（Translation for reference purpose only）

Issuance of JMIS Exposure Draft No. 2, Proposed amendments to “Japan’s Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications”

17 March 2016

Accounting Standards Board of Japan

In June 2015, the Accounting Standards Board of Japan (‘ASBJ’) issued “Japan’s Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications”. JMIS was issued as a result of the endorsement process covering Standards and Interpretations (collectively referred to as ‘Standards’) issued by the International Accounting Standards Board (‘IASB’) as at 31 December 2012.

Since then, the ASBJ examined the Standards issued by the IASB during 2013, and today, the ASBJ issued JMIS Exposure Draft No. 2, Proposed amendments to “Japan’s Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications”, which was approved at its 331st Board meeting held on 9 March 2016.

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Background

1. The ASBJ, following “The Present Policy on the Application of International Financial Reporting Standards (IFRS)” (June 2013) issued by the Business Accounting Council, an advisory body to the Financial Services Agency of Japan (‘FSA’), established the “Working Group for the Endorsement of IFRS” in July 2013 and undertook its endorsement process on the Standards issued by the IASB as at 31 December 2012 (hereinafter called the “initial endorsement process”). As a result of the initial endorsement process, the ASBJ issued JMIS on 30 June 2015.

2. For this round the ASBJ undertook the endorsement process on the Standards issued by the IASB during 2013. This Exposure Draft, composed of the components (a) and (b) shown below, was issued for public comment on the proposed amendments to JMIS as a result of such endorsement process:

   (a) [DRAFT] Application of “Japan’s Modified International Standards”

   (b) [DRAFT] ASBJ Modification Accounting Standard No. 2 “Accounting for Other Comprehensive Income”

Scope of the endorsement process for this round

3. New or amended Standards issued by the IASB during 2013, which were covered by the endorsement process for this round, were as follows:

   (a) IFRS 9 *Financial Instruments* (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) (issued in November 2013) (hereinafter called ‘IFRS 9 (2013)’)

   (b) IFRIC Interpretation 21 *Levies* (issued in May 2013) (hereinafter called ‘IFRIC 21’)

   (c) *Recoverable Amount Disclosure for Non-Financial Assets* (Amendments to IAS 36) (issued in May 2013)

   (d) *Novation of Derivatives and Continuation of Hedge Accounting* (Amendments to IAS 39) (issued in June 2013)

   (e) *Defined Benefit Plans: Employee Contributions* (Amendments to IAS 19) (issued in November 2013)

   (f) *Annual Improvements to IFRSs 2010-2012 Cycle* (issued in December 2013)

   (g) *Annual Improvements to IFRSs 2011-2013 Cycle* (issued in December 2013)

Outline of the endorsement process

4. The endorsement process is a mechanism of determining whether individual Standards issued by the IASB are acceptable in Japan and, for certain Standards, making ‘deletions or modifications’ when considered necessary, and having them designated by the FSA.

5. In undertaking the endorsement process on the Standards issued by the IASB during 2013, consistent with the initial endorsement process, the ASBJ considered the following factors as the criteria for endorsing individual Standards, from the viewpoints of public interest and investor protection, on the premise that the application of JMIS would be voluntary:

    - fundamental thinking on accounting standards generally accepted in Japan;
    - difficulties in practice (preparation costs exceed benefits, etc.); and
    - relationship with peripheral regulations (whether various industry regulations make it difficult, or cause significant costs to adopt).

6. In addition, consistent with the initial endorsement process, in undertaking the endorsement process, the ASBJ decided to limit the ‘deletions or modifications’ to a minimum, i.e., after thorough consideration under the policy of adopting the Standards without ‘deletions or modifications’ to the extent possible, only making ‘deletions or modifications’ for the requirements that have been determined to be unacceptable from the viewpoints of fundamental thinking on accounting standards generally accepted in Japan and difficulties in practice.

Considerations at the endorsement process for this round

Items for which ‘deletions or modifications’ are proposed

7. The ASBJ examined the new or amended Standards issued by the IASB during 2013 as listed in paragraph 3 in the light of the criteria described in paragraphs 5 and 6.　As a result, the ASBJ proposes ‘deletions or modifications’ for the following two items related to IFRS 9 (2013):

    (a) Non-recycling of the hedging gain or loss on fair value hedges of investments in equity instruments measured at fair value through other comprehensive income.

    (b) Basis adjustments in cash flow hedges.

‘Deletions or modifications’ related to ‘non-recycling of the hedging gain or loss on fair value hedges of investments in equity instruments measured at fair value through other comprehensive income’

8. IFRS 9 (2013) requires that, if a hedged item in a fair value hedge is an investment in an equity instrument measured at fair value through other comprehensive income, the gain or loss on the hedging instrument remain in other comprehensive income, i.e., subsequent recycling of that gain or loss is prohibited (paragraph 6.5.8 and BC6.115 of IFRS 9 (2013)).

9. This Exposure Draft proposes ‘deletions or modifications’ to amend IFRS 9 (2013) so that the gain or loss on the hedging instrument arising from fair value hedges described in paragraph 8 that are recognised in other comprehensive income is reclassified to profit or loss.

10. The proposed ‘deletions or modifications’ described in paragraph 9 correspond to the ‘deletions or modifications’ made in the initial endorsement process for investments in equity instruments, which are the hedged items in the above case, so that gain or loss accumulated in other

comprehensive income would be reclassified to profit or loss on the derecognition of the investments, instead of non-recycling.

‘Deletions or modifications’ related to ‘basis adjustments in cash flow hedges’

11. Under IFRS 9 (2013), if a hedged forecast transaction in a cash flow hedge subsequently results in the recognition of a non-financial asset or a non-financial liability, the amount of the gain or loss on the hedging instrument that has been accumulated in other comprehensive income should be removed from the cash flow hedge reserve and included directly in the initial or other carrying amount of the asset or the liability. Such treatment is commonly referred to as a ‘basis adjustment’.

12. This Exposure Draft proposes ‘deletions or modifications’ regarding the basis adjustment described in paragraph 11 so that when the amount is removed from the cash flow hedge reserve, which is a component of equity, a corresponding amount is included in other comprehensive income in the statement of comprehensive income. The ASBJ proposes this ‘deletion or modification’ in order to consistently assert its view that the difference between profit or loss and comprehensive income is essentially a timing difference, which is one of the reasons why the ASBJ argued that all items included in other comprehensive income must be recycled in the initial endorsement process.

13. During the deliberations, some argued that ‘deletions or modifications’ should not be made regarding the basis adjustments in IFRS 9 (2013) described in paragraph 11 from the viewpoint of minimising ‘deletions or modifications’, because it is an issue of whether the change is recognised in other comprehensive income when the amount is removed from the cash flow hedge reserve and does not affect profit or loss. However, the ASBJ proposes this ‘deletion or modification’ related to this issue, emphasising the consistency of its view as described in paragraph 12 that the difference between profit or loss and comprehensive income is essentially a timing difference.

14. The reasons the IASB decided not to include the amount removed from the cash flow hedge reserve in other comprehensive income included: (a) accounting for the basis adjustment as a reclassification adjustment would distort comprehensive income because the amount would affect comprehensive income twice but in different periods: first (in other comprehensive income) in the period in which the non-financial item is recognised; and again in the later periods when the non-financial item affects profit or loss (for example, through depreciation expense or cost of sales) and (b) presenting a basis adjustment as a reclassification adjustment would create the misleading impression that the basis adjustment was a performance event (paragraph BC6.380 of IFRS 9 (2013)).

    Regarding the IASB’s concern that the comprehensive income would be affected twice, the ASBJ believes that the two effects have separate meanings and thus there is no particular problem. That is, the effect on comprehensive income in the period in which the non-financial item is recognised represents the deduction of other comprehensive income recognised for the hedging instruments before the acquisition of the non-financial item and thereby would ensure that the total comprehensive income would reflect the changes in net assets (other than those resulting from transactions with owners in their capacity as owners) for all periods. The effect on comprehensive income in the later periods when the non-financial item affects profit or loss reflects the gain or loss on the hedging instrument included in the asset or the liability in comprehensive income through profit or loss.

Regarding the IASB's concern about the misleading impression that the basis adjustment was a performance event, the ASBJ believes that other comprehensive income arising from basis adjustments would cause no problem from the viewpoint of performance reporting. The ASBJ does not consider the other comprehensive income arising from basis adjustments as performance, because it considers comprehensive income as the change in net assets (other than those resulting from transactions with owners in their capacity as owners) during a period, measured by applying the measurement basis that is relevant from the viewpoint of reporting the entity's financial position to the recognised assets and liabilities that comprise such net assets.

Item for which 'deletions or modifications' were considered but are not proposed

15. As mentioned in paragraph 7, the ASBJ examined the new or amended Standards issued by the IASB during 2013 as listed in paragraph 3 in the light of criteria described in paragraphs 5 and 6. As a result, in addition to IFRS 9 (2013), the ASBJ considered whether 'deletions or modifications' are necessary for IFRIC 21.

16. IFRIC 21, as an interpretation of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, provides guidance on when to recognise a liability for a levy imposed on an entity in accordance with legislation. It provides that a liability to pay a levy should be recognised when the activity that triggers the payment of the levy (the obligating event) occurs. Although IFRIC 21 does not provide guidance for the debit side (such as when to recognise an expense), the timing of recognising a liability for a levy can affect the timing of recognising an expense and thus might affect the usefulness of the resultant profit or loss. Accordingly, the ASBJ considered it from the viewpoint of fundamental thinking on accounting standards. In addition, the ASBJ also considered the difficulties in practice because the effect on the timing of recognising an expense may have some effects on internal management controls.

17. As a result of the deliberations, the ASBJ concluded that, although there might be difference in fundamental thinking on accounting standards, this item is not so significant to justify 'deletions or modifications' from the viewpoint of minimising 'deletions or modifications'. Regarding the concern about the potential effects on internal management controls, the ASBJ concluded that, although future increases in the voluntary application of IFRSs may enlarge the actual effects attributable to the difference in the fundamental thinking on accounting standards and may require further consideration, at present it has not identified difficulties in practice that

require ‘deletions or modifications’. In the light of these considerations, this Exposure Draft proposes not to make any ‘deletions or modifications’ regarding IFRIC 21.

Amendments to “Application of ‘Japan’s Modified International Standards’ ”

18. As a result of the considerations described in paragraphs 7-17, the ASBJ proposes to amend Appendix 1 *Standards Issued by the IASB and Adopted by the ASBJ* and Appendix 2 *ASBJ Modification Accounting Standards* of the *Application of “Japan’s Modified International Standards”*.

Effective date and transition

19. The ASBJ proposes that *Application of “Japan’s Modified International Standards”* as amended as described in paragraph 18 should be effective from the annual reporting period beginning on or after the issuance date of this [DRAFT] Standard when an entity prepares consolidated financial statements in accordance with JMIS.

20. Because of the concerns related to the complexities and lower comparability arising from coexistence of IFRS 9 (2010) and IFRS 9 (2013), the ASBJ proposes to adopt IFRS 9 (2013) only and to exclude IFRS 9 (2010), which was adopted in the initial endorsement process, from Appendix 1 *Standards Issued by the IASB and Adopted by the ASBJ* of the *Application of “Japan’s Modified International Standards”*.