

April 6th, 2022

Share Capital, Financial Reporting and Dividend Regulation in Japan

ELI Webinar on Corporate Sustainability, Financial Accounting
and Share Capital

Clemence GARCIA
Akio HOSHI
Gakushuin University, Tokyo

Mioko TAKAHASHI
Hosei University, Tokyo

Introduction

- What is the report about?

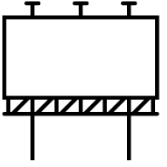
Regulation of equity **capital**

Two main aspects: **financial reporting** and **capital maintenance**

- Why a Japanese report?

Japan is a large jurisdiction, with German and US influences, **multiple accounting standards**, and global businesses.

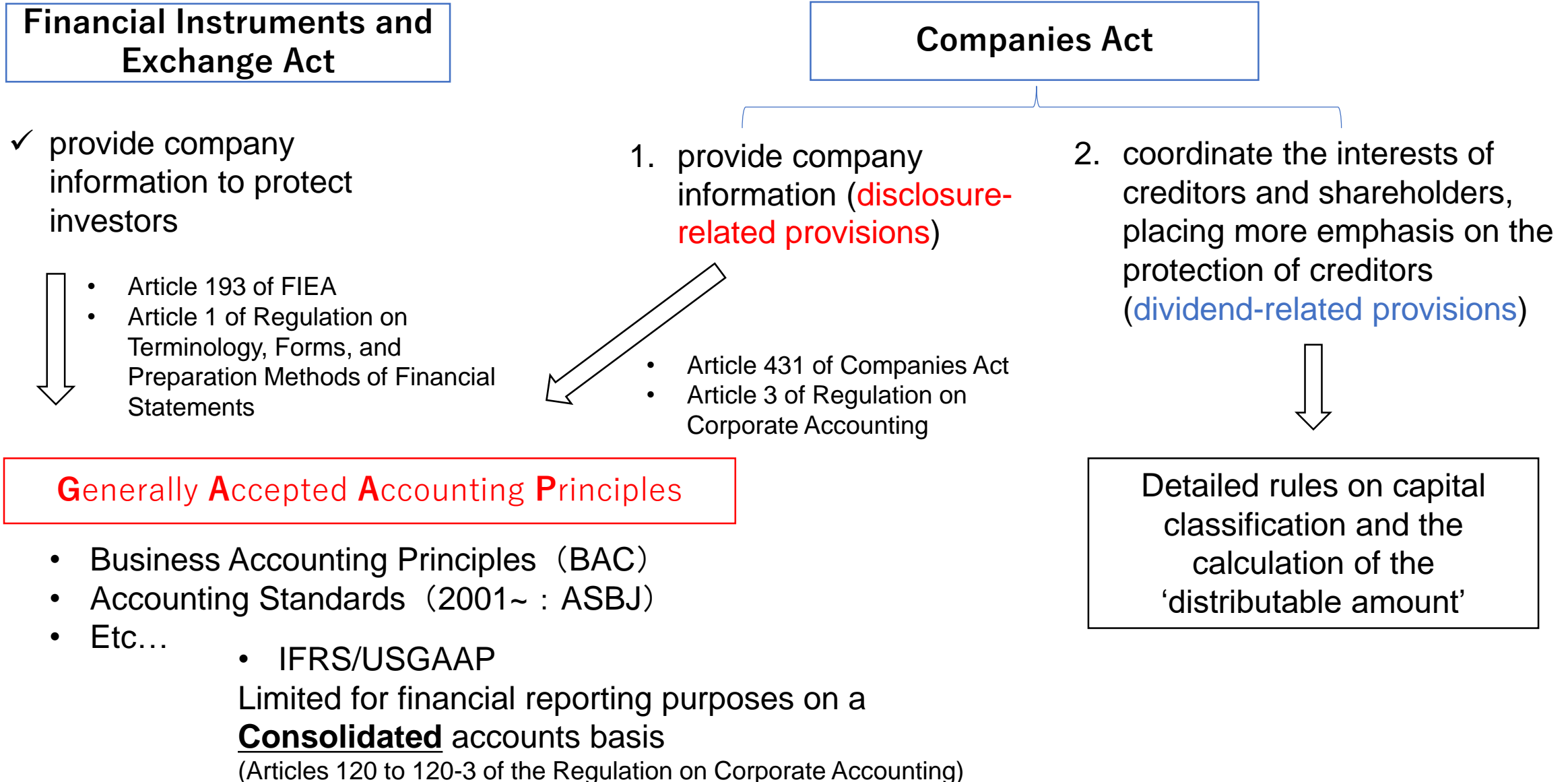
- In this report, we provide an overview of how the Japanese have accommodated IFRS and other foreign imports into their legislation regarding capital.



Outline

1. Introduction
- 2. Financial reporting (by Pr. Mioko Takahashi)**
3. Companies Act provisions on capital (by Pr. Akio Hoshi)
4. Conclusion

Financial reporting under the “Financial Instruments and Exchange Act” and the “Companies Act”



Capital presentation in the Balance Sheet under the Japanese GAAP ①


- ✓ the ASBJ Conceptual Framework emphasises the importance of the **realisation principle of net income**, defined as a '**release from risks**' of the investments
- ✓ This realisation principle of net income plays an important role in regard to capital presentation in the Balance Sheet

Net assets section in the Balance Sheet

Paid-in capital	XXX	
Earned surplus	XXX	Realised
Unrealised gains and losses	XXX	Unrealised
Etc . . .	XXX	

Capital presentation in the Balance Sheet under the Japanese GAAP ②

- ✓ the ASBJ Conceptual Framework, defines **Net Assets** and **Shareholders' Equity*** as two distinct concepts as follows:
- **Net assets** is the difference between the total assets and the total liabilities (ASBJ, 2006, Chapter 3. Paragraph 6).
 - **Shareholders' equity*** is a component of the net assets attributable to the shareholders of the reporting entity (those of the parent company in the case of consolidated financial statements) (ASBJ, 2006, Chapter 3. Paragraph 7).

Assets	Liabilities	
	Net Assets	Shareholders' equity*
		Unrealised gains and losses (Accumulated OCI)
		Stock acquisition rights
		Minority interest


* The term "Owners' equity" is used in the English translation of the Conceptual Framework and related standards

Presentation of Net assets section of the Consolidated Balance Sheet

I. Shareholders' equity	
Paid-in capital	XXX
Capital surplus	XXX
Earned surplus	XXX
Treasury stock	XXX
II. Accumulated other comprehensive income	
Valuation differences on available-for-sale securities	XXX
Deferred gains or losses on hedges	XXX
Foreign currency translation adjustments	XXX
Remeasurements of defined benefit plans	XXX
III. Rights to receive shares as compensation	XXX
IV. Subscription rights to shares	XXX
V. Minority interest	XXX
Total net assets	XXX

Illustrative example based on ASBJ Statement No. 5 and ASBJ Guidance No. 8, updated in 2021

Specific aspects of the Japanese reporting model ①

I. Shareholders' equity	
Paid-in capital	
Capital surplus	
Earned surplus	
Treasury stock	
II. Accumulated other comprehensive income	
Valuation differences on available-for-sale securities	
Deferred gains or losses on hedges	
Foreign currency translation adjustments	
Remeasurements of defined benefit plans	
III. Rights to receive shares as compensation	
IV. Subscription rights to shares	
V. Minority interest	
Total net assets	

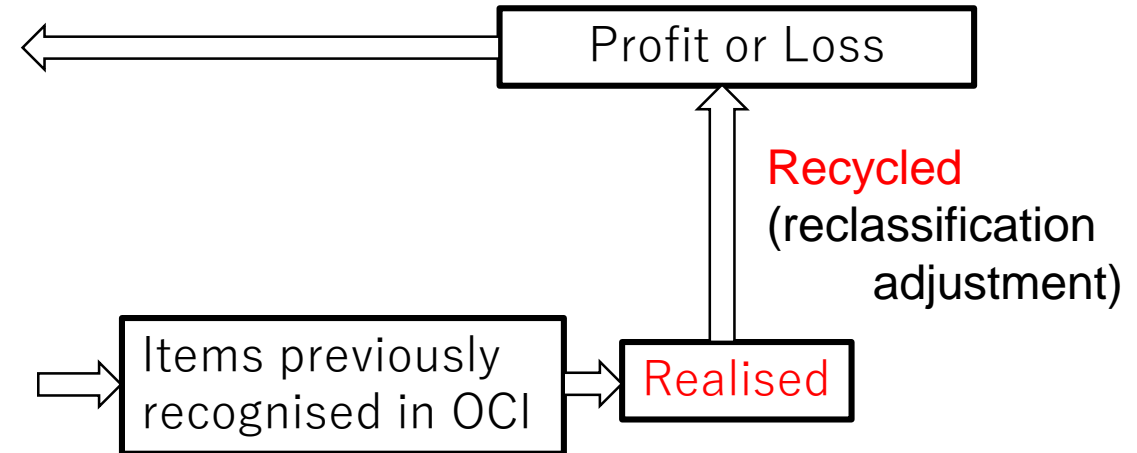
1. Emphasis is placed on clearly delineating the boundaries of **Shareholders' equity**

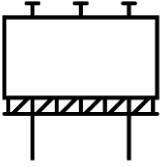
- Realisation principle of net income plays an important role

Specific aspects of the Japanese reporting model ②

I. Shareholders' equity
Paid-in capital
Capital surplus
Earned surplus
Treasury stock
II. Accumulated other comprehensive income
Valuation differences on available-for-sale securities
Deferred gains or losses on hedges
Foreign currency translation adjustments
Remeasurements of defined benefit plans
III. Rights to receive shares as compensation
IV. Subscription rights to shares
V. Minority interest
Total net assets

2. Require systematic and mandatory **recycling of OCI items** to the income statement at the time of realisation.





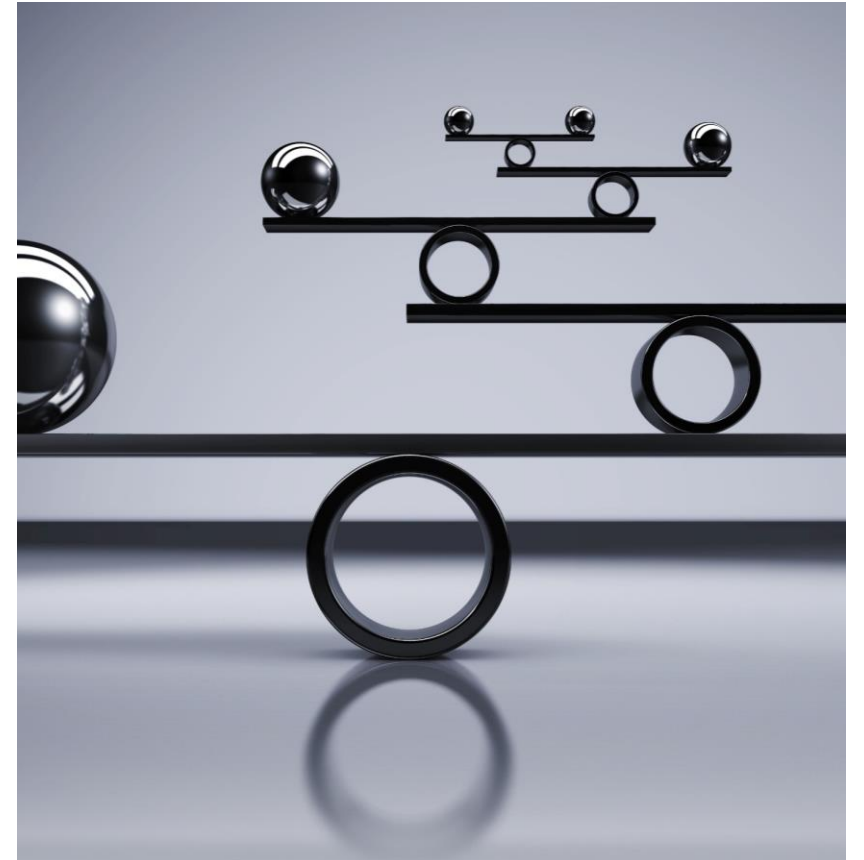
Outline

1. Introduction
2. Financial reporting (by Pr. Mioko Takahashi)
3. Companies Act provisions on capital (by Pr. Akio Hoshi)
4. Conclusion

3. Companies Act Provisions on Capital

Three aspects

- Disclosure-related provisions
- Dividend-related provisions
- Other transactions with shareholders



Disclosure-related provisions

- The purpose of disclosure rules in Companies Act is not the same as FIEA ⇒ creditor protection.
- Companies Act provides the underlying legal concepts of equity items, their definitions and legal regimes.
- The reporting format is harmonized with FIEA, with some minor variations:
 - Minor differences of naming (esp. English translations)
 - Reporting format for individual accounts is more detailed (no equivalent in FIEA)

Regulation on Corporate Accounting (kaisha keisan kisoku, Ministry of Justice Ordinance No. 13 of 2006) Art 76

Dividend-related provisions

Distributable amount is computed based on a two-step approach:

- 1) Determine the surplus (adjusted retained earnings and free reserves) based on some **accounting adjustments**;
- 2) Compute the **distributable amount** based on companies act rules.

In the second step, some restrictions **specific to creditor protection** are applicable, like subtracting goodwill and treasury shares from distributable reserves.

⇒ Accounting and Companies Act provisions are interrelated.

Companies Act, Kaisha Ho, Act No. 86 of 2005 Art 446 and 461



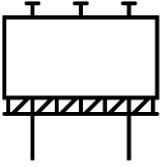
Double dividend limitation

- Dividend limitation is normally based on individual accounts in Japan.
- 2005: Possible option for **consolidated dividend system** only for large and/or listed companies.
- **simplification of procedures** regarding intra-group restructuring and stock acquisitions.
- If a parent opts for consolidated dividends, the limitation of distributable reserves is based the **minimum of consolidated and individual** amounts (both computed from the same rules on slide 6).
- Companies that are presenting their consolidated accounts in IFRS may apply this system, but they are still **obliged to adjust** the distributable amount according to domestic companies act.

Other transactions with shareholders

- Share buybacks and stock options were almost forbidden until 2001.
- Since then, several approval procedures from shareholders' meeting.
- “Treasury shares” and “rights to receive shares as compensation” are both clearly disclosed in financial statements.



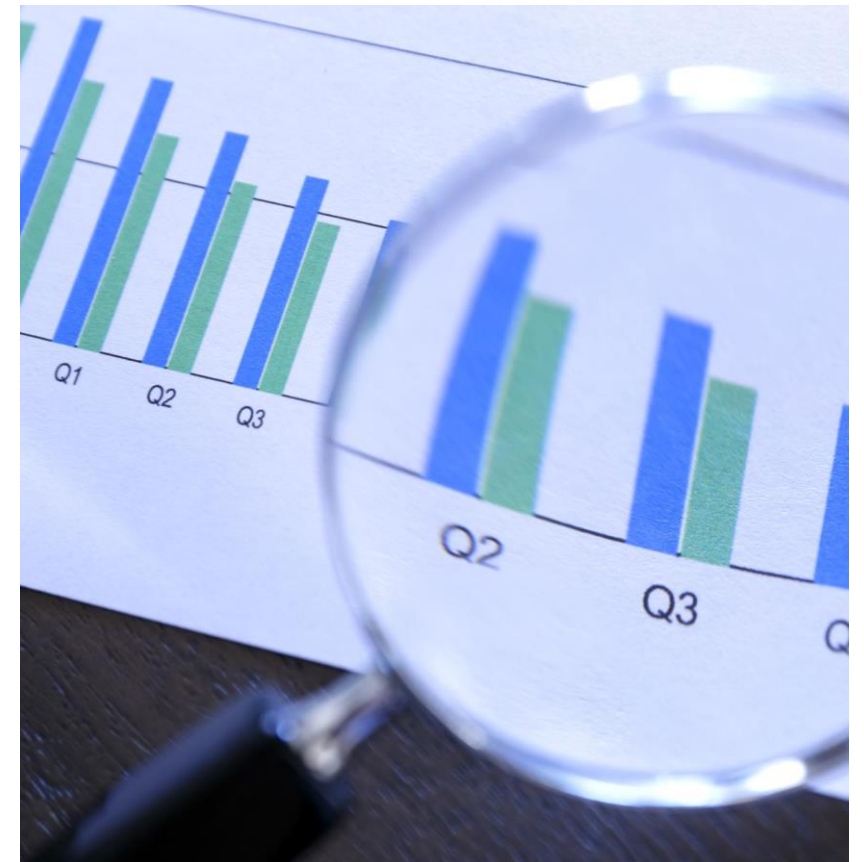


Outline

1. Introduction
2. Financial reporting (by Pr. Mioko Takahashi)
3. Companies Act provisions on capital (by Pr. Akio Hoshi)
4. Conclusion

4. Conclusion

- Regarding financial reporting and dividend restrictions, the Japanese Companies Act and the Financial Market regulation (FIEA) provisions are consistent and complementary with each other.
- For the distributable amount, a two-step approach allows to accommodate accounting rules that are not designed for creditor protection.
- A similar approach could easily be applied with IFRS, provided that European company law set some underlying concepts regarding capital items.



Thank you!