

Report on the Internationalization of Business Accounting in Japan

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Study Group on the Internationalization of Business Accounting

Ministry of Economy, Trade and Industry

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Roster of the Members of the Study Group on the Internationalization of Business Accounting

(Reference) Roster of Business Accounting Committee Members

Tables of International Comparisons of Accounting Standards

Introduction

Under the leadership of the International Accounting Standards Board (IASB), efforts are currently under way to promote international convergence in business accounting, which comprises the infrastructure of capital markets. In the past, uniform business accounting methods particular to major markets were developed as shared standards to present data on enterprise activities to investors and other stakeholders, in formats which were both objective and which enabled comparison, but as corporate activities become increasingly globalized, uniformity is now being sought on an international level. This trend was evident in the 1990s, when the IMF imposed the adoption of international accounting standards as a condition for loans to Asian countries such as Korea, as well as in China's actions to revise its practices to conform with international accounting standards when it joined the WTO.

Traditionally, markets have mutually accepted each other's business accounting standards so as to allow international investment and capital procurement to be conducted smoothly. However, in recent years there has been greater demand for integration of financial reporting content. In 2000, the International Organization of Securities Commissions (IOSCO) announced its support of the International Accounting Standards (IAS) system—which the International Accounting Standards Committee (IASC) had been working to formulate—as the accounting standards to be applied in multinational fund raising. As a result, IAS began to be recognized internationally as the actual standards that apply to corporations. In 2002, the EC¹ prescribed the application of International Financial Reporting Standards (IFRS)² to approximately 7,000 corporations in its market, in an effort to standardize accounting practices used in EU³ markets, in connection with EU market unification.

Business accounting methods developed in the capital markets of individual countries over a number of years, based on the particular systems and practices unique to each market. In Japan, business accounting principles were established in 1949. Since then, Japan's business accounting system has grown from individual financial statements, under a triangular system⁴ in which the Securities Exchange Law, Commercial Code, and

¹ The European Commission: the administrative body.

² The accounting standards that were created by the IASB are collectively called the IFRS, and consist of the IAS of the IASC (established in 1973, and the predecessor of the IASB until 2001), and the narrowly-defined IFRS, established by the IASB.

³ The European Union: the greater European economic region.

⁴ Triangular System: The Securities Exchange Law (whose objective is to protect investors) requires the use of "business accounting standards that are recognized to be generally fair and appropriate" (Japan GAAP: Generally Accepted Accounting Principles in Japan) as the basis for disclosure of securities reports, etc. The Commercial Code (whose objective is to adjust interest among creditors and shareholders) stipulates that "fair accounting practices should be taken into consideration" in the preparation of accounting records. In reality, records are prepared in accordance with the Japan GAAP. Under the Corporate Income Tax Law (whose objectives are fair taxation and tax revenue collection), taxable income

Corporate Income Tax Law play complementary roles. As corporate activities have grown increasingly international, and international commonality is sought in business accounting, the challenge that faces the internationalization of business accounting is the question of how to integrate accounting standards that are deeply rooted in individual countries. Japan is no exception.

Such organizations as the Ministry of Economy, Trade and Industry, the Financial Services Agency, the Japan Federation of Economic Organizations, and the Accounting Standards Board of Japan (ASBJ) are working to tackle the challenges of the present situation. The Study Group on Internationalization of Business Accounting supports the basic position of these organizations, but also believes that a more aggressive approach and better coordination of efforts among all parties are required.

Since December 2003, the Study Group has been honored by the participation of domestic business leaders, scholars, and market experts, as well as leaders of the European and American business communities in Japan⁵. In addition, we invited Japanese members of the ASBJ and the IASB as observers. We conducted a broad-based examination of issues revolving around the internationalization of Japanese business accounting amidst the current trend toward international convergence. This included a questionnaire-based survey⁶ of Japanese corporations and investors, and exchanges of opinions with foreign governments—such as the EC—and overseas standards bodies, such as the IASB (for a total of six meetings).

Of particular concern is an EU directive that, beginning in 2007, requires corporations based outside the EU, and having their stocks listed on European exchanges, to use “either the IFRS or another set of standards deemed equivalent” in their financial statements related to ongoing disclosure or new listings of their securities in the EU market.

In response to this critical issue, the Study Group listened to the opinions primarily of investors and other market participants in the industrial sector⁷, as well as of scholars, to

is computed, based on the financial statements prepared in accordance with the Japan GAAP and finalized pursuant to the Commercial Code. Thus, the Securities Exchange Law, Commercial Code, and Corporate Income Tax Law are closely intertwined in the practical regulation of business accounting.

⁵ The opinions of Mr. Casey Sadgman, Policy Director of the European Business Community in Japan, Mr. Jean-Francois Minier, Tokyo Branch Manager of Dressner Kleinwort Wasserstein, and Mr. Robert F. Grondine, Chairman of the American Chamber of Commerce in Japan were sought.

⁶ The survey was taken of all stock exchange-listed and OTC corporations (excluding securities firms, banks and insurance companies) that are included in the *Kaisha Shiki Ho (Quarterly Report of Corporations)*, totaling 3,488 corporations (with a response rate of 17.1%), and sell-side analysts and institutional investors, and buy-side analysts, totaling 199 corporations (with a response rate of 25.1%). Any reference to the “questionnaire-based survey” in the remainder of this report refers to this survey.

⁷ Opinions about this report were heard by the Corporate Finance Committee (see Reference), which is a committee of the Ministry of Economy, Trade and Industry. The CFOs of Japan’s major corporations sit on the committee.

consider the concept of mutual acceptance. At the same time, the group verified efforts that were initiated in 1998 to rapidly internationalize Japan's accounting standards, and the resultant equivalency of Japanese standards with the IFRS, by conducting technical comparisons of individual standard items. Furthermore, we elaborated on the equivalency of Japan's accounting standards and the IFRS, based on the concept of mutual acceptance and through the verification of accounting standards.

In addition, we analyzed the opinions of the above-mentioned participants to form a unified position on the international convergence of business accounting. We described the efforts made toward internationalization and the challenges that await us.

This interim report summarizes the basic philosophy regarding the internationalization of business accounting in Japan.

1. Effecting Mutual Acceptance

(1) Perspectives on Mutual Acceptance

With the growth of global corporate activities, international commonality is being sought in global standards for business accounting. The IFRS, in particular, is taking a leadership role in this movement. However, business accounting has developed over a number of years in individual countries, based on the market realities that are unique to each capital market, including regulatory systems. In Japan, business accounting evolved as it fulfilled certain roles in meeting the requirements of the Securities Exchange Law, Commercial Code and Corporate Income Tax Law. In contrast, business accounting has evolved over history in such countries as the United States mainly for the protection of investors. As these examples show, each country has its own unique situation.

In order to act in ways that would not hinder the fund raising and other global activities of corporations, while recognizing the individuality of the accounting standards of individual countries, “mutual acceptance” should be sought; countries would mutually recognize one another’s accounting standards only if they were “equivalent.” The evaluation of equivalency should be made by fully incorporating the opinions of market participants, and especially those of investors and corporations. In short, as long as individual standard items that are indispensable to investors and others are clearly stipulated in an explainable format⁸, and the standards are comparable in terms of their usefulness and comparability, these standards should be deemed to be equivalent.

In other words, there are rational reasons behind individual national standards, and differences between national accounting standards should not become obstacles for investors in making international comparisons, as long as the impact of such differences is clearly disclosed. Rather, many investors have expressed their preference for the use of standards that match the realities of the country in which the main business operation of the corporation is conducted, as such usage permits a more appropriate presentation of the realities of the corporation.

“Mutual acceptance” should be adopted so that these equivalent accounting standards are mutually accepted⁹.

(2) Mutual Acceptance with the EU

The urgent task today is mutual acceptance with the EU. At present, financial statements that are prepared in compliance with Japan’s accounting standards are accepted in EU markets. However, the EC announced in 2002 that it will require all companies whose securities are listed in the EU to adopt the IFRS, starting in January 2005. In addition, an EU directive requires corporations based outside of the EU that have their securities listed in the European markets to use “the IFRS or other standards that are deemed to be

⁸ Transparency in setting accounting standards and the way arguments are handled in the process of standard-setting are expected to be highly significant.

⁹ Mutual recognition is positioned as an interim stage in the process of international convergence of business accounting, which is the ultimate goal. Efforts toward international convergence are thus needed. For further details, see 3. International Convergence : Efforts and Obstacles

equivalent to the IFRS” in their financial statements for continuing disclosure in the EU market or new listings of their securities in the EU market. This requirement is expected to be enforced for Japanese and other non-EU corporations starting in 2007¹⁰.

Currently, at least 250 Japanese security issuers (business corporations, etc.) have their stocks and bonds listed in the EU. The majority have used the method of disclosing financial statements that were prepared in compliance with Japanese accounting standards. Should it be judged that Japan’s accounting standards are not equivalent to the IFRS and that disclosures made in compliance with Japanese accounting standards are not accepted by the EU, we have serious concerns about the potential direct impact on fund raising by these Japanese securities issuers in the EU.

Faced with this situation, the Japanese government and the industrial sector of Japan are exchanging views with the EC. However, the EC is still in the process of deliberation. Below we describe the efforts that have been made to rapidly internationalize Japan’s accounting standards since 1998, and the results of such efforts, as well as providing technical verification that the current Japanese accounting standards stipulate individual standard items that are needed by investors in an explainable format and that they are equivalent in terms of usability and comparability.

Furthermore, we earnestly hope that Japan’s accounting standards will promptly be accepted to be equivalent to the IFRS, for the sake of not only European market growth but also the sustenance and strengthening of the economic relationship between the EU and Japan, which centers on increased investment by Japanese corporations in the EU.

(3) The Evolution of Japanese Accounting Standards

Japan’s business accounting system fitted the management realities of Japanese corporations well and did not give rise to any inconvenience in the past. However, the following issues began to be raised about Japanese business accounting in the second half of the 1990s because of concerns about the soundness and reliability of financial statements in light of international discussions:

(i) Consolidated Information

The need for consolidated information increased as corporations began to gravitate toward consolidated corporate management while investors wanted to be able to accurately determine the risks borne and returns earned by groups of corporations. On the other hand, the scope of consolidation was externally set with the result that some subsidiaries were excluded from the scope of consolidation in spite of the presence of control, generating skepticism about the usefulness of information about groups of corporations.

(ii) Information concerning Corporate Income Tax, etc.

¹⁰ The “transparency directive” that pertains to continued disclosure is scheduled to be implemented at the end of 2006. The “prospectus directive” that relates to the listing of securities on stock exchanges is expected to take effect in January 2007 based on the directive’s enforcement regulations.

It has been pointed out that corporate income tax system revisions widened the differences between the financial statement profits before corporate income tax and other deductions and the taxable income. In addition, the timing of corporate income tax payments, etc. does not match the timing of net profits for the current year before deductions for corporate income tax, etc. These are examples of problems related to the calculation and presentation of correct profitability and financial conditions.

(iii) Information Concerning Corporate Pensions

Use of outside organizations to manage corporate pension plans has become increasingly prevalent. At the same time, a drop in the yields from investment of accumulated assets and unrealized losses on such assets have given rise to concerns as to the ability of the plans to secure assets that are large enough to meet the future pension payments. It has been pointed out that the reliability of financial statements is impaired in these ways, since actual conditions were not disclosed in spite of the widening shortfall in allowance for retirement benefit payments.

(iv) Accounting Standards for Financial Instruments

Today, a large number of corporations carry unrealized losses in the wake of the imploding of the so-called economic bubble. To achieve better transparency of business accounting in the face of globalization in the securities and financial markets, disclosure of market value information in footnotes alone is not sufficient. It is now necessary to establish account treatment standards for evaluating financial instruments at market values, as well as for evaluating newly developed financial instruments and trading techniques by weighing their values and risks, and reflect them properly on the balance sheets.

(v) Book Values of Fixed Assets

In Japan, treatment standards concerning impairment of fixed assets have not been clear. In light of the current situation in which the value of real estate and other fixed assets, as well as profitability, has fallen substantially, there is some concern that the current treatment may be allowing “unrealized losses” to be carried forward to future periods while leaving the book values of those assets at an overvalued level. Moreover, some believe that this situation has caused impairment of financial statement reliability, and there is concern about the arbitrary devaluation of fixed assets, due to the absence of solid treatment standards concerning impairment losses.

In response to these concerns, action was initiated in Japan in 1998 to achieve international harmonization and improve accounting standards at a rapid pace by taking into consideration the IFRS and U.S. accounting standards. These changes (termed the “Accounting Big Bang”) were as follows:

(i) Review of the Scope of Consolidation

Starting with the year ended March 2000, all subsidiaries began to be included in consolidation as a general rule. This revision of the scope of consolidation led to a new way to determine a subsidiary, based on whether or not the parent company (parent) “controls” the decision-making body, such as the board of directors, of the subsidiary.

An entity is now deemed to be a subsidiary when 1) the parent holds the majority of the voting rights in substance, or 2) when the parent holds a high percentage of the voting rights and certain facts are recognized that attest to the control of a decision-making body when the parent holds less than 50% of the voting rights.

(ii) Deferred Tax Assets and Liabilities (Tax Effect Accounting)

Starting with the year ended March 2000, tax amounts pertaining to temporary differences (differences between what is recognized for accounting purpose and what is recognized by the tax law), and those pertaining to loss operating carryforwards for tax purposes are recorded as deferred tax assets and liabilities, with the exception of amounts that are not expected to be recovered.

(iii) Accounting for Retirement Benefits

Retirement benefit accounting was introduced, starting with the year ended March 2001. Liabilities for retirement benefits (i.e., liabilities that are computed by discounting the amount that is part of the estimated retirement benefit payments and recognized to have been incurred before the end of the accounting period, using a certain discount rate over the remaining service lives of employees), adjusted for unrecognized past service cost and unrecognized actuarial gains and losses, less the pension asset balance, must be recognized as liabilities for retirement benefit obligations.

(iv) Accounting for Financial Instruments

Starting with the year ended March 2001, a new accounting treatment for financial instruments was adopted. In this accounting method, marketable securities that are held for trading are valued at market¹¹, and valuation gains or losses are noted in the income statement. Bonds that are intended to be held to maturity are valued at their amortized cost. All other marketable securities are valued at market, and the valuation gains or losses, which are computed by first reversing the book value to the historical acquisition cost and measuring the difference between the market value and the historical acquisition cost in each period, are directly recognized to equity. In Japan, there is a business tradition of crossholding of stocks. Even the stocks that cannot be sold immediately now have to be valued at market, and valuation differences calculated in the equity section. The adoption of this treatment thus places an immense burden on Japanese corporations. For this reason, this action deserves to be viewed as very ambitious, even in comparison with the actions of foreign countries.

(v) Accounting for Impairments

When the sum of undiscounted future cash flows falls below the book value of a fixed asset, an impairment loss is recognized. As a standard for measurement of impairment losses, the recoverable price (net sales price or value in use, whichever is greater) is computed, and if it is lower than the book value, the difference is noted as an impairment loss expense in the income statement. The impairment accounting began to be applied on a voluntary basis starting with the year ended March 2004, and will be required from the year ending March 2006.

¹¹ Both the market value as of the balance sheet date and the average market value over a one-month period prior to the balance sheet date are acceptable.

Furthermore, through revisions of the Commercial Code and the Corporate Income Tax, including the removal of the ban on holding companies, together with adoption of a consolidated tax payment system and the elimination of restrictions on treasury stock purchases and holdings, a legal system has been constructed that can respond to consolidated business management and flexible equity policies.

The Accounting Big Bang imposed a heavy burden on corporations' balance sheets in the process of financial instrument valuation at market and the recognition of projected pension benefit obligations. Specifically, the aggregate equity of the 400 largest corporations of Japan decreased in FY 2002 for the first time since the 1980s. On income statements, special loss in excess of ¥10 trillion¹² has been reported for several years in succession since FY 1999. This special loss was a jump from the few trillion yen figures that were the norm prior to 1999¹³. This phenomenon is believed to have encouraged reorganization of corporations, improved the soundness of balance sheets, and ultimately contributed to the realization of structural reform of the Japanese economy. The result, it is believed, will be a recovery of the Japanese economy across the board as Japanese corporations regain their competitiveness and profitability.

Today's recovery of Japanese corporations came about through this series of reforms. In other words, Japanese accounting standards have been formulated and contributed to the Japanese economy, because of the dedication and efforts of market participants, and especially those of corporations that took on challenges in a harsh environment¹⁴. Efforts continue to be made to develop and improve accounting standards under the leadership of a private-sector accounting standards-setting body that is equipped with transparency and independence.

(4) Japanese Accounting Standards and IFRS Equivalency

The IASB has been developing a single set of understandable, implementable, high-quality accounting standards (IFRS) with the objective of assisting the international convergence of national accounting standards. The IASB is the sole organization that works toward international convergence of business accounting today. The IASB is an international private-sector organization that separates itself from governments. Its members are from various countries; Japan has one member on the board¹⁵.

¹² Includes losses other than those resulting from changes in accounting treatment.

¹³ The source of the aggregate equity and special loss figures is a survey by Nomura Securities Co., Ltd.

¹⁴ The questionnaire-based survey revealed that 56% of corporations (issuing corporations), 59% of analysts, and 75% of institutional investors responded that the series of revisions and new additions to the accounting standards that were made following the Accounting Big Bang brought positive results.

¹⁵ The current members of the IASB are from the following countries: U.S.A. (5 members), U.K. (2 members), Japan, Germany, France, Canada, Sweden, Australia, and South Africa (1 member each). Fourteen members sit on the board.

Equivalency of the IFRS and Japanese accounting standards is currently a major issue. As stated earlier, Japanese accounting standards have become harmonized internationally as the result of the Accounting Big Bang. Needless to say, however, Japanese accounting standards and the IFRS are not identical. Certain differences do exist. This Study Group made a comparison of Japanese accounting standards, and the IFRS and U.S. accounting standards with respect to 23 major accounting standard items, including financial statement presentation, retirement benefit accounting, financial instruments and impairment accounting. (The comparison was made at the end of March 2004, when major IFRS items were presented. See the attachment.) Descriptions are given with respect to the main accounting standards as follows:

(i) Scope of Consolidation

With respect to the scope of consolidation, both Japanese accounting standards and the IFRS rely on the concept of “control” to determine subsidiaries. Specifically, the IFRS’s concept of “control” is stated as “the power to influence the financial and operating policies of a corporation so that benefit is gained from the activity of the corporation.” This is nearly identical to the definition of control under Japanese accounting standards.

(ii) Deferred Tax Assets and Liabilities (Tax Effect Accounting)

Regarding recognition of deferred tax assets and liabilities, Japanese accounting standards are similar to the IFRS and the US accounting standards in the sense that all of them recognize tax amounts relating to temporary differences and those pertaining to loss operating carryforwards for tax purposes as deferred tax assets or liabilities, with the exception of amounts that are not expected to be recovered or paid in the future.

(iii) Accounting for Retirement Benefits

As for accounting for retirement benefits, Japanese accounting standards and the IFRS are fundamentally the same with respect to the recognition of pension obligations as liabilities, the methods for treating retirement benefit obligations and past service cost, and the treatment method for unrecognized actuarial gains and losses. The IFRS uses the straight-line method to amortize past service cost over the average period until the rights to receive benefits have vested instead of the average remaining service lives. Regarding past service cost, Japan applies the average remaining service lives, whereas the IFRS uses the straight-line method of amortization over the average period until the right to receive benefits has vested. This is not believed to create a substantial difference. Furthermore, both the IFRS and the U.S. accounting standards use the so-called “corridor approach” that permits the portion of the unamortized accumulated actuarial gains and losses that fall within 10% of the greater of the pension benefit obligation and pension assets to be not amortized. In comparison with Japanese accounting standards, which call for a review when significant fluctuations occur in assumptions, the difference is not considered to be substantial.

(iv) Accounting for Financial Instruments

The IFRS also classify marketable securities that are held for trading as financial assets whose value is measured at fair value through the income statement. Other marketable securities are treated as available-for-sale financial assets and measured at fair value.

Fluctuations in their value are noted directly in the equity section through the statement of changes in equity. The IFRS is thus fundamentally the same as Japanese accounting standards.

As for the derecognition of financial assets, Japanese accounting standards derecognizes an asset when the control over the contractual rights has been transferred. Complete isolation from the risks of the transferee, such as its bankruptcy, is required for the transfer of control, just as under the U.S. accounting standards.

Under the IFRS, a determination is first made as to whether or not substantially all of the risks and economic benefits of a financial asset have been transferred. When such a determination is not possible, control and the presence of continued involvement are used for determination. Isolation from bankruptcy is not required. In comparison, Japanese accounting standards are more conservative. With respect to computation of an estimate for bad debt, Japanese accounting standards and the IFRS are fundamentally the same, as both estimate by discounting the future cash flows of individual claims.

(v) Accounting for Impairments

With respect to the standards for recognizing impairment losses of fixed assets, Japanese accounting standards, as well as U.S. accounting standards, use undiscounted cash flows as the basis, whereas the IFRS uses the recoverable amount as the basis. Regarding the standards for measurement of impairment losses, however, both Japanese accounting standards and the IFRS use the recoverable amount. Therefore, no significant difference exists between the two. With respect to the treatment when the recoverable amount bounces back, the IFRS permits reversing, whereas neither the Japanese accounting standards nor the U.S. accounting standards permit a reversal. The Japanese accounting standards can thus be said to be more conservative.

(vi) Accounting for Business Combinations

The IFRS permits only the purchase method of accounting for business combinations. It does not permit the pooling of interest method. Under the Japanese accounting standards, the pooling of the interest method is permitted under certain extremely specific conditions¹⁶ in consideration of the international trends in accounting standards. This is a reflection of the economic reality of Japan, where major on an equal footing is widely practiced as a mode of business combination, and should help improve, rather than harm, the reliability of financial statements.

Furthermore, Japanese accounting standards require amortization of goodwill that results from the use of the purchase method. The IFRS does not permit amortization of goodwill. However, the value of the excess profit-earning capability that is obtained from the acquired entity and included in goodwill should under normal circumstance deplete. Even when such excess profit-earning capability is sustained, it may be supplemented with additional investment made following a business combination. This in substance amounts to recognition of internally-generated goodwill over time. For this reason, it is

¹⁶ Within the range of plus or minus 5 points of 50:50 voting rights, and the absence of any substantive controlling relationship.

believed that goodwill should be amortized to be consistent with the accounting principles. This would be more conservative accounting treatment.

(vii) R&D Cost and Intangible Assets

Japanese accounting standards, as well as the U.S. accounting standards, treat the entire R&D cost as expenses when they are incurred. The IFRS, on the other hand, recognize research expenditures as expenses upon their incurrence, but require intangible assets that arise from development to be capitalized when certain criteria of determination can be verified. The Japanese and the U.S. accounting standards can therefore be said to be more conservative.

As for the initial recognition and measurement of intangible assets, Japanese accounting standards do not contain any detailed provisions. However, they use acquisition cost as the basis for recognition, and do not permit capitalization of internally generated goodwill or brand. They are thus similar to the IFRS.

Aside from the technical examination of the accounting standards described above, there has been no practical instance in which European investors or others raised any business accounting issues regarding the current Japanese accounting standards, which so far have been accepted in Europe.

Based on the foregoing analysis and accounting practice, and after listening to the opinions of not only the Japanese investors and other market participants but also European and American corporations and investors in Japan, this Study Group concludes that the Japanese accounting standards are at a level that compares well with the IFRS and thus are equivalent to the IFRS when judged by such criteria as usefulness, comparability, reliability and transparency, even though there are some small technical differences between the two sets of standards.

2. Resolution of the Legend Issue

The “legend” refers to a statement that is included in the footnotes to financial statements that are prepared in accordance with Japanese accounting standards, and informs readers that “the statements do not present the financial condition, operating results or cash flows that were prepared in accordance with accounting principles and practice that are generally accepted in countries other than Japan.” The objective of such a legend is to reduce the risk of misleading mainly foreign users into assuming that such statements were prepared in accordance with the U.S. accounting standards or the international accounting standards. The inclusion of such a legend was initiated around 1999 at the request of mainly U.S. audit firms in connection with audits that were conducted by Japanese audit firms of their member.

In Japan, international harmonization of accounting standards has been promoted rapidly through the Accounting Big Bang. At this stage, we believe that the Japanese accounting standards are at a level that compares well with the accounting standards of European and American countries. Nonetheless, the legend has yet to be eliminated.

Japanese audit firms should unite and strive for early resolution of the issue by powerfully influencing their European and American member firms so as to keep Japanese corporations from running into obstacles in their overseas business activities. This Study Group will urge European and American audit firms to eliminate the legend affixation through Japanese audit firms.

3. International Convergence: Efforts and Obstacles

(1) Efforts to Promote International Convergence

International convergence of business accounting is not a simple matter of dichotomy. Countries cannot simply adopt existing accounting standards of another country (or market) or some newly created standards. It is a process in which the involved parties of each country debate the benefits and shortcomings of the accounting standards that have been developed in their respective countries, integrate the accounting standards of different countries, and aim to ultimately establish a single set of high-quality accounting standards by consolidating national standards into international standards with the consensus of all countries.

As stated earlier, the IASB has been working to draft the IFRS, by members from various countries. In addition, the IASB and the Financial Accounting Standards Board (FASB), the body that determines accounting in the United States, which has the largest capital market in the world, reached an agreement (in September 2002 in Norwalk) to work toward achieving future convergence of their respective accounting standards. Currently, rigorous integration efforts are under way between the two organizations. These represent part of the process of achieving international convergence of accounting standards that will lead to the establishment of new accounting standards.

International convergence of business accounting is a long-range goal beyond the intermediate goal of mutual acceptance. Even if national accounting standards may be equivalent today, it is undoubtedly more desirable to bring different national accounting standards close together to achieve international convergence, and move in the direction of setting a single set of high-quality accounting standards. Consequently, it is necessary to achieve mutual acceptance with the EU, which is an urgent task, while continuing to tackle international convergence at a steady pace. This has been manifest in the remarks of certain European parties, as well as in the joint statement (of April 2004)¹⁷ that was issued by the Japan Federation of Economic Organizations and La Union des Confederations de l'Industrie et des Employeurs d'Europe (UNICE).

Such international convergence would ensure the usefulness and comparability of financial statements, and help the Japanese capital market to grow without being isolated internationally. Furthermore, it would promote mutual investments on an international scale. It would be extremely burdensome for Japanese corporations to have to prepare accounting reports of multiple standards containing different information as they conduct global operations and raise funds. To minimize such burdens, international convergence must be targeted¹⁸.

¹⁷ The joint statement of the Japan Federation of the Economic Organization and the UNICE states that "In order to reach the goal of sharing a single set of international accounting standards, Europe and Japan should join forces to influence the definition of international accounting standards that are likely to best serve the public interest. Given the present situation and before reaching convergence, joint efforts could be made to allow for an interim phase of mutual recognition."

¹⁸ The questionnaire-based survey revealed that 65% of corporations (issuing corporations), 77% of analysts and 79% of institutional investors consider the integration of the accounting standards of Japan,

In formulating business accounting standards that converge internationally, it is important to consider the usefulness, comparability, reliability and transparency that are internationally accepted, as described earlier, while also taking into consideration the accounting standards that have become well established in major countries. To achieve efficiency and effectiveness in this process, special efforts should be made to bring together the accounting standards of the United States, Europe and Japan, which are the major capital markets of the world. The direction that should be pursued is one in which the accounting standards of Japan, the United States and Europe are steadily meshed so that the opinions of market participants, such as investors and corporations, are fully reflected. Such work should in turn accelerate the convergence, and win the support and endorsement of market participants for the international convergence and integration of business accounting standards over the long run.

Japan therefore believes that sufficient debate among all parties involved, including market participants, and consensus formation are necessary in this endeavor, and that we should work toward this long-term goal while sharing our views with the United States and Europe as we proceed with our task.

(2) Obstacles to International Convergence

The following major issues for the future, which are currently being debated by the IASB, pose obstacles to international convergence. Japan is gravely concerned about these issues, as specific concepts seem to run ahead without reflecting the opinions of market participants, such as investors and corporations, being fully incorporated. Looking ahead, adequate discussions that involve market participants, including investors and corporations, are called for, together with formation of a consensus. These issues could become major obstacles that deter international convergence in Europe and America, as well as in Japan.

(i) Performance Reporting (Comprehensive Income¹⁹)

Views have been expressed in favor of preparing corporate performance reports, based on the concept of comprehensive income. This means that performance is expressed as a change in the net asset amount between the end of the year and the beginning of the year. Comprehensive income itself is a disputable concept. An additional problem is that the ongoing deliberation is moving in the direction of abolishing the currently used net profit presentation and banning the recycling²⁰ of unrealized gains or losses when these become realized.

the U.S.A. and European countries to be desirable. Regarding the process of integration, 85% of corporations (issuing corporations), 73% of analysts and 86% of institutional investors think it is appropriate to harmonize the national accounting standards of Japan, the U.S.A. and European countries to the point where mutual recognition is possible, and to let market participants lead the integration as they choose.

¹⁹ Comprehensive income: A change in net assets during the period (excluding transactions with shareholders)

²⁰ Recycling: Treatment to reclassify what was presented as unrealized gains or losses to realized gains or losses when these becomes realized

However, net profit that is presented today is founded on the concept of realization. Thus, it facilitates the forecasts of future profits and cash flows. (This point has been supported in a number of corroborative studies.) Accordingly, it is essential from the perspective of financial statement usefulness to permit recycling and the concurrent presentation of net profit as it is practiced today, even if the disclosure of comprehensive income is adopted²¹.

Net profit figures are truly useful and necessary for not only corporations but also investors as an important evaluation and management indicator that is used in the analysis and forecast of future corporate value and profitability. For this reason, many in the corporate and economic sectors are clamoring to have net profit information preserved²².

(ii) Accounting for Retirement Benefits

The current standard requires that retirement benefit obligation is recognized as a liability based on an estimate, and actuarial gains and losses²³ are recognized as a liability over multiple subsequent periods, using a consistent method. The IASB, on the other hand, plans to review the accounting for retirement benefits, including the method of immediate recognition of actuarial gains and losses²⁴.

Opinions have been expressed that altering the current treatment that has reasonable support from practitioners and adopting instead a new accounting treatment of this nature would unnecessarily increase the volatility of accounting profits, and could cause investors to make erroneous judgements. There is a strong concern that the usefulness of income information for future profit projections will be damaged.

(iii) Accounting for All Financial Instruments at Fair Value

Regarding accounting of all financial instruments at fair value, a JWG²⁵ draft was issued in 2000, but failed to gain widespread support. Judging from the same perspective as that

²¹ The IASB uses two levels of the quality of cash flows based on their future predictability, and states that it gives consideration to users' forecast of future cash flows.

²² According to the questionnaire-based survey, 56% of corporations (issuers) and 68% of analysts and institutional investors are opposed to the elimination of net profit.

²³ Actuarial gains and losses: gains and losses that result from differences between the expected investment yields of pension assets and their actual yields, differences between the estimates made at the beginning of a period, which were used for the actuarial computations of retirement benefit obligation, and the actual figures at the end of the period, etc..

²⁴ The IASB asserts that it is conducting a review based on its view that the realities of actuarial gains and losses are obscured by treatment to not recognize or delay the recognition of such gains and losses.

²⁵ JWG (Joint Working Group): A joint working group consisting of standard-setting bodies or organizations of accountants from the U.S.A., the U.K., Canada, Australia, France, Germany, Norway, New Zealand, Japan and the IASC that addresses the accounting standards for financial instruments.

adopted in the projects mentioned above in (i) and (ii) (Performance Reporting (Comprehensive Income) and Accounting for Retirement Benefits), and also from opinion exchanges with foreign accounting standards setting bodies, the IASB appears to still be eager to adopt full fair value accounting for all financial instruments.

However, there is a concern that such treatment would mislead investors because measuring liabilities at fair value, in particular, would cause liabilities to give rise to profit when the credit rating of a corporation that issues financial statements is lowered. On the asset side, too, fluctuations in the fair value of assets would be recognized as profit or loss regardless of the intention of the management with respect to the ownership of such assets.

It is important to press for a review of the articles of incorporation of the IASB, including the composition of its board members and the due process of establishing accounting standards, and also to work to improve the IASB governance so that Japan's opinion, as well as the opinions of such market participants as investors and industries of various countries including Japan, will be reflected in the IFRS. Specifically, the relationship with the main body that establishes the accounting standards should be strengthened, and representatives of major capital markets (Japan, Europe and America) should sit on the IASB board. Furthermore, the articles of incorporation should include provisions that establish a due process to delineate all arguments and explain precise policies and reasons in detail, and stipulate procedures for a sunset review²⁶ by a third party when opinions that are submitted in response to an open draft are not adopted.

²⁶ Procedure by which issues are examined as a project, and if no conclusion is reached within a certain time frame, the project is suspended.

Conclusion

Judging from the opinions of foreign business accounting professionals regarding Japan's accounting standards and auditing practices, there seems to be insufficient understanding outside of Japan regarding not only Japanese accounting standards but also the current status of disclosure and audits, the fundamental accounting concepts used in Japan, and Japan's philosophy and stance toward international convergence.

To improve this situation, it is necessary to energetically and effectively conduct PR activities overseas to disseminate information about Japanese accounting standards and the fundamental concepts behind them, as well as Japan's philosophy and stance toward international convergence.

Specifically, Japan must construct a system that enables all concerned parties to cooperate with one another and continuously forward information to foreign countries in a coordinated manner. As many reports and papers on Japanese accounting standards and practices as possible should be translated into English. It is also essential to promote international exchanges between people. Most urgently needed is a stream of information to the EC and other foreign governments, as well as to foreign standard-setting bodies, such as the IASB, about Japan's stance on mutual acceptance, the efforts that Japan has already made toward internationalization of its accounting standards, and the equivalency achieved by Japanese accounting standards with the IFRS as the fruit of such efforts.

Additionally, Japan's philosophy on international convergence and the efforts the country has made should be mentioned. Working under such a basic concept, Japan should take an active role in the formation of the IFRS, and ensure that the opinions of market participants, including Japanese industries and investors, should be reflected sufficiently in the performance reporting (comprehensive income) discussions that are taking place within the IASB.

End.

(Appendix)

List of Committee Members of the Study Group
on the Internationalization of Business Accounting

Chairman	Kazuo Hiramatsu	President, Kwansei Gakuin University
Deputy Chairman	Shinichiro Ito	Adviser, Sumitomo Electric Industries, Ltd.
Committee Members	Toru Anjo	Managing Director, Keizai Doyukai
	Mami Indo	General Manager, Business Research Department, Daiwa Securities SMBC Co., Ltd.
	Ryoichi Ueda	Operating Officer & Controller, Mitsubishi Corporation
	Syukichi Umemoto	General Manager, Finance&Accounting Center, Asahi Glass Co., Ltd.
	Hiroshi Endo	Former Director, Economics Division, Japan Federation of Economic Organizations
	Hiroaki Kakuta	Statutory Auditor, DaimlerChrysler Japan Co., Ltd.
	Atsushi Kato	Managing Director, The Japanese Institute of Certified Public Accountants
	Akihiko Shimizu	Executive Officer & Accounting Division General Manager, Ito-Yokado Co., Ltd.
	Tetsuo Seki	Senior Corporate Auditor, Nippon Steel Corporation
	Eiko Tsujiyama	Professor, Study of Commerce Faculty, Waseda University
	Yoshihiro Tokuga	Professor, Faculty of Economics, Kyoto University
	Teruki Nakajima	General Manager, Accounting & Finance Department, Teijin Limited.
	Eisuke Nagatomo	Managing Director & Executive Officer, Tokyo Exchange Stock, Inc.
	Shinji Nishio	Executive Vice President & Representative Director (CFO), Nippon Oil Corporation

	Yu Nishida	Project General Manager, Budget Division, Accounting Department, Toyota Motor Corporation
	Yoshihiro Nomura	Senior Strategist, Investment Strategy Department, Nomura Securities Co., Ltd.
	Hiroshi Fukumoto	General Manager, Management Group, Accounting & Finance Department, Kao Corporation
	Noriyuki Matsushima	Managing Director, Equity Research Department, Nikko Citigroup Limited.
	Masao Yanaga	Professor, Graduate School of Business Sciences, University of Tsukuba
	Hiroshi Yamada	Councilor, Accounting Group, Matsushita Electric Industrial Co., Ltd.
	Robert. F. Grondine	Chairman, The American Chamber of Commerce in Japan
Observers	Ikuo Nishikawa	Vice Chairman, Financial Accounting Standards Foundation
	Tatsumi Yamada	Liaison Board Member, International Accounting Standards Board

(Reference)

List of Business Accounting Committee Members

Chairman	Shinichiro Ito	Adviser, Sumitomo Electric Industries, Ltd.
Deputy Chairman	Tetsuo Seki	Senior Corporate Auditor, Nippon Steel Corporation
Committee Members	Ryuji Araki	Executive Vice-President, TOYOTA MOTOR CORPORATION
	Hiroshi Ito	Managing Director, SHOWA DENKO K.K
	Masamichi Ogura	Member of the Board, Corporate Executive Vice President and CFO, Fujitsu Limited.
	Masao Katsurauma	Managing Director, Toray Industries, Inc.
	Sadao Kato	Managing Director, Nippon Life Insurance Company
	Tetsuya Kawakami	Senior Managing Director (CFO), Matsushita Electric Industrial Co., Ltd.
	Setsuji Kimura	Auditor, Aichi Sangyo Co., Ltd.
	Nobuyuki Oneda	Operating Officer & Managing Director, Sony Corporation
	Tasuku Kondo	Executive Director & Executive Vice President (CFO), Mitsui & Co., Ltd.
	Tsuyoshi Sasaki	Senior Counselor, METOCEAN ENVIRONMENT, INC.
	Noriaki Shimazaki	Member of the Board, Senior Managing Executive Officer, Sumitomo Corporation
	Junji Tanehashi	Managing Director, Sumitomo Mitsui Banking Corporation
	Katsutoshi Chikudate	Executive Vice-President, The Tokyo Electric Power Company Incorporated
	Shinji Nishio	Executive Vice President And Chief Financial Officer, Nippon Oil Corporation
	Toshio Hasumi	Managing Director & General Director in charge of Corporate Administration , The Daiei, Inc.
	Masaru Hattori	Corporate Senior Vice President, ORIX Corporation
	Motoo Makita	Managing Director, Mitsubishi Heavy Industries, Ltd.

Yoshiki Yagi	Director, Hitachi, Ltd.
Toru Anjo	Managing Director, Keizai Doyukai
Toru Shinohara	Managing Director, The Japan Chamber of Commerce and Industry
Yoshio Nakamura	Senior Managing Director, Japan Federation of Economic Organizations

Appendix

Summary Table of International Comparisons of Accounting Standards

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Introduction

The International Accounting Standards Board (IASB) has moved rapidly with the revision of existing standards and development of new standards, bearing in mind the adoption of the International Accounting Standards (IAS) by the EU. The results of their work are now being published in succession. As of the end of March 2004, all major items of the accounting standards had been unveiled. At this point, it appears meaningful to take a bird's eye view of the relationship among the Japanese accounting standards, the IAS and the accounting standards of the United States, which has the greatest capital market in the world and exerts enormous global influence.

In this study report, the accounting standards of Japan, the IAS and the U.S. standards as they stood at the end of March 2004 were investigated and summarized into a comparison table so that it can be used as an aid in the examination of future action to be taken by Japan.

Readers should take note of the following points in using this study report:

- The study examined the latest accounting standards that were published as of March 31, 2004. These included some that had not become applicable as of that date.

- In order to present the differences among the accounting standards in a concise and easy-to-understand manner, we included in the comparison table only a limited number of items, and provided only brief explanations of accounting standards. For this reason, readers are advised to examine the original accounting standards documents for accurate and detailed understanding of these accounting standards.

Presentation of Financial Statements

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Financial statements that need to be prepared.	<ul style="list-style-type: none"> - Balance sheet - Income statement - Statement of retained earnings - Statement of cash flow - Supporting schedules <p>* The statement of changes in equity is not included.</p>	<ul style="list-style-type: none"> - Balance sheet - Income statement - Statement of changes in equity - Statement of cash flow 	<ul style="list-style-type: none"> - Balance sheet - Income statement - Statement of comprehensive income (May be included in another report.) - Statement of changes in equity - Statement of cash flow - Supporting schedules
Departures from the standards	There are no special provisions.	Provisions exist for extremely exceptional situations.	The accounting standards do not contain any special provisions. Provisions are found in the audit standards.
Comparative information	A comparison between two accounting periods is presented.	A comparison between two accounting periods is presented.	Balance sheet comparisons are made between two periods. All others are compared over three periods.
Reporting periods	The Securities Exchange Law requires annual and semi-annual reports. Quarterly reports are required by the Tokyo Stock Exchange Mothers.	Reports must be prepared at least annually. Semi-annual or quarterly reports are not required. Requirements of national regulatory authorities should be heeded.	Annual and quarterly reports are required.
Disclosure of discontinued operations	There are no special provisions.	Disclosure is required.	Disclosure is required.

Accounting Changes

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Changes in accounting estimates	<p>Accounting treatment of changes in accounting estimates is not necessarily clear.</p> <p>Changes in accounting estimates are disclosed in a footnote together with changes in accounting policies as part of supplementary information.</p>	<p>The impact of a change in an estimate is included in the computation of net income for the period which is affected by the change. The change does not affect prior periods. When a change in an accounting estimate materially affects the current or future periods, the nature of the change and the amount are disclosed.</p>	<p>When there is a change in an accounting estimate, the amount affected is recognized in the period which is affected. The change does not affect financial statements for prior periods.</p> <p>When a change in an estimate materially affects multiple future periods, its impact on profit before extraordinary items, net income and earnings per share for the current period is disclosed.</p>
Material errors	<p>There are no special provisions. However, corrections to material errors that pertain to prior periods are included in the income statement for the year in which the errors are discovered.</p> <p>* No retroactive correction is made. No revision is made to prior period statements.</p>	<p>Retroactive adjustments are made in the first set of financial statements that are finalized after the discovery of the material error.</p>	<p>Retroactive adjustments are made in correcting errors.</p>
Changes in accounting policies.	<p>Post-change figures are presented, using accounts similar to those used prior to the change. The fact that a change took place and the amount affected are disclosed in a footnote.</p> <p>* No retroactive correction is made. No revision is made to prior period statements.</p>	<p>If the change is for the initial application of standards, etc. and there are clear provisions pertaining to transition to the standards, etc., the provisions are complied with. If that is not the case, or if the accounting policy change is voluntary, revisions are made retroactively.</p>	<p>As a general rule, cumulative effects of a change in accounting principles as of the beginning of a period are presented between the extraordinary items and net income on the income statement of the year in which such a change is effected. In addition, the effects of the change on profit before adjustments for extraordinary items, those of the change on net income for the year, and pro forma profit before extraordinary items and net income are presented as supplementary information.</p>

Inventories

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Application of the lower-of-cost-or-market criterion	Acquisition cost as a general rule, except when market value falls substantially below the acquisition cost, in which case market value is used unless there is a possibility of a recovery. (Cost method) When market value falls below cost, market value can be used on the balance sheet. (Lower-of-cost-or-market method)	Inventories are valued at either cost or net realizable value, whichever is lower.	When the value of inventories falls below their cost, the loss is measured using market value (replacement cost), and the inventory value is lowered.
Cost allocation method	- Specific identification method - FIFO method - LIFO method - Average cost method	When the specific identification method is not applied, - FIFO method - Weighted average method	When the specific identification method is not applied, - FIFO method - Average method - LIFO method

Tangible Fixed Assets, Investments in Real Estate, and Borrowing Cost (Part 1)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Capitalization of borrowing cost	Allowed for self-constructed fixed assets, and expenditures for real estate development projects.	Approved in certain cases.	Required in certain cases.
Capital expenditures and revenue expenditure	There are no specific criteria. Some tax law provisions exist.	A decision to capitalize or not is made by taking into consideration the criterion of recognition upon initial acquisition. The recognition criterion upon initial acquisition is as follows: (i) There is a strong possibility that future economic benefit relating to the particular assets will flow to the corporation. ()The corporation is able to measure the acquisition cost of the particular assets with reliability. * There are criteria for capitalization.	There are no specific criteria. There are provisions with respect to cost relating to asbestos and environmental pollution.
Measurement subsequent to the initial recognition	Measured at the acquisition cost, reduced by accumulated depreciation and accumulated impairment losses. The "Law concerning Revaluation of Land" contains a provision for revaluation of land that is used for business. This, however, is nothing but temporary revaluation that is permitted by a special law.	Either the cost model or the revaluation model is selected. <Cost Model> Measured at the acquisition cost, reduced by accumulated depreciation and accumulated impairment losses. <Revaluation Model> Measured at the revalued amount, which equals the fair value, reduced by subsequent accumulated depreciation and accumulated impairment losses. * Revaluation is permitted.	Measured at the acquisition cost, reduced by accumulated depreciation and accumulated impairment losses. (There are no specific provisions.)
Depreciation method	Depreciation is taken systematically and in an orderly manner using a prescribed method. The straight-line, declining balance, sum-of-the-digit, and unit-of-production methods are included.	Depreciation is taken by reflecting a pattern in which the economic benefit of an asset is consumed. The straight-line, declining balance and unit-of-production methods are included.	Allocation is made over an estimated useful life, using a systematic and rational method.

Tangible Fixed Assets, Investments in Real Estate, and Borrowing Cost (Part 2)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Treatment of fixed assets scheduled for sale	There are no provisions that directly deal with treatment. (There is a possibility that impairments apply.)	Valued at either book value or fair value, reduced by selling expense, whichever is lower.	Valued at either book value or fair value, reduced by selling expense, whichever is lower.
Treatment of investments in real estate.	Valued at the acquisition cost as tangible fixed assets, due to the absence of specific provisions.	Either the cost model or the fair value model is selected. * There are provisions concerning investments in real estate.	Valued at the acquisition cost as tangible fixed assets, due to the absence of specific provisions.

Accounting for Leases (Accounting Treatment by Lessees)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Types of lease transactions	Leases can be broken down to the following two types: (i) Finance lease transactions (1) Finance lease transactions with title transfer (2) Finance lease transactions without title transfer (ii) Operating lease transactions	Leases can be broken down to the following two types: (i) Finance lease transactions (ii) Operating lease transactions	Leases can be broken down to the following two types: (i) Capital lease transactions (ii) Operating lease transactions
Accounting treatment of finance leases (capital leases)	- Accounted for in accordance with a method that applies to ordinary selling and buying transactions as a general rule. - Finance lease transactions without title transfer can be treated in accordance with a method that applies to ordinary lease transactions. * There are exceptions relating to finance lease transactions without title transfer.	A method that applies to ordinary selling and buying transactions applies.	A method that applies to ordinary selling and buying transactions applies.

Accounting for Impairment

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Criteria for recognition of impairment	Impairment loss is recognized when the sum of undiscounted future cash flows is less than the book value.	Impairment loss is immediately recognized when the recoverable amount is less than the book value.	Impairment loss is recognized when the sum of undiscounted future cash flows is less than the book value.
Criteria for measurement of impairment	The recoverable amount is used as the basis for the measurement of impairment loss. The difference between the book value and the recoverable amount is recognized as impairment loss.	The recoverable amount is used as the basis for the measurement of impairment loss. The difference between the book value and the recoverable amount is recognized as impairment loss.	The fair value is used as the basis for the measurement of impairment loss. The difference between the book value and the fair value is recognized as impairment loss.
Impairment loss of goodwill	<p>(1) When there is an indication of impairment, testing for impairment loss is performed on a unit that is large enough to include both a group of assets that are associated with the operation to which the goodwill is attributed, and goodwill.</p> <p>Any increase in the amount of impairment loss that is computed by adding goodwill is allocated to goodwill as a general rule.</p> <p>(2) When it is possible to allocate the book value of goodwill to groups of assets that are associated with the attributed operation on a reasonable basis, the book value of goodwill is allocated to individual asset groups first, and then the recognition of impairment loss is tested.</p> <p>Recognized impairment loss is allocated to goodwill first, and the remainder is allocated over individual component assets using a rational method, such as allocation that is proportionate with book values.</p>	<p>(1) Goodwill is allocated to a cash-generating unit at the time it is acquired as the result of business combinations. When it cannot be allocated, a comparison is made between the book value excluding goodwill and the recoverable amount of the cash-generating unit being examined.</p> <p>(2) When the book value of goodwill can be allocated to a cash-generating unit, it is allocated to the cash-generating unit being examined. A comparison is made between the book value after goodwill allocation and the recoverable amount, either annually or whenever there is an indication.</p> <p>In connection with (1) and (2) mentioned above, if the recoverable amount is less than the book value, impairment loss is recognized at the level of the smallest unit to which goodwill can be allocated. The impairment loss thus recognized is allocated to goodwill first, and the remainder is allocated over individual component assets using a rational method, such as allocation proportionate with book values.</p>	<p>Testing for the recognition of impairment loss relating to goodwill is performed in two steps as follows:</p> <p>Step 1: The fair value and the book value of the reporting unit are compared. If the fair value of the reporting unit is less than its book value, Step 2 is performed.</p> <p>Step 2: The fair value of goodwill is computed by deducting from the fair value of the reporting unit the fair value of all recognized and unrecognized assets and liabilities. The excess of the carrying amount of goodwill over this amount is recognized as impairment loss.</p> <p>Only when a group of assets is a reporting unit or includes a reporting unit, goodwill is included in the group of assets for testing of impairment loss recognition. * Testing for impairment loss recognition of goodwill is performed in two steps.</p>

R&D Cost and Intangible Assets

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Treatment of R&D cost	Expensed as incurred. However, cost expended especially for the adoption of new technology or a new management organization, resource development, or development of a new market can be recognized as deferred assets in some instances.	Research expenditures are recognized as expense as incurred. Intangible assets that arise from development are required to be capitalized when certain criteria can be proven. * Development cost is governed by a conditional capitalization method.	Expensed as incurred.
Treatment of Software	Software that meets certain criteria in each of the following categories is included in assets: (1) Software that is customized. (2) Software intended for sale in the market. (3) Software for internal use. Software is depreciated, using a rational method that is suited to the nature of the software. However, the depreciation expense in each period must not be less than the amount of the straight-line allocation that is based on the remaining useful life.	Only a description of some examples of development cost capitalization is offered. * There are no provisions solely for software.	<u>Software for sale in the market</u> The cost of creating a product master after the establishment of technical feasibility is capitalized. Depreciation is taken on a product-by-product basis. <u>Software intended for internal use</u> Development cost incurred during the development phase is capitalized if such development is for a functional improvement or addition, and depreciated using the straight-line method as a general rule. Expenditures during the preparation phase, etc. are expensed.
Initial recognition and measurement of intangible assets	Recognized, using the acquisition cost as the basis. There are no detailed provisions.	Capitalized at cost. Internally generated goodwill, brands, customer lists, etc. are expensed as incurred.	Initially recognized and measured based on the fair value. Expensed as incurred when it is not possible to make clear identification or determine the useful life, and when the cost is for self-creation, maintenance or repair of intangible assets (including goodwill) associated with the entire corporation.
Depreciation method and depreciation period of intangible assets	The acquisition cost of an intangible asset is amortized in each accounting year over the useful life of the asset, using a consistent amortization method.	The depreciation method must reflect the pattern of consumption of economic benefits. When an appropriate method cannot be applied, the straight-line method is used. Intangible assets whose useful lives are uncertain are not depreciated.	The depreciation method must reflect the trend in which the economic benefits of the intangible asset is consumed or depleted. When such a trend cannot be determined, the straight-line method is used. Intangible assets whose useful lives are uncertain are not depreciated.

Provisions, Contingent Liabilities and Contingent Assets (Part 1)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Provisions (1) Definition and recognition	<p>Provisions consist of liability reserves and valuation reserves (asset deductions). The former is broken down to reserves that entail obligations and those that do not entail obligations.</p> <p>Provisions are recognized in the following instances:</p> <ul style="list-style-type: none"> (i) Specific future expense or loss. (ii) An event prior to the current period gave rise to the incurrence. (iii) The incurrence is probable. (iv) The amount can be estimated reasonably. <p>*Includes those that do not entail obligations.</p>	<p>Provisions are liabilities of uncertain timing or amount. Provisions are recognized in the following cases:</p> <ul style="list-style-type: none"> (i) A present obligation (legal or constructive) has arisen as the result of past events. (ii) An outflow of resources is probable. (iii) The amount of the obligation can be estimated reliably. 	<p>Estimated loss arising from contingent loss is reported in the income statement when the following two conditions are met:</p> <ul style="list-style-type: none"> (i) It is known on the balance sheet date that there is a strong possibility that assets have been impaired or liabilities have been incurred. (ii) The amount of the loss can be estimated reasonably.
Provisions (2) Measurement	<p>Based on a reasonable estimate.</p>	<p>The best estimate at the balance sheet date is used. The following are taken into consideration in arriving at an estimate.</p> <ul style="list-style-type: none"> - Risks and uncertainty - Effects of the time value of money. <p>Future events that affect the amount of settlement of obligations.</p> <p>* Discounting of an expected value is also performed.</p>	<p>Based on a reasonable estimate.</p>
Provisions (3) Application of recognition and measurement rules	<p>Specific names are given for provisions. In addition, specific treatment is established in individual standards with respect to several provisions, such as provision for bad debt and provision for loss on guarantee of liabilities.</p> <p>* There are no clear rules regarding provisions relating to restructuring.</p>	<p>The necessity for a provision is discussed in specific instances. In addition, specific rules are set in connection with (i) future operating loss, (ii) disadvantageous contracts, and (iii) restructuring.</p>	<p>Examples of contingent losses are provided. In addition, rules are individually set for certain items, such as the initial recognition of guarantee of liabilities, and cost associated with withdrawal and disposition activities relating to restructuring.</p>

Provisions, Contingent Liabilities and Contingent Assets (Part 2)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Contingent liabilities	The nature and the amount of contingent liabilities are disclosed in footnotes.	Except in cases in which there is little probability of outflows for settlement, a brief explanation about the nature is disclosed. If possible, disclosure is made as to the uncertain nature of the financial impact and the total amount and timing of the outflows.	Even when contingent loss is not reported (in the income statement), disclosure is made about the nature and the estimation of either the amount of the loss or its upper and lower limits when incurrence of such a loss is at least reasonably possible.
Contingent assets	No specific rules.	Disclosure is required when the probability of the inflow of economic benefits becomes high.	Proper disclosure is required so as to avoid misunderstanding about contingent events that bring benefits.

Retirement Benefits

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Recognition of liabilities for pension obligations	Retirement benefit obligations, adjusted for unrecognized liabilities for past service costs and unrecognized actuarial gains and losses, less the amount of pension assets, are reported as liabilities for retirement benefit payments.	If the amount computed as follows is a positive number, liabilities must be recognized: - Present value of liabilities for vested benefits - Unrecognized insurance actuarial gains and losses. (Added if gains result.) - Unrecognized past service cost - Fair value of pension assets	Pension cost payable must be included in liabilities. When there is an amount of the ABO (accumulated benefit obligations) that is not fully funded, the amount must be recognized as a liability at the minimum. (The minimum pension liability)
Retirement benefit obligations	Computed by discounting the amount of the estimated retirement benefits that are deemed to have been incurred as of the balance sheet date at a certain discount rate and over the remaining service years.	Present value of the projected future payment amount that will be required to settle the obligations that arise from employees' services rendered during the current period and the past years (before pension assets are deducted).	The PBO (projected benefit obligation) is basically used. However, the unfunded amount of the ABO is the minimum amount that must be recognized as a liability. (The minimum pension liability)
Treatment of past service costs	As a general rule, an amount that is incurred in each period is prorated over a certain number of years within the average remaining service years and expensed in each of the periods. The portion that pertains to retired employees can be expensed immediately.	Amortized using the straight-line method over the average period until the rights to receive the benefits are vested. Those that are already vested are immediately amortized.	Past service costs relating to current employees are amortized using the straight-line method over the remaining service years of the individual employees or the average remaining service years. For the portion relating to retired employees, deferred amortization over their remaining life span is used.
Treatment of actuarial gains and losses	As a general rule, an amount that is incurred in each period is prorated over a certain number of years within the average remaining service years and expensed in each of the periods. A review is not required unless material changes occur in the basic rates.	The portion of the unamortized cumulative amount that is less than 10% of the pension liabilities or that of the pension assets, whichever is greater, does not have to be amortized. (The corridor approach) The portion in excess of 10% is required to be amortized equally over the remaining service years of employees at the minimum.	The portion of the unamortized cumulative amount that is less than 10% of the pension liabilities or that of the pension assets, whichever is greater, does not have to be amortized. (The corridor approach) The portion in excess of 10% is required to be amortized equally over the remaining service years of employees at the minimum.

Treasury Stock, Etc.

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Presentation of treasury stock	Presented as a deduction from the equity section.	Presented as a deduction from the equity section.	Presented as a deduction from the equity section.
Rights to subscribe to new shares (The issuer side)	Reported in the liability section. The rights are reclassified to equity when exercised. When the rights expire before they are exercised, they are recognized as profits.	Reported in the equity section as equity financial instruments.	Reported in the equity section as equity financial instruments.
Distinction between liabilities and equity	Definitions of liabilities and equity are not given. No clear rules are established.	There are provisions concerning the inclusion of equity financial instruments in the equity.	There are provisions for situations where financial instruments that possess both the characters of liabilities and those of equity are required to be included in the liability section.

Income and Construction Contract

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Income recognition (general discussion)	The realization principle is adopted. The criteria of realization are generally as follows: (i) Goods or services are offered. (ii) Cash equivalents, etc. are received.	Income is recognized in the income statement when future economic benefits relating to an increase in assets or a decrease in liabilities are generated and they can be measured reliably. * This is believed to be consistent with the asset liability approach.	The following two requirements are considered: (1) Income is realized or realizable, and (2) Income is earned. <u>Requirements of Income Recognition (SAB 104)</u> (1) Presence of persuasive evidence that an arrangement exists. (2) Delivery of goods or execution of services. (3) Selling price is set or determinable. (4) Collection is guaranteed rationally.
Income recognition - sale of goods	In practice, income is recognized when sale is acknowledged to have taken place, based on the delivery standards, shipping standards or commercial practice.	Income is recognized when all five conditions, including the transfer of material risks and economic value to the buyer, are met. (In many cases, this occurs simultaneously with the transfer of legal title and possession to the buyer.)	Seven examples are presented as cases of income and profit recognition.
Income recognition - services offered	When services are offered only once, income is recognized when the services are complete. When services are offered continuously in accordance with an agreement, income recognition is based on the passage of time.	As a general rule, the stage of completion method is used.	It is interpreted that income is recognized in accordance with the offer of services.
Recognition of construction contract income	Either the percentage-of-completion or the completed-contract method is selected for long-term construction contracts.	(1) The outcome of the construction contract can be estimated reliably. The percentage-of-completion method is used. Recognition in accordance with the progress. (2) The outcome cannot be estimated reliably. Of the actually incurred cost, recognition is made up to the amount that is projected to be recoverable. * Use of the completed-contract method is not approved.	Generally, with long-term construction contracts, (1) The percentage-of-completion method is preferred if the cost estimate and the degree of progress until completion can be estimated rationally. (2) The completed-contract method is preferred in the absence of a reliable estimate, and when forecast figures, etc. are doubtful, due to inherent obstacles.

Government Subsidies

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Outline of accounting treatment for government subsidies.	<p>Government subsidies are recognized generally as profit when received rather than as capital surplus.</p> <p>Reduction entries are permitted when fixed assets are acquired. Methods of reduction consist of the following:</p> <p>(i) Direct reduction method, and</p> <p>(ii) Profit appropriation method.</p> <p>* Profit is not recognized all at once under the (i) direct reduction method, but recognized at once under the (ii) profit appropriation method.</p>	<p>Government subsidies are not recognized until there is rational guarantee as to (a) the corporation's satisfying the conditions that are attached to the granting of the subsidies, and the (b) granting of subsidies. Government subsidies are recognized as profit systematically over a required period as they are matched against related expenses that are reimbursed. (The income approach)</p> <p>For balance sheet presentation, one of the following two methods may be selected:</p> <p>(i) The method of presenting deferred income.</p> <p>(ii) The method of deducting from the book value of assets.</p>	<p>The treatment follows the guidelines for general income recognition as no standards for recognizing government subsidies are established.</p> <p>* Generally believed to be in conformity with the provisions of the IAS 20.</p>

Deferred Taxes relating to Corporate Income Tax, etc.

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Recognition of deferred tax assets and liabilities	The amounts of taxes relating to temporary differences and losses carried forward for tax purposes are recognized as deferred tax assets and liabilities with the exception of the amounts that are not projected to be recovered or paid in the future.	With the exception of certain cases, deferred tax liabilities are recognized with respect to all taxable temporary differences. As a general rule, deferred tax assets are recognized with respect to all deductible temporary differences to the extent that taxable profit will probably be available against which the temporary difference will be utilized in the future. The same applies to tax losses carried forward.	Deferred tax liabilities or assets are recognized with respect to all temporary differences, loss carryforward and tax credit carryforward. When it is “probable” (with a probability in excess of 50%) that part or all of the deferred tax assets will not be realized, deferred tax assets are written down by using a valuation allowance.
Presentation of deferred tax assets and liabilities on the balance sheet.	Presented in either the current or non-current sections, based on the classification of the relevant assets and liabilities. Part of the deferred tax assets relating to losses carried forward that are projected to be cleared in the following period are presented as current assets. All others are presented as investments and other assets. Current deferred tax assets and liabilities, and non-current deferred tax assets and liabilities offset each other. However, deferred tax assets and liabilities of different tax paying entities cannot be offset.	When assets and liabilities are separated into current and noncurrent sections on the balance sheet, deferred tax assets and liabilities must not be classified to current assets and liabilities. Deferred tax assets and deferred tax liabilities are offset on the balance sheet only in the following case: (1) The enterprise has the legally enforceable right to offset, and (2) intends to settle on a net basis..	Classified to current and noncurrent sections, based on the classification of related assets or liabilities. Deferred tax assets that relate to loss carryforward are classified according to the dates on which their temporary differences will be reversed. All current deferred tax assets and liabilities, and non-current deferred tax liabilities and assets are presented on a net basis with respect to specific tax-paying bodies within an enterprise and within a specific tax authority jurisdiction.

Financial Instruments (Part 1)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Derecognition of financial instruments – transfer of control	Financial assets are derecognized when the control over contractual rights transfers. Transfer of control requires insulation from bankruptcy.	An assessment is first made of a financial asset as to whether or not substantially all risks and economic value have been transferred. When such an assessment is not possible, presence of control and continued involvement are used for assessment. (Pass-through transactions are exceptions.) * Determination of derecognition, resulting from transfer of risks and economic value, is first made. Transfer of control does not require insulation from bankruptcy.	Financial assets are derecognized when the transferor's control is transferred. Transfer of control requires insulation from bankruptcy.
Valuation of marketable securities Classification of marketable securities - Marketable securities held for trading	(1) Marketable securities held for trading Valued at market, with valuation gains and losses recognized in current income.	(1) Financial assets and liabilities that are measured at fair value through the income statement.* Measured at fair value, and variation gains and losses are included in the income for the current period. * Any financial instrument can be designated to this classification at the time of initial recognition. However, subsequent transfer to other accounts is prohibited.	(1) Marketable securities held for trading Measured at fair value. Variation gains and losses are included in income for the current period.
- Bonds intended to be held to maturity	(2) Bonds intended to be held to maturity Valued at amortized cost.	(2) Investments intended to be held to maturity Measured at amortized cost.	(2) Bonds intended to be held to maturity Measured at amortized cost.

Financial Instruments (Part 2)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
- Other securities	<p>(3) Other securities Valued at market (both the market value as of the balance sheet date, and the average market price over the one-month period prior to the balance sheet date are acceptable). Valuation gains and losses, measured by the difference between the acquisition cost and the market value, are accounted for by either (i) the fully, directly recognized to equity method, or (ii) the partially, directly recognized to equity capitalization method.</p> <p>* The average market price over a one-month period prior to the balance sheet date can be used as the market value. In addition, (ii) the partial capitalization method (under which only valuation losses are recognized through P/L) may be used.</p>	<p>(3) Available-for-sale financial instruments Measured at fair value. Variation gains and losses are directly recognized in the equity section through the statement of changes in equity.</p>	<p>(3) Available-for-sale financial instruments Measured at fair value. Variation gains and losses are recognized in other comprehensive income.</p>
Accounting for impairment of marketable securities	An impairment loss is recognized when market value decreases materially, unless there is a possibility of recovery.	If there is objective evidence of impairment, an impairment loss is recognized.	An impairment loss is recognized when a drop in fair value below amortized cost is not temporary.
- Reversal of impairment losses	Reversal of impairment losses is not permitted.	Reversal of impairment losses is not permitted with respect to available-for-sale equity financial instruments, but may be permitted with respect to some debt instruments.	Reversal of impairment losses is not permitted.
Valuation of monetary rights - Classification of monetary rights and estimation of bad debt	<p>Monetary rights are classified to the following three categories, based on the method of estimating bad debt:</p> <p>(1) Normal monetary rights: The method of using the historical percentage of uncollectables</p> <p>(2) Doubtful monetary rights: Either the financial condition evaluation method or the discounted cash flow method.</p> <p>(3) Claims in bankruptcy and rehabilitation: The financial condition evaluation method</p>	<p>Determination of impairment is made when there is objective evidence of impairment and the book value exceeds the estimate of recoverable amount.</p> <p>In such an event, valuation is reduced to the discounted present value of future cash flows at the effective interest rate.</p>	<p>A loss is recognized when impairment is probable and its amount can be estimated rationally.</p> <p>When it is probable that the principal and interest of individual monetary rights are not likely to be collectible as agreed upon, valuation is lowered to the discounted present value of future cash flows at the effective interest rate.</p> <p>In consideration of practical convenience, claims at fair value and collateral at fair value are permitted as the bases of measurement.</p>

Financial Instruments (Part 3)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Valuation of derivatives transactions (excluding those whose objective is hedging)	Valued at market. Valuation gains and losses are recognized through current-year income.	Measured at fair value. Valuation gains and losses are recognized through current-year income.	Measured at fair value. Valuation gains and losses are recognized through current-year income.
Types of hedges and methods of hedge accounting	<p>Hedge transactions consist of those that offset the market fluctuations of assets or liabilities that underlie the hedges (equivalent to fair value hedges), and those that avoid the fluctuations of cash flows (equivalent to cash flow hedges).</p> <p>As a general rule, hedges are accounted for by the deferred hedge accounting method. Use of the mark-to-fair-value hedge accounting is permitted only with other securities.</p> <p>There are exceptions to the treatment of interest rate swaps.</p> <p>* The deferred hedge accounting is the norm.</p>	<p>Hedges are classified into the following categories:</p> <p>(1) Fair value hedges Profit or loss is recognized by adjusting the carrying amount of the part that is attributable to the risks of an asset or liability or a firm commitment that underlies a hedge.</p> <p>Regarding hedging instruments, recognition is made in current-year profit or loss.</p> <p>(2) Cash flow hedges A cash flow hedge is a hedge of future planned transactions, etc.</p> <p>The portion of the gain or loss on the hedging instrument that is an effective hedge is recognized directly in equity section through the statement of changes in equity.</p>	<p>Hedges are classified into the following categories:</p> <p>(1) Fair value hedges Profit or loss is recognized by adjusting the carrying amount of the part that is attributable to the risks of an asset or liability or a firm commitment that underlies a hedge.</p> <p>Regarding hedging instruments, recognition is made in current-year profit or loss.</p> <p>(2) Cash flow hedges A cash flow hedge is a hedge of future planned transactions, etc.</p> <p>The portion of the gain or loss on the hedging instrument that is an effective hedge is recognized in comprehensive income.</p>
- Portfolio hedge		* Use of a fair value hedge accounting is separately allowed with a portfolio hedge of interest rate risk (macro hedging).	
Hybrid financial instruments - Embedded derivatives	When there is a possibility that the risks of embedded derivatives will spill over to the underlying financial assets or liabilities (or for interest-bearing financial assets, a possibility that the initial principal will decrease), the derivatives are accounted for separately.	When the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract, an embedded derivative is separated from its host contract and accounted for separately.	When the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract, an embedded derivative is separated from its host contract and accounted for separately.

Accounting for Foreign Exchange

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Hedging of foreign currency transactions	Use of hedge accounting is permitted. When criteria for hedge accounting are met, use of the synthetic instrument approach is permitted for a while.	Use of hedge accounting is permitted. The matching method is not permitted.	Use of hedge accounting is permitted. The matching method is not permitted.
Classification of foreign operation	Classified between foreign branches and foreign subsidiaries. Depends on legal perspectives.	Using the functional currency approach, classification is made, based on whether or not the functional currency of foreign operation is the same as the reporting currency.	Using the functional currency approach, classification is made, based on whether or not the functional currency of foreign operation is the same as the reporting currency.
Conversion of financial statement items of foreign subsidiaries, etc. - Assets and liabilities - Income and expense	The so-called balance sheet date rate method is used. The foreign exchange rate as at balance sheet date. The average market rate during the period. The foreign exchange rate on balance sheet date is also acceptable.	The so-called balance sheet date rate method is used. The foreign exchange rate as at balance sheet date. Foreign exchange rates in effect at the time of the transaction. Use of a reasonable average rate for the period is also accepted.	The so-called balance sheet date rate method is used. The foreign exchange rate as at balance sheet date. Foreign exchange rates in effect at the time of the transaction. Use of a reasonable average rate for the period is also accepted.
Treatment of adjustments to the carrying values of goodwill and subsidiaries, etc. at the time of acquisition.	Goodwill is recognized in the Japanese currency as it is generated in the process of consolidating capital of the parent company (in the Japanese currency). Adjustments to the carrying value of assets and liabilities of foreign subsidiaries that are generated as the result of market valuation in the capital consolidation process are converted to yen at the foreign exchange rates in effect at each balance sheet date.	Recognized as assets or liabilities by the foreign economic entity, and converted at the foreign exchange rate in effect at each balance sheet date.	Recognized as assets or liabilities by the foreign economic entity, and converted at the foreign exchange rate in effect at each balance sheet date.

Business Combinations

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Classification of business combinations and basic accounting treatment	Classified to “acquisition” and “uniting of interest”. The purchase method is used with the former, and the pooling of interest method is used with the latter. * The pooling of interest method is used in specific cases.	No classification is made between “acquisition” and “uniting of interest.” All business combinations are accounted for by the purchase method.	No classification is made between “acquisition” and “uniting of interest.” All business combinations are accounted for by the purchase method.
Purchase method of accounting – treatment of positive goodwill	Systematically amortized over a period in which goodwill is effective, not to exceed 20 years. * Goodwill is amortized systematically.	Must not be amortized. An impairment must be performed annually or more frequently when a possibility of impairment is indicated by events or changes in the circumstance.	Must not be amortized. An impairment must be performed annually or more frequently when a possibility of impairment is indicated by events or changes in the circumstance.
Purchase method of accounting – treatment of negative goodwill	Recognized as liabilities. Systematically amortized over an appropriate period in accordance with the reality of acquisition, not to exceed 20 years. * Negative goodwill is amortized systematically.	Not recognized. (a) Recognition and measurement of identifiable assets and liabilities, and contingency liabilities are re-examined. (b) Any balance that still remains is immediately recognized as a gain.	Not recognized. Deducted from assets (excluding certain assets) on a pro rata basis. Any balance that cannot be deducted is recognized as an extraordinary gain.

Consolidated Financial Statements, Equity Method and Interest in Joint Ventures (JV) (Part 1)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Scope of consolidation	All subsidiaries are consolidated as a general rule. Determination of a subsidiary is made, based on whether or not the decision-making body is “controlled.” The following cases amount to subsidiaries in the absence of evidence to the contrary: (i) Own the majority of the voting rights in substance. (ii) Own a high percentage of voting rights even if the percentage is 50/100 or lower, and certain facts are recognized that control the decision-making body.	All domestic and foreign subsidiaries are consolidated as a general rule. Determination of a subsidiary is based on the presence of “control” (the power to influence the financial and operating policies of an entity so as to gain benefits from its operation.) Presence of control is established by the ownership of the majority of voting rights but certain facts can also be used to establish the presence of control.	As a general rule, subsidiaries are consolidated if the majority of their voting rights are owned. * The share-holding method is adopted.
Treatment of special purpose corporations, etc.	Special purpose corporations that meet certain criteria are deemed not to be subsidiaries of the corporation that transferred assets to the special purpose corporations and investors.	When the substance of the relationship between a corporation and a special purpose enterprise (SPE) indicates that the SPE is controlled by the corporation, the SPE is consolidated.	Qualified SPEs (QSPEs) that meet certain criteria are excluded from the scope of consolidation by the transferor of assets. When an SPE that is not a QSPE is a variable interest enterprise (VIE), the primary beneficiary among the holders of variable interests consolidates the VIE.
Consolidation procedures Transactions among consolidated entities	Outstanding balances of receivables and payables, and amounts of transactions among consolidated corporations are eliminated. Unrealized profits are eliminated in full downstream, and the equity in unrealized profits is eliminated upstream.	Outstanding balances of receivables and payables, and amounts of transactions among consolidated corporations are eliminated. All unrealized gains are eliminated.	Outstanding balances of receivables and payables, and amounts of transactions among consolidated corporations are eliminated. Both the full elimination of unrealized gains and the elimination of interest in unrealized gains are permitted.
Standardization of accounting policies	Transactions of the same nature, carried out in the same environment, are accounted for by standardized policies as a general rule. Standardization is not required when accounting treatment that is adopted by a foreign subsidiary is permitted by the accounting standards of the country in which the subsidiary is located.	Standardized accounting policies must be used in similar transactions and other events in like situations.	No provisions. (Standardization is considered to be evident.)

Consolidated Financial Statements, Equity Method and Interest in Joint Ventures (JV) (Part 2)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Presentation of minority interest	Minority shareholder interest is presented in the liabilities section as a separate category. Gains and loss from minority interest are presented as a category in the net profit calculations.	The minority interest is presented separately from the parent company's interest in the equity section. Gains and losses of the minority interest are presented separately on the income statement from income attributed to the parent company as an allocation of net profit for the current year. * Presented in the equity section.	No provisions. (Left to the discretion of practitioners.)
Application of the equity method	Investments in nonconsolidated subsidiaries and affiliate corporations. The following cases amount to affiliate corporations” (i) 20% or more of the voting rights are owned, or (ii) A certain number, if less than 20%, of the voting rights are owned, and certain facts are recognized that indicate material influence can be exerted.	Applied to investments in affiliate corporations. An affiliate corporation must be neither a subsidiary nor a JV, and able to exercise material influence. When an enterprise owns 20% or more of the voting rights, it is deemed to have material influence in the absence of evidence to the contrary.	Applied to investments in common stock of JVs and those in corporations to which material influence can be exercised. When an enterprise owns 20% or more of the voting rights, it is deemed to have material influence in the absence of evidence to the contrary.
Treatment of jointly controlled enterprises	The equity method is applied as affiliate corporations.	In accordance with one of the following: (a) Pro rata consolidation (b) Equity method	The equity method is applied as joint ventures.

Interim Financial Reporting

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Costs that are incurred unevenly during a financial year	Deferral or accrual of operating cost that would not be adopted in the preparation of annual financial statements is not permitted.	Deferral or accrual of operating cost that would not be adopted in the preparation of annual financial statements is not permitted.	When cost that is expensed for annual reporting purposes contributes clearly to two or more interim periods (such as annual major maintenance work), an appropriate portion of the annual cost is levied to individual interim periods, using accrual or deferral methods.
Revenues received seasonally, cyclically or occasionally	Revenues from sales or services that are offered are recognized to have been earned during an interim period, using the same standards that are used for the entire financial year.	Revenues from sales or services that are offered are recognized to have been earned during an interim period, using the same standards that are used for the entire financial year.	Revenues from sales or services that are offered are recognized to have been earned during an interim period, using the same standards that are used for the entire financial year.

Cash Flow Statements

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Format of the cash flow statement	Presented in three segments, consisting of (i) operating activities, (ii) investing activities, and (iii) financing activities.	Presented in three segments, consisting of (i) operating activities, (ii) investing activities, and (iii) financing activities.	Presented in three segments, consisting of (i) operating activities, (ii) investing activities, and (iii) financing activities.
Scope of funds	Cash and cash equivalents	Cash and cash equivalents	Cash and cash equivalents
Method of presenting cash flows from operating activities	Either the direct method or the indirect method may be selected.	The direct method is recommended but the indirect method is acceptable.	The direct method is recommended but the indirect method is acceptable.
Presentation of interests and dividends	Interest and dividends received: operating or investing activities Interest paid: operating or financing activities Dividends paid: financing activities	Interest and dividends received: operating or financing activities Interest paid: operating or financing activities Dividends paid: operating or financing activities	Interest and dividends received: operating activities Interest paid: operating activities Dividends paid: financing activities

Segment Information

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Method of segment identification	<p>(By line of business) Consideration is given to similarities of product types and characters, manufacturing methods, sales markets, etc.</p> <p>(By geographical location) Consideration is given to geographical proximity, similarities of economic activities, interrelationship of business activities, etc.</p>	<p>- Segments are identified based on differences in risks and returns (profitability). - The enterprise's organizational structure and internal financial reporting system are looked at. (Management approach) - Segments are identified either by line of business or geographical locations.</p>	<p>- "Operating Segments" are identified, based on the enterprise's organizational structure and internal financial reporting system (Management approach). Segmentation other than that based on business or geographical area is permitted.</p>
Disclosure items	<p><u>By Line of Business</u> In addition to sales, operating income (or ordinary income), etc., disclosure is made of the method of business segment identification, names of major products in each segment, etc.</p> <p><u>By Geographical Location</u> In addition to sales, operating income (or ordinary income), etc., disclosure is made of the method of country or regional segment identification, names of major countries or regions in each segment.</p> <p><u>Overseas Sales</u> Overseas sales made in countries or regions outside of Japan are disclosed.</p>	<p><u>Basic Report Presentation</u> In addition to revenues (sales), income and loss (usually operating income and loss), etc., disclosure is made of reconciliation with financial statements.</p> <p><u>Supplementary Report Presentation</u> External sales, total assets, and capital expenditures are disclosed.</p>	<p><u>General Information</u> Criteria used for segment identification, types of products and services, etc. are disclosed.</p> <p><u>Information concerning segment income, loss, and assets, and their measurement standards</u> Income from external customers, income from other segments, etc. are disclosed.</p> <p><u>Schedule of Reconciliation with Financial Statements</u> Total segment revenues, incomes and losses, and schedules of reconciliation with financial statements are disclosed.</p> <p><u>Corporate Information</u> Sales by product groups, external sales by geographical area, and the balance of long-term assets, and information concerning dependence on major customers are disclosed.</p>

(As of March 31, 2004)

Subsequent Events

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Dividends	Not treated as subsequent events. Presented in the statement of appropriation of retained earnings.	Treated as subsequent events.	Treated as subsequent events.

Earnings Per Share (EPS)

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Disclosed “earnings per share (EPS)”	Two kinds of EPS information must be disclosed; “the amount of net profit (net loss) for the current period per share” and “the amount of net profit for the current year per share after adjustments for potential shares.”	Two types of EPS, consisting of the “basic earnings per share” and the “diluted earnings per share,” are disclosed with respect to profit from continued operations (attributable to the parent company) and net profit for the current period (attributable to the parent company).	Two types of EPS, consisting of the “basic earnings per share” and the “diluted earnings per share,” are disclosed with respect to profit from continued operations and net profit for the current period.
Disclosure of EPS when the number of shares changes as the result of a stock split, etc.	The EPS for the preceding year that is computed as if the stock split, etc. had occurred at the beginning of the preceding year is disclosed as a footnote to the financial statements for the current period. *No retroactive adjustments are made.	The calculation of EPS for all periods presented is adjusted retrospectively, and presented again.	The calculation of EPS for all periods presented is adjusted retrospectively, and presented again.

Stock Options

Item	Japanese Standards	International Accounting Standards	U.S. Standards
Expense measurement methods of stock options	<p>No provisions.</p> <p>(The issuer of new share subscription rights recognizes the issue price as a liability. However, stock options, which are deemed to be free distributions under the Commercial Code, carry zero issue price. Consequently, neither expense nor liability is recognized.)</p>	<p>A transaction is measured by taking into consideration the fair value (based on market prices, if available, or an estimate obtained using a valuation technique, if market prices are not available) of the equity financial instrument that is granted as of the grant date.</p>	<p>- Recognize and measure at fair value of the equity certificates issued. (Stock options are estimated by using the option pricing model on the grant date.) (General Rule)</p> <p>- Measure at the intrinsic value of the options as of the expense measurement date. (Exception)</p>