（Translation for reference purpose only）

Foreword to “Japan’s Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications”

30 June 2015

Accounting Standards Board of Japan

I. Background

1. In June 2009, the Business Accounting Council, an advisory body to the Financial Services Agency of Japan (‘FSA’), published the “Interim Report: Opinion on the Application of International Financial Reporting Standards (IFRS) in Japan” (‘Interim Report’), recommending the voluntary application of International Financial Reporting Standards (‘IFRS’). Based on the recommendations in the Interim Report, in December 2009, the FSA amended the “Regulations for Terminology, Form and Preparation of Consolidated Financial Statements” to introduce ‘Designated IFRS’ and allow entities that met specified criteria to submit consolidated financial statements prepared in accordance with Designated IFRS as financial reports to be filed under the requirements of the Financial Instruments and Exchange Act.

   The Business Accounting Council continued its deliberations on how to apply IFRS in Japan and, in June 2013, published “The Present Policy on the Application of International Financial Reporting Standards (IFRS)” (‘Present Policy’).

2. The Present Policy indicated that the globally achieving the goal of developing a single set of high-quality global standards would be beneficial from the viewpoint of enhancing the efficiency and the vigour of the global economy. It also stated that the proactive involvement of Japan to achieve this goal is not only useful for Japanese entities in conducting their business activities and raising funds, but also important for ensuring the international competitiveness of Japanese markets.

3. Furthermore, the Present Policy indicated that it is important to build up the number of entities voluntarily applying IFRS and to actively express Japanese constituents’ views on IFRS and, as one measure, recommended the introduction of the process of endorsing IFRS. The Present Policy also stated that the Accounting Standards Board of Japan (‘ASBJ’), which is capable of developing accounting standards, should first examine the standards and then the FSA should designate the individual standards that were examined by the ASBJ.

4. Following the issuance of the Present Policy, in July 2013, the ASBJ established the “Working Group for the Endorsement of IFRS” (‘Working Group’) comprised of financial statement preparers, users, auditors and academics. The Working Group held 17 public meetings. Based on the discussions at the Working Group, the ASBJ deliberated and, at the 292nd Board

meeting held on 24 July 2014, approved the issuance of the Exposure Draft on "Japan's Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications". The Exposure Draft was issued on 31 July 2014.

5. After the three-month comment period the ASBJ and the Working Group deliberated the responses to the Exposure Draft. At the 314th Board meeting held on 29 June 2015, the ASBJ approved the issuance of "Japan's Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications", which is being issued today.

II. Outline of the endorsement process

6. Under the Present Policy, the endorsement process is a mechanism of determining whether individual Standards and Interpretations (collectively referred to as 'Standards') issued by the International Accounting Standards Board ('IASB') are acceptable in Japan and, for certain Standards, making 'deletions or modifications' when considered necessary, and having them designated by the FSA. This endorsement process is operated separately from the designation process for Designated IFRS. Within this process, the ASBJ carries out the portion of determining whether to make 'deletions or modifications' to individual Standards.

7. The steps for the ASBJ's portion to determine whether to make 'deletions or modifications' to individual Standards are as follows:

   1) the IASB issues a new or revised Standard.

   2) the ASBJ examines whether that Standard can be adopted without any 'deletions or modifications'. In this context, 'deletions or modifications' refers to not applying all or some of the requirements or a part of the requirements in that Standard, or to make additions or modifications to certain requirements in that Standard.

   3) if the ASBJ determines that the Standard should be adopted without any 'deletions or modifications', it will issue an Exposure Draft proposing as such. If the ASBJ determines that the Standard should be adopted with certain 'deletions or modifications', it will prepare and issue an Exposure Draft of an ASBJ Modification Accounting Standard (see "V. Application of JMIS").

   4) in the light of comments received on the above Exposure Drafts, the ASBJ will deliberate and finalise the adoption.

8. The JMIS issued today is based on the endorsement process covering Standards issued by the IASB as at 31 December 2012 (the portion of the endorsement process carried out by the ASBJ

is hereinafter called the ‘initial endorsement process’). Regarding the portion of the endorsement process which will be carried out by the ASBJ in the future, see “VI. Scope of the endorsement process and related issues 2) Endorsement process in the future”.

III. Objective of the endorsement process

9. Regarding Designated IFRS that are currently used for voluntary application, the designation process allows the FSA not to designate certain Standards, but that process was not designed to modify any Standards.

   At present, all Standards issued by the IASB are designated by the FSA and, as a result, Designated IFRS is the same as Standards issued by the IASB. The Present Policy indicated that the application of the Designated IFRS has essentially been the adoption of Pure IFRS and, in addition, the application of Pure IFRS needs to be maintained, given that there are entities that have voluntarily applied Designated IFRS with the intention of applying Pure IFRS. In addition, when there are Standards that are inconsistent with the fundamental thinking on accounting standards generally accepted in Japan or that involve significant practical difficulties, establishing a mechanism to adopt IFRS through the endorsement process by making ‘deletions or modifications’ to certain requirements would enable a more flexible acceptance of IFRS and allow Japanese constituents to express their views on those requirements.

10. The fundamental thinking on accounting standards generally accepted in Japan as stated above includes maintaining the usefulness of profit or loss information as an overall indicator of performance.

    The notion underlying such fundamental thinking is that accounting standards should provide discipline to the entity’s management, thereby playing a role in assisting in its sustainable growth and the long-term increase in its corporate value.

    Given that accounting standards are considered a critical part of the infrastructure that form the foundation of capital markets, an endorsement process that reviews each Standard based on this fundamental thinking is expected to enhance the usefulness to decision making by users of financial statements and provide benefits to both preparers and users of financial statements.

11. In the initial endorsement process, the ASBJ reviewed existing Standards to determine whether they are acceptable mainly in the light of the fundamental thinking on accounting standards generally accepted in Japan, and decided to express Japanese constituents’ views on existing Standards as an applicable set of accounting standards.

    Moreover, by appropriately expressing Japanese constituents’ views on the development of IFRS during the IASB's deliberations, it is expected that the endorsement process would urge the IASB to develop Standards that are acceptable in Japan. This is considered necessary for Japan to contribute to the development of a single set of high-quality global standards in a more proactive manner. In addition, it is expected that the discussions undertaken as part of the endorsement process will provide a better understanding of IFRS to Japanese constituents and enrich the discussions for the development of high-quality global standards.

12. Furthermore, in the initial endorsement process, the ASBJ considered how to address practical difficulties. During the deliberations, the ASBJ considered developing guidance or educational material in order to facilitate the application of Standards in a way that is more consistent with the specific circumstances in Japan. The ASBJ will further consider developing guidance or educational material, taking into account the effects on practice under Designated IFRS, including whether any guidance developed by the ASBJ should apply to both Designated IFRS and JMIS.

IV. Relationship with IFRS issued by the IASB

13. The IFRS endorsement process is an effort to promote the application of IFRS in Japan towards the ultimate goal of achieving a single set of high-quality global standards. Limited 'deletions or modifications' to the Standards issued by the IASB that are made today may be resolved depending on future discussions in Japan and at the IASB. Accordingly, they should be viewed as transitional treatments and the ASBJ will continue to express views on these requirements.

V. Application of JMIS

14. When preparing consolidated financial statements in accordance with JMIS, entities must apply the Standards in accordance with the "Application of 'Japan's Modified International Standards'".

15. Under the "Application of 'Japan's Modified International Standards'", when an entity prepares consolidated financial statements in accordance with JMIS, an entity shall comply with the requirements of the Standards issued by the IASB and adopted by the ASBJ, with 'deletions or modifications' specified by the ASBJ Modification Accounting Standards.

16. Issuing ASBJ Modification Accounting Standards that address only the requirements that warrant 'deletions or modifications', rather than directly making 'deletions or modifications' to the Standards issued by the IASB, would enable users of financial statements to easily identify the 'deletions or modifications' that have been made. In addition, it is considered appropriate

to combine ‘deletions or modifications’ of the same nature into the same Modification Accounting Standard to enable the ASBJ to set out the reasons for the ‘deletions or modifications’ more prominently. Furthermore, it would become more prominent that JMIS are derived from the Standards issued by the IASB.

VI. Scope of the endorsement process and related issues

1) Initial endorsement process

17. In JMIS issued today, all Standards issued by the IASB as at 31 December 2012 have been covered, namely:

    (a) thirteen (13) International Financial Reporting Standards;

    (b) twenty-eight (28) International Accounting Standards;

    (c) seventeen (17) IFRIC Interpretations; and

    (d) eight (8) SIC Interpretations.

    The *Conceptual Framework for Financial Reporting* issued by the IASB is not included in the scope of the endorsement process.

2) Endorsement process in the future

18. Subsequent to the initial endorsement process, the endorsement process for Standards issued by the IASB as at 31 December 2013 will be completed shortly and following that the endorsement process for Standards issued by the IASB after 31 December 2013 will be undertaken.

VII. Criteria for ‘deletion or modification’

1) Criteria in the Present Policy

19. As mentioned in “II. Outline of the endorsement process”, 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.

20. The Present Policy indicated that, given that the application of JMIS would be voluntary, due attention should be given to the following points as the criteria for endorsing individual Standards, from the viewpoints of public interest and investor protection:

- 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).

2) Minimising ‘deletions or modifications’

21. In undertaking the endorsement process in accordance with the criteria described above, it is considered appropriate to limit ‘deletions or modifications’ to a minimum (that is, after thorough consideration under the policy to adopt 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), for the following reasons:

    - Standards have been developed and issued by the IASB through its established due process, in which the ASBJ and Japanese constituents have been involved;
    - the more ‘deletions or modifications’ are made, the less likely constituents would perceive that the JMIS are derived from the Standards issued by the IASB;
    - only few jurisdictions have made ‘deletions or modifications’ in their respective IFRS endorsement processes and, for those jurisdictions that have, the number of items have been limited to the minimum necessary;
    - comparability with the Standards issued by the IASB needs to be considered; and
    - limiting the number of ‘deletions or modifications’ would result in expressing Japanese constituents’ views more strongly.

22. In terms of minimising ‘deletions or modifications’, the Present Policy also indicated that “items that are deleted or modified should be limited to a range that can be reasonably explained to the global community, with the purpose of achieving a single set of high-quality accounting standards, while paying due attention to the national interests of Japan”.

23. For items that the ASBJ has previously expressed views on to the global community but decided not to make ‘deletions or modifications’ from the viewpoint of minimising such items, it is necessary to continue to express Japanese constituents’ views.

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VIII. Consideration at the initial endorsement process

1) Selecting the issues

24. To consider whether Standards issued by the IASB can be adopted without any ‘deletions or modifications’, the Working Group selected issues by comparing Standards that were effective as at 31 December 2012, with Japanese accounting standards. At the same time, the Working Group considered and selected the items that potentially required guidance or educational material.

25. As a result of this process, issues listed in Appendix A were selected. Those issues can be broadly categorised into the following:

(a) issues for which there are significant differences in the fundamental thinking on accounting standards; and

(b) issues for which there are difficulties in practice in promoting voluntary application of IFRS (including those related to peripheral regulations).

2) Issues for which there are significant differences in the fundamental thinking on accounting standards

26. Items identified as “issues for which there are significant differences in the fundamental thinking on accounting standards” include the following:

- non-amortisation of goodwill;
- items related to recycling of items of other comprehensive income and profit or loss;
- scope of fair value measurement; and
- capitalisation of development costs.

These are items for which concerns were raised in providing users of financial statements with appropriate information about an entity’s financial position and performance.

<u>Non-amortisation of goodwill</u>

27. IFRS precludes the amortisation of goodwill and requires only impairment for goodwill (IFRS 3 *Business Combinations*). The ASBJ believes that goodwill constitutes the cost of the investment and should be amortised and recognised as an expense, so that it corresponds with the operating results after the business combination. Accordingly, the ASBJ decided to adopt the requirements relating to non-amortisation of goodwill with ‘deletions or modifications’ in

endorsing IFRS because the thinking in IFRS is critically different from the fundamental thinking on accounting standards generally accepted in Japan. The specific 'deletions or modifications' and detailed reasons for the 'deletions or modifications' are set out in ASBJ Modification Accounting Standard No. 1, *Accounting for Goodwill*.

Items related to recycling of items of other comprehensive income and profit or loss

28. IFRS requires so-called 'non-recycling' for the items below. Non-recycling means that there will be no reclassification adjustments (recycling) for items previously recognised in other comprehensive income.

    - changes in the fair value of investments in equity instruments measured at fair value through other comprehensive income (IFRS 9 *Financial Instruments*)
    - changes in the fair value of financial liabilities measured at fair value through profit or loss attributed to the changes in the issuer's own credit risk (IFRS 9)
    - remeasurements of the net defined benefit liability (asset) (IAS 19 *Employee Benefits*)
    - revaluation surplus under the revaluation model for property, plant and equipment and intangible assets (IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*)

29. The ASBJ believes that such non-recycling decreases the usefulness of profit or loss information as an overall indicator of performance. Therefore, the ASBJ decided to adopt the requirements relating to non-recycling (other than for the revaluation surplus under the revaluation model for property, plant and equipment and intangible assets) with 'deletions or modifications' because the thinking in IFRS is critically different from the fundamental thinking on accounting standards generally accepted in Japan. The specific 'deletions or modifications' and detailed reasons for the 'deletions or modifications' are set out in ASBJ Modification Accounting Standard No. 2, *Accounting for Other Comprehensive Income*.

30. Although revaluation surplus under the revaluation model for property, plant and equipment and intangible assets also is not recycled, the ASBJ decided to adopt these requirements without 'deletions or modifications', considering that it appears to have aspects different from other non-recycling items in that there is a conceptual debate as to whether the revaluation surplus is based on the concept of physical capital maintenance.

Scope of fair value measurement

31. "Scope of fair value measurement" is an issue closely related to the determination of profit or

loss, and it is considered to be a critical issue in Japan. The ASBJ believes that it is basically inappropriate to recognise changes in the value of assets and liabilities in profit or loss except for those arising on investments expecting capital appreciation.

32. From that viewpoint, the ASBJ thinks that the "revaluation model for property, plant and equipment and intangible assets (IAS 16 and IAS 38)", "fair value model for investment property (IAS 40 *Investment Property*)", "fair value measurement of investments in unquoted equity instruments (IFRS 9)" and "fair value measurement of biological assets and agricultural produce (IAS 41 *Agriculture*)" are inappropriate to some extent. Detailed discussions about these issues are set out in the Appendix B to this document.

    However, the ASBJ decided that measurement of these items should be adopted without any 'deletions or modifications' from the viewpoint of minimising the items with 'deletions or modifications' to the extent possible.

<u>Capitalisation of development costs</u>

33. Relevance of the capitalisation of expenditures at the development phase was questioned due to concerns regarding the usefulness of the information provided. Detailed discussions about this issue are set out in the Appendix B to this document.

    However, the ASBJ decided that this item should be adopted without any 'deletions or modifications' from the viewpoint of minimising the items with 'deletions or modifications' to the extent possible.

3) Issues for which there are difficulties in practice in promoting voluntary application of IFRS (including those related to peripheral regulations)

34. "Issues for which there are difficulties in practice in promoting voluntary application of IFRS (including those related to peripheral regulations)" have been selected from the viewpoints of whether they can be adopted without 'deletions or modifications', and which items potentially require guidance or educational material.

    As a result, the issues that were selected can be categorised into the following:

    (a) items relating to the implementation and interpretation of accounting standards;

    (b) other items relating to accounting treatments that may involve significant difficulties in practice; and

(c) items relating to disclosures.

Items relating to the implementation and interpretation of accounting standards

35. “Items relating to the implementation and interpretation of accounting standards” include:

    (a) selection of depreciation methods (the selection between the declining balance method and the straight line method) (IAS 16);

    (b) fair value measurement of investments in unquoted equity instruments (IFRS 9); and

    (c) treatment of different reporting dates between the parent and its subsidiaries or associates (IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*).

    In the Exposure Draft, the ASBJ proposed that these items should be considered as potentially requiring guidance or educational material, without making ‘deletions or modifications’.

36. Many respondents to the Exposure Draft supported the development of guidance or educational material, but some suggested that the ASBJ should develop guidance or educational material that applies not only to JMIS but also to Designated IFRS. Others were concerned about the effects on practice under Designated IFRS when the guidance or educational material is issued solely for JMIS.

    In the light of the responses received on the Exposure Draft, the ASBJ decided to further consider developing of guidance or educational material, taking into account the effects on practice under Designated IFRS, including whether any guidance should apply to both Designated IFRS and JMIS.

    The ASBJ defined guidance as documents that need to be complied with in applying Standards and educational material as reference material that are not mandatory in applying Standards. The ASBJ decided to consider how to establish its deliberation process, including the submission of issues to the IFRS Interpretations Committee and how to address the issues when they are rejected by the IFRS Interpretations Committee, taking into account the efforts made in other jurisdictions adopting IFRS to be consistent with international developments. In developing the process, the ASBJ will keep in mind that guidance should not become ‘deletions or modifications’ in substance. Furthermore, for educational material, the ASBJ decided to consider releasing information regarding how to deal with Standards in practice, also noting that it should not become interpretations in substance.

Other items relating to accounting treatments that may involve significant difficulties in practice

37. "Other items relating to accounting treatments that may involve significant difficulties in practice" include issues that may have significant effects that would make the application of IFRS extremely difficult, although only limited industries and entities may be affected.

Such issues include the issue on "functional currency (IAS 21 *The Effects of Changes in Foreign Exchange Rates*)". Details of the concerns and discussions about the requirements related to the functional currency are set out in the Appendix B to this document. Other issues in this category include items which may have a significant impact on specific industries. A depreciation method used in certain industries was identified as an example of this type of issue.

The ASBJ decided not to make 'deletions or modifications' for these issues, considering the current situation regarding the voluntary application of IFRS in Japan and the viewpoint of minimising 'deletions or modifications' to the extent possible. Reconsideration of such decision may be necessary depending on how the number of entities voluntarily applying IFRS increases in Japan in the future.

Items relating to disclosures

38. Concerns from the viewpoint of costs and benefits have been raised regarding certain items in the notes to annual financial statements, and interim disclosures (in particular, statements and notes for the first and third quarters).

The ASBJ decided not to make 'deletions or modifications' for these items, in order to avoid fundamental changes in the appearance of financial statements and to minimise 'deletions or modifications' to the extent possible.

IX. Effective date

39. An entity may apply JMIS to consolidated financial statements for annual periods ending on or after 31 March 2016. Regarding quarterly financial reporting, an entity may apply JMIS to consolidated interim financial statements for quarters within annual periods beginning on or after 1 April 2016.

（Translation for reference purpose only）

Appendix A

List of issues selected as ‘items for which consideration is needed’

The following list shows the issues selected as ‘items for which consideration is needed’ in comparing the Standards issued by the IASB as at 31 December 2012 and Japanese accounting standards in order to consider whether Standards issued by the IASB can be adopted without any ‘deletions or modifications’ or whether development of guidance or educational material may become necessary.

(a) Issues for which there are significant differences in the fundamental thinking on accounting standards

1) Items which the ASBJ has expressed its views to the IASB through the Agenda Consultation 2011 and others

(Items related to recycling of items of other comprehensive income and profit or loss)

(1) Changes in fair value of investments in equity instruments measured at fair value through other comprehensive income (IFRS 9)

(2) Changes in fair value of financial liabilities measured at fair value through profit or loss attributed to the changes in the issuer’s own credit risk (IFRS 9)

(3) Remeasurements of net defined benefit liability (asset) and past service cost (IAS 19)

(4) Revaluation surplus under the revaluation model for property, plant and equipment and intangible assets (IAS 16 and IAS 38）

(Items related to scope of fair value measurement)

(5) Revaluation model for property, plant and equipment and intangible assets (IAS 16 and IAS 38）

(6) Fair value model for investment property (IAS 40)

(7) Fair value measurement of investments in unquoted equity instruments (IFRS 9)

(8) Fair value measurement of biological assets and agricultural produce (IAS 41)

(Other individual items raised in the Agenda Consultation 2011)

(9) Non-amortisation of goodwill (IFRS 3)

(10) Capitalisation of development costs (IAS 38)

(11) Reversal of impairment of long-lived assets (IAS 36 *Impairment of Assets*)

2) Other items related to the fundamental thinking

(12) Presentation of equity in the statement of financial position (IAS 1 *Presentation of Financial Statements*)

(13) Stepwise presentation in the statement of comprehensive income (IAS 1)

(14) Recognition criteria for provisions (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)

(15) Full goodwill method in business combinations (IFRS 3)

(b) Issues for which there are difficulties in practice in promoting voluntary application of IFRS (including those related to peripheral regulations)

1) Items relating to the implementation or interpretation of accounting standards

(16) Selection of depreciation methods and determination of useful lives for property, plant and equipment (IAS 16)

(17) Capitalisation of development costs (IAS 38)

(18) Fair value measurement of investments in unquoted equity instruments (IFRS 9)

(19) Paid annual leave (IAS 19)

(20) Classification between financial liabilities and equity (IAS 32 *Financial Instruments: Presentation*)

(21) Treatment of different reporting dates between the parent and its subsidiaries or associates (IFRS 10 and IAS 28)

(22) Determining whether an arrangement contains a lease (IFRIC 4 *Determining whether an Arrangement Contains a Lease*)

2) Other items relating to accounting treatments that may involve significant difficulties in practice

(23) Functional currency (IAS 21)

(24) Translation of debt instruments denominated in foreign currencies (IAS 21)

(25) Valuation method for investment funds (IFRS 9)

(26) Depreciation method used in certain industries (IAS 16)

(27) Accounting for adjusting events after the reporting period (IAS 10 *Events after the Reporting Period*)

(28) Impairment of financial assets measured at amortised cost (IAS 39 *Financial Instruments: Recognition and Measurement*)

3) Items relating to disclosures

(29) Disclosures in annual financial statements (risk sensitivity analysis, disclosures about defined benefit plans and summarised financial information of subsidiaries and associates)

(30) Scope of interim financial reporting and periods covered by it (including footnotes to financial statements) (IAS 34 *Interim Financial Reporting*)

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Appendix B

Items adopted without ‘deletions or modifications’ for which particular concerns were raised

This Appendix outlines the items that are adopted without any ’deletions or modifications’, but were subject to major concerns by many Japanese constituents because the thinking in IFRS is different from the fundamental thinking on accounting standards generally accepted in Japan, or there are difficulties in practice. The ASBJ decided to adopt these items without any ‘deletions or modifications’, primarily from the viewpoint of minimising ‘deletions or modifications’ to the extent possible.

1. Scope of fair value measurement

1) Revaluation model for property, plant and equipment and intangible assets

1. Under IAS16 and IAS38, for property, plant and equipment and intangible assets, an entity is required to choose and apply either the cost model or the revaluation model. There are no criteria provided to make that decision other than the requirement that an entity choose one of these models as its accounting policy and apply that policy to an entire class of property, plant and equipment or intangible assets.

2. Japanese constituents expressed concerns about the revaluation model for property, plant and equipment and intangible assets under IFRS for the following reasons:

   (a) remeasuring operating fixed assets at their fair values would not reflect the purpose of the investments because those assets are generally used in conjunction with other assets to contribute to the generation of cash flows, and attaining profits on changes in their fair values is not the purpose of such investments.

   (b) if the objective of applying the revaluation model were to maintain physical capital through fair value measurement, it may be appropriate to recognise the differences arising from revaluation directly in equity.

2) Fair value model for investment property

3. Under IAS 40, an entity shall choose either the fair value model or the cost model for investment property. If the fair value model is chosen, gains and losses on remeasurement would be recognised in profit or loss.

4. Japanese constituents expressed concerns about the fair value model for investment property

under IFRS for the following reason:

- investment property include both (i) investments mainly aimed at attaining capital gains from changes in fair value, and (ii) real estate aimed solely at earning rental income in the long-term. For the latter, there may be cases where the cost model would be appropriate, such as when the property is closely tied with various know-how or brands of the entity and incidental services. Accordingly, a free choice of the measurement model for investment property as an accounting policy could impair faithful representation and comparability. It would be appropriate to specify the criteria for when the fair value model or the cost model should be used, based on the nature of the investment property.

3) Fair value measurement of investments in unquoted equity instruments

5. IAS 39 requires an entity to measure at cost investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured. IFRS 9 did not carry forward this requirement and thus requires an entity to measure all investments in equity instruments at fair value.

6. Japanese constituents expressed concerns about the fair value measurement of investments in unquoted equity instruments under IFRS 9 for the following reasons:

   (a) some investments in unquoted equity instruments may contribute to the generation of cash flows in conjunction with other assets. In those cases, their values should reflect the embedded value of internally generated goodwill and, therefore, fair value measurement would be inappropriate.

   (b) reliably measuring investments in unquoted equity instruments is generally considered to be difficult and recognising changes in their fair values (gains in particular) may not be relevant.

4) Fair value measurement of biological assets and agricultural produce

7. IAS 41 requires an entity to measure a biological asset at fair value less costs to sell, except when its fair value cannot be measured reliably. Changes in the fair value are recognised in profit or loss. Agricultural produce harvested from biological assets is required to be measured at fair value less costs to sell at the point of harvest.

8. Japanese constituents expressed concerns about the fair value measurement of biological assets and agricultural produce under IFRS for the following reason:

- biological assets and agricultural produce are assets that should be measured at cost because the purpose of investing in these assets is generally not to attain profits from changes in fair value.

2. Capitalisation of development costs

9. IAS 38 requires an entity to recognise expenditures at the research phase as an expense when incurred and not to recognise an intangible asset related to research. At the development phase, an entity is required to recognise an intangible asset if all of the criteria in paragraph 57 of IAS 38 are met.

10. Japanese constituents expressed concerns about the capitalisation of development costs under IFRS for the following reasons:

(a) capitalisation of development costs would not provide useful information because of the high uncertainty about its contribution in earning revenue.

(b) development costs capitalised under IAS 38 represent only limited expenditures at the development stage because it is generally not possible to demonstrate that the expenditures meet the capitalisation criteria (such as technical feasibility and generating probable future economic benefits) until a considerable amount of expenditures has been expensed. Therefore, the usefulness of the information provided is questionable.

3. Functional currency

11. IAS 21 defines a functional currency as “the currency of the primary economic environment in which the entity operates”. IAS 21 requires an entity to determine the functional currency taking into consideration various factors. There is a hierarchy for these factors, that is, there are factors that should be given priority (such as operating cash flows) and factors to be considered as additional supporting evidence.

12. Japanese constituents expressed concerns about the treatment of the functional currency under IFRS, for the following reasons:

(a) although operating cash flows are indeed a major source of generating cash flows to an entity, there may be cases where another currency is equally important in determining the functional currency, for example, the currency of cash inflows from financial activities or the currency of the payment of income taxes in the domicile of the parent entity (which is affected by the results of operations also involving a currency other than functional currency) or dividends to shareholders. Accordingly, the hierarchy for determining the functional currency in IAS 21 should be reconsidered so that all of the key factors are collectively considered rather than always giving priority to operating cash flows.

(b) if the functional currency of the parent company differs from the local currency of the jurisdiction in which the parent company resides, financial reporting may not reflect the entity’s internal management controls. In addition, if the tax law or company law (determination of distributable profits) in the jurisdiction where the parent company resides does not allow the use of financial statements prepared in the functional currency, an entity would need to prepare multiple books based on multiple currencies, which would cause costs that overweigh the benefits.