Unit B3 - Accounting and financial reporting

Directorate-General for Financial Stability, Financial Services and Capital Markets Union.

European Commission

1049 Bruxelles/Brussel.

Belgium

DATE July 2018

Re: Fitness check on the EU framework for public reporting by companies

The Corporate Reporting Users' Forum (CRUF) is pleased to comment on the EC's Public Consultation "Fitness check on the EU framework for public reporting by companies". This comment letter is based on discussions held at CRUF Japan meetings from 15th May to July 13th 2018. We would like to submit additional comments to questions from "III. The EU financial reporting framework for listed companies", specifically, question 19, 20, 21, 22, 23, 24, and other comment in 67.

Question 19. Given the different levels of commitment to require IFRS as issued by the IASB around the globe, is it still appropriate that the IAS Regulation prevents the Commission from modifying the content of IFRS?

☒ **Yes**

☐ No, due to the risk of uneven level playing field for EU companies vis-à-vis companies established in third countries that do not require the use of IFRS as issued by the IASB.

☐ No, due to the risk that specific EU needs may not properly be addressed during the IASB standard setting process.

☐ No, due to other reasons.

☐ Don't know

If you answered "No, due to other reasons ", please specify.

Question 20. Since the adoption of IFRS by the EU in 2005, topics such as sustainability and long-term investment have come to the forefront of the regulatory agenda. Is the EU endorsement process appropriate to ensure that IFRS do not pose an obstacle to broader EU policy objectives such as sustainability and long-term investments?

☒ Yes

☐ No

☐ Don't know

If you answered "No", please explain your position:

Question 21. How could the EU ensure that IFRS do not pose an obstacle to sustainability and long-term investments:

☐ By retaining the power to modify the IFRS standards in well-defined circumstances;

☐ By making explicit in the EU regulatory framework that in order to endorse IFRS that are conducive to the European public good, sustainability and long term investment must be considered;

☒ **Other, please specify**

☐ Don't know

Comment to Question 19,20, and 21:

We believe that IFRS does not post any obstacle to sustainability and long-term investment. First of all, disclosure of the latest financial position by fair value accounting (FVA) contributes to the financial stability. We did not have the FVA in early 1990s in Japan, which resulted in the failure of timely recognition of impairment losses on financial instruments such as loans to property related sectors. This so called "too little, too late" recognition of credit losses on nonperforming loans made it extremely hard for Japanese policymakers and investors to evaluate the health of financial system. As a consequence, fatal delay in the decisive action to address the banking crisis massively damaged Japanese financial system and significantly decelerated the long-term growth. From our own experience, we are convinced that the FVA should not be denied from the perspective of sustainability and long-term investment.

Second, it is the well-known fact that the Europe has overwhelming share in the outstanding amount of the global ESG related investments, the proxy of sustainability and long term investments. Given this fact, with adoption of the IFRS standards as the accounting standards for the jurisdiction, the European capital markets appear to be effectively and efficiently functioning enough to provide the high-quality long-term capital to "sustainable finance" in Europe. In this regard, we are seriously concerned that any significant change in the current European endorsement process may create unintended and undue turmoil in the well-functioning corporate reporting system in Europe, undermining the European capital markets' ability to meet your policy goals.

We believe the long-term investment and sustainability will be achieved through constructive dialogue between companies and investors more effectively than through radical change in the accounting and corporate reporting system.

Question 22. The True and Fair view principle should be understood in the light of the general accounting principles set out in the Accounting Directive18. By requiring that, in order to be endorsed, any IFRS should not to be contrary to the true and fair view principle, a link (which) has been established between IFRS and the Accounting Directive. However, the principle of true and fair view is not laid down in great detail in the Accounting Directive, nor is it underpinned by e.g. a European Conceptual Framework that would translate these principles into more concrete accounting concepts such as recognition and measurement, measurement of performance, prudence, etc. Do you think that an EU conceptual framework should underpin the IFRS endorsement process?

☐ Yes

☒ No

☐ Don't know

If you answered "No", please explain your position:

Comment to Question 22:

We believe there are neither contradiction nor conflicts between the "true and fair view principles" and "qualitative characteristics of useful financial information" of IASB's conceptual framework. Among others, "faithful representation" of fundamental qualitative characteristics must be compatible with true and fair view principles. We therefore do not believe that "true and fair view principles" per se should justify the development of an European conceptual framework. We are concerned that an European conceptual Framework could rather be a source of confusion in the European endorsement process, as it could not be identical, by definition, with IASB's conceptual framework.

Question 23. The EU has not endorsed the IASB Conceptual Framework for Financial Reporting. The conceptual framework is a set of concepts used to develop IFRSs but can also be helpful in interpreting how IFRS standards have to be understood and applied in specific circumstances. This could enhance a common application of IFRSs within the EU.

Should the EU endorse the IASB Conceptual Framework for Financial Reporting?

Should the EU endorse the IASB Conceptual Framework for Financial Reporting?	1 ☐	2 ☐	3 ☐	4 ☐	5 ☐	Don't know ☐

(1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5 = totally agree)

Please explain your response and substantiate it with evidence or concrete examples.

<u>Comment to Question:23</u>

5. Totally agree

As already indicated in our answer to Question 22, we would rather encourage the EU to endorse the IASB's Conceptual Framework. We, the members of the CRUF Japan, respect the EU's own legitimate right to make comments to IASB in your endorsement process to protect the interests of stakeholders in the EU. We strongly believe you can leverage your influence with your legitimate comments based upon the ISAB's conceptual framework, instead of making comments based upon the European conceptual framework. ISAB's conceptual framework is a globally accepted conceptual framework, therefore we believe that the EU's influence on the IFRS based upon the IASB's conceptual framework is clearly more acceptable to the global investors outside of EU, which will not hamper the long-term capital inflows to the Europe.

Question 24. Contrary to the Accounting Directives the EU endorsed IFRSs do not require companies to present financial information using a prescribed (minimum) lay-out for the balance sheet and income statement. Mandatory use of minimum layouts could enhance comparability of human readable financial statements.

Do you agree with the following statement?

Prescribed (minimum) layouts enhance comparability of financial statements for users and should therefore be introduced for companies using IFRS.	**1** ☐	**2** ☐	**3** ☐	**4** ☐	**5** ☐	**Don't know** ☐

(1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5 = totally agree)

Please explain your response and substantiate it with evidence or concrete examples.

Comment to Question:24

3. Partially disagree and partially agree.

As users of financial statements in Japan, we are very familiar with the prescribed templates for the financial statements prepared by the listed companies based upon the Japanese GAAP, the default accounting standards for Japanese companies. Honestly speaking, we are somewhat confused by the lack of consistency in the financial statements provided by the IFRS volunteer adopters. Nonetheless, we recognize benefits from the flexibility for the management to tell their story which the IFRS allows, to faithfully represent the company's economic reality.

In this regard, we strongly support the IASB's performance reporting project, which we hope to enhance the global comparability of the IFRS based financial statements. We are concerned that the introduction of the proprietary European template might seriously undermine the expected benefits from this important project of the IASB.

Question 67. Do you have any other comments or suggestions?

Comments to Question 67:

We had a serious debate on our legitimacy to respond this EU's consultation from Japan, because we have the JMIS, a Japanese accounting standards which was developed through modification of the pure IFRS as issued by the IASB. The members of the CRUF Japan, however, have concluded that it is our responsibility to respond the EU's fitness check with our maximum integrity, as participants in the global capital markets including Europe as well as Japan.

First of all, we are all beneficiaries of the free capital flows among the global capital markets. We believe that we could not have such benefits if there were not for the IFRS. On that note, we do appreciate and respect that the EU's decision you made in 2000 to adopt the IFRS as your accounting standards for single European market in 2005. It is apparent that your adoption of the IFRS was the greatest catalyst for the IFRS to penetrate around the globe, making it as one of the most important and valuable public goods in the global capital markets.

We believe that EU is the largest beneficiary from the IFRS as the global public good; as you attract high-quality long-term capital from outside of EU, the European investors can benefit from the global diversification at the same time.

All these free capital flows have been achieved through the consolidation of the regional accounting standards into the IFRS. The EU has consistently been the leader and the most influential player in this process. Thus the EU has established itself as the dominant leader in the global ESG investment.

We are concerned that the consequences of introduction of the proprietary EU accounting standards, albeit how similar it is to the pure IFRS, is more devastating to both Europe and the world than beneficial. We ardently hope your prudence in changing the European endorsement process and accounting standards for your own interests as well as for your stakeholders outside the EU including ourselves.

Lastly, we would like to provide you more information regarding JMIS for you to establish a better understanding of the nature of its curve-in/curve-out mechanism. JMIS was developed and has been maintained to show the stakeholders outside Japan the ideal model of the IFRS from the Japan's perspective. JMIS has the curve-in/curve-out mechanism and it is different from the pure IFRS in two aspects including the full recycling of the other comprehensive income, and “amortization plus impairment” model of the goodwill. JMIS is a complete set of accounting standards, which any company can prepare the financial statements based upon it.

Having said that, it is the Japanese government commitment to encourage Japanese companies to adopt the pure IFRS voluntarily instead of the JMIS. As of the end of June 2018, there are 193 Japanese listed companies which have already adopted or decided to adopt to IFRS voluntarily. Such 193 companies are accounting for about 30 percent of total market capitalization in Japan.

There has been no Japanese listed company which has voluntarily adopted JMIS. We expect there will not be any Japanese company to voluntarily adopt the JMIS, and we expect that JMIS will continue to have practically no impact on the Japanese capital markets in the future.

We strongly believe the JMIS's curve-in/ curve-out mechanism do not pose any significant threat to the global capital markets, while we are concerned that European curve-in/ curve-out should have.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organizations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organizations. The CRUF does not seek to achieve consensus views. However, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. The participants in the Forum that have specifically endorsed this response are listed below.

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