastructure of securities market. Eventually accounting systems are modified in order to keep up these developments. In consideration of the reason that impacts the Japanese accounting standards, Toshio meant that Japan has always been under pressure from external partners. By not accepting foreign standards and ways of thinking, Japan will be isolated.

Considering another barriers such as the “Triangular legal system” and corporation structure towards implementation of IFRSs, Chitoshi regarded them as temporary matters as that Japan has no other option than to adopt, hence these accounting-related components would be amended along with the process. Toshio expressed that both factors would not be significant obstacles for adoption of IFRSs. He explained that the constitution of "Triangular legal system" is not firm, so the regulations can be easily revised when accounting standards have been modified. Furthermore he asserted that the power to impact the corporation structure is neither from shareholdings or producers, but from consumers at the moment. Toshio perceived business structure at certain degrees as a hinder and also as a driving force for the process of the adoption.

For the current Japanese accounting situation, Chitoshi emphasized the importance of ground design in terms of the direction of the accounting standards that has not yet come to a resolution. He meant that without a ground design, a strategy could not be properly formed to the issue whether adoption is appropriate for Japan or not. He expressed that it would be interesting to see any increase in number of companies adopting IFRS when the adoption will be permitted on a voluntary basis in Japan in 2010.

Toshio stated that adopting IFRSs does not only imply amendments in accounting standards, but also a new way of thinking within Japanese companies. The adoption will be time-consuming but once Japanese companies fully recognize the benefits of the adoption, the procedure will speed up. Regarding the voluntary adoption of IFRSs in Japan in 2010, he expected the numbers of companies adopting the international standards would be increased.

5. Analysis of empirical data

In this chapter an analysis will be presented into two topics regarding the internationalization of accounting and the future adoption of IFRSs in Japan. At each topic, relevant empirical data will be analyzed by reflecting constantly back to the theoretical framework.

5.1 Internationalization of accounting standards

There are different approaches used for adopting IFRSs among countries which has adopted IFRSs such as full adoption of IFRSs immediately, full adoption of IFRSs with time lags, selective adoption of IFRSs and national standards developed on basis of IFRSs. (Chand and Patel, 2008) In terms of Japan, Chitoshi considered that full adoption of IFRSs would be applied but with slight differences in some parts. From a different direction, Toshio discerned that Japan should choose the selective adoption approach. In that way, the Japanese GAAP could be rationalized and continued with good Japanese accounting practices in combination of IFRSs on purpose to fulfill the requirements of globalization. Both the professors perceived that those approaches advance the procedures of accomplishing a uniformity of accounting standards in the world.

As stated by Nobes and Parker (2006), Choi (2005) and Rodrigues and Craig (2006), the most significant benefit contributed by IFRSs are increased comparability of information in a company's financial statements, which consequentially would lead to a reduction of capital cost due to decreased risks for investors, especially when the company is operating its business across the borders. Smith (2006) also asserted that financial disclosures need to be comparable in order that investors can make an investment decision based on them. In the interviews, both Chitoshi and Toshio expressed in an absolute agreement with the theory that comparability of financial information will be increased with adoption of IFRSs. Chitoshi stated that the adoption of IFRSs for Japanese accounting standards is essential in consideration with the critique to Japanese financial disclosures around the world aligned with Kim (2007) and Saitou (2007). Furthermore he pointed out the enhanced comparison between companies across nations in terms of adopting IFRSs. However Toshio explained that only with improved comparability of financial statement it is not sufficient to be able to compare concerns across borders, which also involve differences of various cultural backgrounds and traditions. Beside that Chitoshi affirmed that Japanese companies could have easier access to international markets by adopting IFRSs in coincidence with other researchers such as Choi (2007) and Saitou (2007) etc. Toshio asserted the adoption could stimulate Japanese businesses to join the process of globalization. However Chitoshi pointed out that at the current stage it is too early to draw any conclusions since adoption of IFRSs is a long and complicated process, thus the advantages are not yet firmly verified.

Despite of the advantages, there are some potential disadvantages of IFRSs that should not be overlooked. At first, IFRSs is being assessed regardless of the differences in social and cultural backgrounds between countries related to manner and quality of preparing financial statements (Chand and Patel, 2007; Choi, 2007; Hail et al, 2009; Saitou, 2007; Kim, 2007), which corresponds to the views from Chitoshi and Toshio on the issue. In addition the function and meaning of IFRSs differ for companies in different types and sizes, hence a proposal of "differentiated reporting system" was announced by IASB, which suggests IFRSs for listed companies and national GAAP for unlisted companies. (Rodrigues and Craig, 2006) Hail et al demonstrated this tendency in countries that adopted IFRSs in their study[2]. According to Chitoshi IFRSs is indeed the best option for Japanese multinational companies listed in the international markets, while unlisted companies, especially SME, are more willing to apply domestic rules and refer to national GAAP. This approach was also advocated by Nippon Keidanren (2008) for the future adoption in Japan. A reason for this phenomenon would be that it is too difficult for SME to maintain required skills since the implementation of IFRSs is after all a cost issue in accordance with Rodrigues and Craig (2006). As Chitoshi indicated, adopting IFRSs involves greater complexity for Japanese companies since they traditionally are used to a more principle-based accounting. This in turn requires more knowledge and competences than before in financial disclosures for SME.

In contrast, Toshio argued that IFRSs should be applied to all companies without concerns of scales and types, if IFRSs are of high quality standards as it should be. He asserted that SME had been forced to face international competitions and establish relationships outside of Japan due to the impact of globalization on the Japanese business environment. Hence he believed that all Japanese companies should sooner or later adopt IFRSs. Toshio underlined that approaches to the adoption should be carefully evaluated on account of accounting situation in one country. Although the prominent disadvantage according to Toshio is that the process of the adoption will take time.

Furthermore another disadvantage is the high transition cost (Hail et al, 2009; Choi, 2006) in relation to benefits. Hail et al regarded that the cost-benefit trade-off is totally depending on one company's choice whether cost is considered to weigh over the benefit or not. However citing from the study[3] done with Rimmel in 2005, Chitoshi concluded that the cost was not the main reason of the negative attitude from Japanese managers regarding adoption of IFRSs but the lack of proper educational staff in IFRSs. In the opinion of Toshio cost was not either considered to be a problem.

Nevertheless, one more pitfall of IFRSs stated by Chitoshi would be modest enhancement of "true and fair" view, which is one of the backbones behind the constitution of IFRSs. He expressed that the effect is trivial because of eliminations of all social factors in one country, which are vital for reflecting an actual picture of a company. Besides that Toshio assessed that the Japanese traditional business relationship would also be a hinder to achieve a "true and fair" view when for example neutral transaction based on trust would not be recorded in financial statements.

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[2] Hail L, Leuz C, Wysocki P, summary of *Global Accounting Convergence and the Potential Adoption of IFRSs by the United States: An Analysis of Economic and Policy Factors.* 2009

[3] Chitoshi K, Rimmel G. *Accounting harmonization and diffusion of international accounting standards: the Japan case* . 2007

5.2 Future adoption of IFRSs in Japan

Japanese accounting standards have inherited the Continental tradition from an early adoption of German accounting system. Later it was upgraded with the Anglo-Saxon tradition when U.S. accounting practices and principles were introduced in Japan in order to enhance Japanese accounting standards to be more open and investor-oriented. (Kim, 2007) Thus the Continental tradition has been eliminated little by little, as the Japanese GAAP is approaching to IFRSs according to Chitoshi. In alignment with him, Toshio also indicated that the Anglo-Saxon tradition has taken over the Japanese accounting tradition.

The reasons to the adoption of foreign accounting standards could be summarized into two factors. The first one is the level of Japanese economic growth in relation to other nations. Another factor depends on external forces, which imbue new political, economical and cultural substances into the old system. Although at present the Japanese economy is equivalent to the West, Japan is still in need of thorough changes in social and economic structure in parallel of implementation of IFRSs. (Kim, 2007) Otherwise the shift to IFRSs will not have the expected effects in enhancing the manner and the quality of financial statements. (Hail et al, 2007). In consistence with the theories, Toshio and Chitoshi shared same opinion that the main reason to accounting reforms is the impact of external forces as stated above. Chitoshi asserted that already from 1996 Japan had initiated a series of changes in accounting standards because of globalization of financial and capital markets. The revision of financial disclosures to be more adapted for users from that time is assessed as the most significant changes according to Toshio in align with Kim (2007). Thereafter following with the movements of EU and USA, Chitoshi stated that Japan is now in the end of the phase of the convergence between the Japanese GAAP and IFRSs with consideration to advance further towards the adoption. Toshio criticized this process as a pure political matter, which is regarded as not healthy for the improvement of accounting standards in general. Although he explained the fact that Japan accepted political pressures is because of a deficiency of generally accepted accounting standards from Japan in the context of international trade.

To the second factor that whether Japan could fundamentally modify the infrastructure of the Japanese financial and capital market, the “Triangular legal system” and business structure in forms of main-bank system and shareholdings are perceived as rigid barrier towards adoption of IFRSs. (Kim, 2007) Chitoshi argued that the affects of these systems would gradually be diminished considering the extent of impact of globalization over Japanese economy. He presumed that requirements from external forces initiate changes in corporate structure that in turn alter the structure of securities markets and thereafter accounting systems. According to him, the process will continue until Japanese accounting standards have reached the requirements. Toshio’s view on the issue coincided with Chitoshi that both the legal system and business structure would not be in the way for the adoption of IFRSs. However his answer to the impact on business structure differed from Chitoshi in that changes in the structure depends at the moment on the power of consumer from both domestic and international markets.

In 2005, there were only 2 of 123 companies[4] adopted IFRSs in Japan and the view on adoption of IFRSs were pessimistic from Japanese company mangers. In the interview with Chitoshi (2009), he asserted that there are no changes in the numbers over time. An explanation to this result, according to him, could be a lack of official support from Japanese institutions and the government since the adoption of IFRSs has not been settled yet. For Toshio the low rate of the adoption among Japanese companies depends simply on the absence of requirement of IFRSs in the legal regulations while assistance from institutions and the government is not concerned to be crucial.

In spite of the low numbers of companies that have adopted IFRSs in Japan, both the professors affirmed that Japanese large companies are ready for the adoption. According to Chitoshi, the reasons behind this may have to do with that the companies are relatively large and that it is important for them not being left behind when the competition in international markets is tough. From Toshio's point-of-view, the main driving force seems to be from the external factors as mentioned before in forms of politic pressure. Furthermore the attitude of Japanese management towards adoption of IFRSs has changed in a positive way as stated in the report of "Future direction of Japanese accounting standards" by Nippon Keidanren (2008). Chitoshi stated that this change is nearly predictable since IFRSs is already widespread and generally acknowledged by the world.

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[4] The number of companies responded to the survey in the article of *Accounting harmonization and diffusion of international accounting standards: the Japan case* by Chitoshi K and Rimmel G. (2007).

6. Concluding discussion

This chapter will present a discussion and summary to give account for the conclusions of the study by answering the main questions. In the end of the chapter there will be recommendation for future work.

6.1 Conclusions

The adoption of IFRSs has inevitably become a trend after the adoption in European countries and the proposal of future adoption by the USA. Hence it is essential and necessary for Japan to be along with the procedure to maintain a place as one of the most attractive capital markets for investors. In this study, the purpose is to depict the developments in Japanese accounting standards in order to evaluate the potential direction of Japanese accounting standards in the near future and to assess any changes within Japanese business environment and companies in a practical context in relation with IFRSs.

Reforms in Japanese accounting standards were considered as results of forces from the outside. However, this has become a long and complicated process since Japan has a tradition of not being open to change. Today in Japan there are almost no companies adopting IFRSs in consideration that there is not any enforcement yet. Therefore the actual impact of IFRSs on Japanese companies at the moment is merely possible to observe for this study.

However, IFRSs have been perceived as a useful tool to fulfill the goal set by IASB towards a uniform financial reporting language in the world and to be on the right track at the moment. Insofar the benefits of implementing IFRSs have been proven by several researchers to be more significant than continuing with national GAAP for at least large multinational companies listed in global markets. With the accelerated pace towards the adoption, large Japanese companies have already prepared before the adoption. Being contingent with the factors stated above, Japanese private and prominent organization as Nippon Keidanren which represents senior financial managers, and JICPA which represents public certificated accountants, have expressed a positive view on the adoption of IFRSs.

Still it is noteworthy that uniform and high quality accounting standards with considerable effects for all adopting companies cannot be accomplished simply with a mutual regulatory framework. Derived from the literature and the interviews, even though IFRSs are recognized as the international financial reporting language by all countries in the world, there have been few statistical analysis and academic confirmations of the effects of IFRSs. Through the study there are some specific concerns towards the compatibility of IFRSs in overall as it has showed as a body of conflicts. With a “true and fair” view as one of the central backbones, IFRSs are assessed to fail to present “true and fair” picture of a company in its financial statements. Another concern is regarding the extent of the impact of IFRSs in relation to one country’s accounting practices and principles. If the statement proposed by Hail et al (2008) is true, IFRSs will not be able to improve the quality and the manner of financial statement, if the fundamental changes in one country’s social and economic structure have not occurred during the process. At last, in agreement with Toshio, the involvement of politic matter should be limited to a minimum level while determining the implementation of a set of new accounting standards in one country. Although this scenario could be extremely hard to accomplish.

Acquiring from past experiences of harmonization and convergence, the process to approach IFRSs has been notified as dynamic. This indicates the width of involvements of several synchronous actors in the arena in relation to adopt IFRSs. Being able to establish a set of appropriate accounting standards applicable for all companies across nations, it is in need to consider other interests' views in terms of the interpretation of the standards and the manner of the approaching procedure. Some of the predominant interests are the bodies that have the task to interpret the standards, stock exchange organizations, accounting firms and listed companies.

In sum, Japanese accounting standards are definitively evolving towards the goal set by IASB and the globalization, to be more liberal, open and disclosed. As of 1986s the reform of double bookkeeping system, Japan has gone through severe reforms in forms of the harmonization and the convergence to the final phase of adoption of IFRSs at the current stage. Even though the Japanese accounting standard-setters are in deep considerations whether IFRSs can contribute its effect into Japanese accounting standards, it is conclusive that Japan will finalize the adoption, but in which extent, it will depend on the underlying developments in ground infrastructure in terms of the social factors and the business environments in Japan.

All things considered, more concrete conclusions regarding the potential contributions from IFRSs to accounting practices and standards in Japan would probably be discerned if the study was conducted about five years or more, then IFRSs have been applied among Japanese companies for a while.

6.2 Recommendation for further researches

In terms of recommendation for future work, further researches should evaluate developments of the Japanese accounting standards about few years from now when the adoption of IFRSs has been finalized in Japan to have a more accurate observation regarding the attitude of Japanese business community and the actual impact of IFRSs on Japanese accounting practices. In addition, another suggestion is to perceive the issue from a different perspective of another group such as accounting companies or senior financial managers.

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Appendix – Interview questions to professors

The interview guide consists of. The interviews are based on two main topics that hopefully could answer the two main questions stated in 1.3 regarding the movements of Japanese accounting standards and potential changes in business environment and companies. These two topics include Internationalization of accounting standards and future adoption of IFRSs in Japan.

The contacts with the interviewees were through e-mails and personal interviews.

Internationalization of accounting standards in relation to Japan

1.What do harmonization, convergence and adoption of IFRSs mean for you?

2.What are the advantages of the adoption of IFRSs?

3.What are the disadvantages of the adoption of IFRSs?

4. How do you perceive the convergence and adoption of IFRSs from cultural aspects in considerations with different accounting traditions and backgrounds across countries?

5. Will it be easier to compare concerns across border by preparing financial statements based on IFRSs?

6. Does IFRSs give a more “true and fair” picture of a company?

7. What do you experience Japan’s role in the process of accounting internationalization?

Future adoption of IFRSs in Japan

8. What are the most significant changes that have occurred in Japanese accounting standards in order to move towards IFRSs?

9. How well-prepared have you experienced with that Japan has been in the preparation of the adoption of IFRSs?

10. Is there any support from Japanese standard-setters and/or leading accounting organizations such as ASBJ?

11. Has the number of companies adopted IFRSs increased than few years ago compared to the time before the convergence project?

12. What are the predominate reason behind the reforms in Japanese accounting standards to impose for example the convergence and ongoing process of adoption of IFRSs? Is it because of internal or external factors?

13. In consideration with the “Triangular legal system” and corporate structure in form of zaibatsu and keiretsu, do you think there is a possibility for Japan to adopt IFRSs in time?

14. What do you think the convergence/adoption of IFRSs in Japan in relation to the previous convergence of German and American accounting systems?