



FINANCIAL SERVICES AGENCY
GOVERNMENT OF JAPAN
3-1-1 Kasumigaseki Chiyoda-ku Tokyo 100-8967 Japan

21 December 2004

Mr. Fabrice Demarigny
Secretary General
Committee of European Securities Regulators
11-13 avenue de Friedland
75008 Paris
France

Re: Draft Concept Paper on Equivalence of Certain Third Country GAAP and on Description of Certain Third Countries Mechanisms of Enforcement of Financial Information

Dear Mr. Demarigny:

As Deputy Commissioner for International Affairs of the Financial Services Agency of Japan ("Japanese FSA"), I am pleased to submit this letter on behalf of the Japanese FSA in response to the request, published on 21 October 2004, of the Committee of European Securities Regulators ("CESR") for comments on the draft concept paper on equivalence of certain third country GAAP and on description of certain third countries mechanisms of enforcement of financial information (the "Draft Concept Paper").

We appreciate that the CESR-Fin gave us the opportunity to participate in and make comments on the Draft Concept paper at the open hearing held on 23 November. We are also grateful to have the chance to make comments through this comments letter. **We sincerely hope that the CESR-Fin will make further efforts to ensure a fair, unbiased and transparent process for assessing equivalence of third country GAAP.**

With the increasing globalization of the world capital markets, including in particular cross-border offerings and investments, it could be said that the world capital markets have been in the process of de-facto convergence. What is important for policy-makers and regulators in the major capital markets in the world including the integrated EU capital market is to provide supportive environments to such market-driven process, and thus maintain the global and open nature of the capital markets. From this viewpoint, we believe that in assessing the equivalence **priorities should be put on the promotion of the global and open nature of the EU capital markets and ensuring investment opportunities for investors in the EU capital markets as well as the protection of investors.**

Through the so-called "Accounting Big Bang" in the late 1990s and early 2000s, the Japanese GAAP has been rapidly developing, and we believe it has become **consistent and equivalent with international accounting standards.** The Accounting Standards Board of Japan ("ASBJ"), a private accounting standards setting body established in July 2001, states in its Medium-term Operating Policy announced on 15 July 2004 that **the ASBJ supports the goal of international convergence toward high-quality accounting standards** and has continuously been improving the Japanese GAAP in line with the developments in the other major internationally recognized accounting standards including IAS/IFRS and US GAAP. **The ASBJ has also started talks with the International Accounting Standards Board ("IASB") about the joint project for convergence. The Japanese FSA supports such efforts by the ASBJ,** and is confident that such efforts will have further positive effects on the assessment of the equivalence of the Japanese GAAP with International Accounting

Standards / International Financial Reporting Standards ("IAS/IFRS").

Based on the above basic comments, we make comments on the questions provided in the Draft Concept Paper.

Proposed definition of equivalence and reference to investors' needs

The most basic characteristic required for accounting standards in Japan is, like the IAS/IFRS, to provide useful information for investment decision-making of investors. Therefore, we support the notion that equivalence should not be defined as being identical, and generally understand that the definition is whether or not the third country GAAP enables investors to make a similar decision in terms of whether to invest or divest.

The real issue then is how to judge whether or not the third country GAAP enables investors to take a similar investment decision. The Draft Concept Paper states that the CESR looks to market participants, especially to users of financial information, preparers and auditors, for providing input on this respect.

However, we wonder whether it is possible to make an objective judgment as to whether or not enable a "similar decision" by using views of market participants. Therefore, **we respectfully request the CESR to be objective in its consideration of the views of market participants.** For example, we believe that the CESR should not give an inappropriate weight to the views of "experts" who do not have sufficient knowledge of the Japanese GAAP through actual practice. **A much larger weight should be extended to the views of the interested parties with ample knowledge and experience with respect to the Japanese GAAP, including the Japanese interested parties, than to those of other external experts** without such knowledge and experience. We welcome that the CESR will engage the relevant third countries' standard setters and regulatory agencies in an ongoing dialogue throughout the process in order to ensure an appropriate and meaningful understanding of the third country frameworks. We believe that the Japanese interested parties are willing to contribute to the CESR's work.

In addition, **we respectfully request the CESR to make transparent processes of looking to a consultative working group of markets participants ("CWG") and external technical support ("ETS").** We have no concrete information of such processes at present. **We believe it necessary for the CESR to disclose participants of the CWG and the ETS, make public inputs from the CWG and ETS, and give us an opportunity to make comments, if necessary, on the inputs, in order to ensure real transparency of the processes to assess the equivalence.**

Knowledge of third country GAAP by EU investors

We believe that EU institutional investors can be assumed to have a good knowledge of third country GAAP including Japanese GAAP, but it is difficult to assume that EU individual investors have a good knowledge of IAS/IFRS and third country GAAP. Therefore, **we respectfully request the CESR to ensure that views of EU institutional investors, not EU individual investors, are considered in assessing whether or not third country GAAP enables a similar decision.** This is also justified by the assumption that EU individual investors mostly make investments in securities of third country issuers through institutional investors such as collective investment schemes. **We also respectfully request the CESR not to distinguish professional and individual investors in assessing equivalence.**

Institutional investors make investments globally on a portfolio basis by allocating their assets, for example, to the Japanese securities for a certain percentage point. Therefore, the Draft Concept Paper is right in indicating that it can be argued that Canadian, Japanese and US GAAP are already used to varying extents in EU markets. In addition, it can also be said that **EU institutional investors actually**

make a large amount of investment in Japanese securities by relying on Japanese GAAP. The ratio of foreign investors in trading value of the stocks of the Japanese markets in 2003 was 31 percent. The ratio becomes 46% if dealings by securities companies are excluded. Among foreign investors, EU investors occupied 47 percent. The shareownership by foreign investor amounted to 22 percent at the end of FY2003 (March 2004), the highest number in history.

Use of a third country GAAP by an issuer not regulated by the third country

The Draft Concept Paper states that the assessment of GAAP equivalence is limited to the most common situations, i.e. third country GAAP as applied and enforced in that third country. However, if this means that the Japanese issuers could not use US GAAP in the EU capital markets even if US GAAP is assessed as equivalent, such an outcome would not be appropriate because the assessment of GAAP should not be related to enforcement issues. Furthermore, the use of US GAAP is allowed even to eligible Japanese issuers for the domestic financial reporting purpose under the Securities and Exchange Law in Japan and subject to enforcement by the FSA. **If US GAAP is assessed as equivalent, the use of US GAAP by Japanese issuers, including both registrants and non-registrants with the US SEC, should be accepted in the EU capital markets.**

Topics covered by IAS/IFRS

It should not be appropriate to deny equivalence only because third country GAAP does not cover all the topics covered by IAS/IFRS. As stated in the Draft Concept Paper, **if lacking accounting standards are not relevant to third country issuers, such lack should not deny equivalence of the third country GAAP.**

For example, Japanese GAAP does not have corresponding standards to Financial Reporting in Hyperinflation Economics (IAS 29) and Agriculture (IAS41) because these standards are not relevant in Japan.

The Draft Concept paper states that the CESR is to focus the technical assessment only on the significant differences between IAS/IFRS and third country GAAP, which we support. **We respectfully request the CESR in review of general principles to focus only on the significant differences between topics covered by IAS/IFRS and third country GAAP.**

Technical Assessment

The Draft Concept Paper states that the CESR will only consider third country GAAP applicable as of 1 January 2005 for financial years starting this date, which will therefore not encompass future standards (e.g. standards whose application is dated after 1 January 2005 or draft standards).

However, **we respectfully request the CESR to consider those accounting standards whose introductions have been already decided before 1 January 2005 and which will be mandatory as of 1 January 2007** because the equivalent requirement for non-EU issuers will be applied from around 2007.

With regard to Japanese GAAP, **we respectfully request the CESR to include Impairments of Assets and Business Combinations in the consideration.** Impairment of Assets was issued in August 2002, and will become mandatory starting April 2005. Issuers have been able to use this accounting standard on a voluntary basis since FY2003. It can also be said that Impairment of Assets will be applicable as of 1 January 2005. Business Combinations was issued on October 2003, and will be mandatory starting April 2006. The business consolidation, which took this accounting standard into consideration, has already taken place in Japan.

We support that the CESR is required to focus the assessment only on the significant differences between IAS/IFRS and third country GAAP. In making a judgment as to whether there are "significant differences," **it is important not to conduct an excessive degree of detailed technical comparison of accounting standards, and not to give too much weight to symbolic differences.** The key criteria should be whether or not the financial statements prepared in accordance with third country GAAP provide equivalently sound quality financial information and enable a similar investment decision as those prepared in accordance with IAS/IFRS. If any difference is based on a sound accounting theory and does not cause a material difference in the quality of disclosed financial information in practice, the differences should be judged as not significant.

In addition, the judgment should be made in light of the promotion of the global and open nature of the EU capital markets, and the benefits to EU investors through the enlargement of investment opportunities, and by considering if the country to which the third country GAAP relates recognizes IAS/IFRS as equivalent to its GAAP.

Remedies

We believe that Japanese GAAP should be assessed as having equivalence with IAS/IFRS, and thus remedies will not be necessary. Our comments as follows are in response to the questions in the Draft Concept Paper.

First, **the distinction among the three remedies is not sufficiently clear.**

Second, among the three remedies, **statements of reconciliation and supplementary statements are not appropriate from the viewpoint of costs and benefits.** Considerable reconciliation required under not only supplementary statements but also statements of reconciliation would force third country issuers to bear a large burden in light of costs, which would be no different from the burden under restatement. Such burden could discourage financial activities of third country issuers within the EU capital markets, encourage their delisting from securities exchanges in the EU markets, and shift the focus of Japanese financing efforts outside Japan to non-EU markets. Such an outcome would neither be beneficial to Japanese issuers nor EU investors.

Third, the Draft Concept Paper limits the application of additional disclosures to cases where the differences from IAS/IFRS arise from different disclosure requirements. However, considering that EU institutional investors have a good knowledge of third country GAAP, **the remedy of additional disclosures should be also provided to cases of different accounting treatment.** We believe that EU institutional investors can make similar investment decisions through such remedy. In such cases, considering that under the Japanese law and regulations foreign issuers which use major GAAP including IAS/IFRS can use such GAAP only with the additional narrative disclosure of differences in accounting standards, the additional disclosure should be limited to the narrative disclosure of differences in accounting standards. If an additional quantitative disclosure were required, this would make it difficult to distinguish the additional disclosure and the statements of reconciliations. Such an outcome would not be appropriate.

Therefore, **we respectfully request the CESR to provide only the additional narrative disclosure of the differences in accounting standards, as the remedy in cases where there are significant differences in accounting standards.** This treatment will make a proper balance among the important policy objectives of the protection of investors in EU markets, the maintenance of open and global nature of EU markets, and ensuring investment opportunities for EU investors.

With regard to responsibility for application of remedies, we understand that application of a remedy depends on the materiality for a given issuer of the significant GAAP difference. On the other hand, it would not be easy in practice for a company and its auditors to make a judgment for the application of a remedy without sufficient

dialogue with the relevant competent authority. Therefore, **it is important for the relevant authority to provide clear guidance and hold thorough dialogues with the company and the auditors.**

Early warning mechanisms

Considering that accounting standards are to be in the process of ongoing improvement, we understand the need for early warning mechanisms. The issue is frequency of reassessment. We believe it is important to ensure a stable platform for issuers. From this viewpoint, **an annual reassessment goes too far, and is not appropriate. A longer interval, such as once every three years or more, is necessary for a reassessment.**

We would greatly appreciate it if you would seriously consider our views.

Yours Sincerely,

Toru Shikibu
Deputy Commissioner for International Affairs
Financial Services Agency, Japan