（Translation for reference purpose only）

Issuance of JMIS Exposure Draft No. 5, Proposed amendments to "Japan's Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications"

31 October 2017

Accounting Standards Board of Japan

The Accounting Standards Board of Japan ('ASBJ') undertakes the endorsement process on the Standards and Interpretations (collectively referred to as 'Standards') issued by the International Accounting Standards Board ('IASB') and issues "Japan's Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications". To date, JMIS has been issued as a result of the endorsement process covering IFRS 15 *Revenue from Contracts with Customers* (hereinafter referred to as 'IFRS 15') and related amendments to Standards as well as the Standards issued by the IASB as at 31 December 2016 which become effective by 31 December 2017.

For this round, the ASBJ undertook the endorsement process mainly on the amendments made by IFRS 9 *Financial Instruments* issued in July 2014 (hereinafter referred to as 'IFRS 9 (2014)'). Today, the ASBJ issued JMIS Exposure Draft No. 5, Proposed amendments to "Japan's Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications", which was approved at its 371st Board meeting held on 26 October 2017.

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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 to undertake its endorsement process on the Standards issued by the IASB and issue “Japan’s Modified International Standards (JMIS): Accounting Standards Comprising IFRSs and the ASBJ Modifications”.

2. The ASBJ issued its latest amendments to JMIS on 31 October 2017 and, as a result of its works to date, has concluded its endorsement process on IFRS 15 and related amendments to Standards as well as the Standards issued by the IASB as at 31 December 2016 which become effective by 31 December 2017.

3. For this round, the ASBJ issued this Exposure Draft, having undertaken the endorsement process on the amendments made by IFRS 9 (2014) and the Standards issued by the IASB as at 30 June 2017 which become effective on or after 1 January 2018, except for IFRS 16 *Leases* (hereinafter referred to as ‘IFRS 16’) and IFRS 17 *Insurance Contracts* (hereinafter referred to as ‘IFRS 17’). This Exposure Draft proposes the amendments to the following documents that constitute JMIS:

   (a) *Application of “Japan’s Modified International Standards”*

   (b) ASBJ Modification Accounting Standard No.1 *Accounting for Goodwill*

   (c) ASBJ Modification Accounting Standard No.2 *Accounting for Other Comprehensive Income*

Standards covered by the endorsement process for this round

4. The scope of the endorsement process for this round is as mentioned above. Specifically, it covers the following Standards:

   (a) Amendments made by IFRS 9 (2014)

   (b) Standards issued by the IASB as at 30 June 2017 which become effective on or after 1 January 2018, except for IFRS 16 and IFRS 17 (hereinafter referred to as ‘other Standards’)

      (i) *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28) (issued in September 2014) and *Effective Date of Amendments to IFRS 10 and IAS 28* (issued in December 2015)

      (ii) *Classification and Measurement of Share-based Payment Transactions* (Amendments to IFRS 2) (issued in June 2016)

      (iii) *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts (Amendments to IFRS 4) (issued in September 2016)

(iv) IFRIC Interpretation 22 *Foreign Currency Transactions and Advance Consideration* (issued in December 2016)

(v) *Transfers of Investment Property* (Amendments to IAS 40) (issued in December 2016)

(vi) *Amendments to IFRS 1* First-time Adoption of International Financial Reporting Standards, and *Amendments to IAS 28* Investments in Associates and Joint Ventures (both included in *Annual Improvements to IFRS® Standards 2014-2016 Cycle*) (issued in December 2016)

(vii) IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* (issued in June 2017)

Outline of the endorsement process

5. 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.

6. In undertaking the endorsement process on the Standards listed in paragraph 4, consistent with the previous endorsement processes, 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).

7. In addition, consistent with the previous endorsement processes, in undertaking the endorsement process on the Standards for this round, 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, because:
   - IFRS Standards have been developed and issued through the specified due process and also with the involvement by the ASBJ and Japanese constituents.
   - Too many 'deletions or modifications' might prevent the JMIS from being perceived as derived from IFRS Standards by constituents.
   - Looking at the endorsement processes in foreign countries or regions, only a limited number of countries or regions make 'deletions or modifications' and those 'deletions or modifications' are minimal even when they are made.
   - Consideration of comparability with the Standards issued by the IASB is needed.

- Limiting ‘deletions or modifications’ to a small number of items would enable expressing Japanese views more strongly.

Considerations in the endorsement process for this round

Amendments made by IFRS 9 (2014)

Scope of consideration for the amendments made by IFRS 9 (2014) and outline of the considerations

8. Although IFRS 9 was covered by the previous endorsement processes, IFRS 9 (2014) has made the following amendments to IFRS 9, which are subject to the endorsement process for this round:

   (a) Limited amendments related to classification and measurement

   (b) Impairment

9. In considering the above amendments, the ASBJ took into account the following matters:

   (a) The endorsement status in the European Union (EU) (including Endorsement Advices to the European Commission (EC) by the European Financial Reporting Advisory Group (EFRAG))

   (b) The following documents issued by the Basel Committee on Banking Supervision in relation to impairment requirements

      (i) “Guidance on credit risk and accounting for expected credit losses” (issued in December 2015)

      (ii) Consultative document, “Regulatory treatment of accounting provisions – interim approach and transitional arrangements” (issued in October 2016)

      (iii) Standards, “Regulatory treatment of accounting provisions – interim approach and transitional arrangements” (issued in March 2017)

   (c) Impact assessment of IFRS 9 (2014) by the European Banking Authority (EBA)[1]

   (d) Follow up of the views expressed from Japan during the development of IFRS 9 (2014)

10. Having considered the above matters, the ASBJ examined the items in paragraph 8 from the viewpoints described in paragraph 6, considering the matters mentioned in the following paragraphs. As a result, this Exposure Draft proposes not to make any ‘deletions or modifications’ for the amendments made by IFRS 9 (2014).

Considerations of ‘deletions or modifications’: The limited amendments related to classification

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[1] European Banking Authority, “EBA report on results from the second EBA impact assessment of IFRS 9,” July 2017.

and measurement

11. One of amendments in the limited amendments related to classification and measurement is the introduction of the fair value through other comprehensive income (FVOCI) category for financial assets held for both collecting and selling, which reflects the objective of a business model in which an entity holds debt instruments. Another amendment is the clarification to the 'solely payments of principal and interest' (SPPI) criterion for a financial asset to qualify for measurement at amortised cost or FVOCI.

12. The ASBJ concluded that 'deletions or modifications' are not necessary for the introduction of the FVOCI category for debt instruments because it involves no particular problem from the viewpoints in paragraph 6. The ASBJ noted that it enables the presentation reflecting the economic reality of diverse types of investments in financial instruments and thus improves the usefulness of financial statements and that it would have no adverse effect on the usefulness of profit or loss as an overall performance measure because the cumulative gains or losses previously recognised in other comprehensive income would be recycled to profit or loss on derecognition of the investments measured at FVOCI.

13. The clarification to the SPPI criterion was not considered to significantly change its basic concept. Therefore, given that IFRS 9 prior to the amendments made by IFRS 9 (2014) had already been examined in the previous endorsement processes, the ASBJ also concluded that 'deletions or modifications' are not necessary for this clarification from the viewpoints in paragraph 6.

Considerations of 'deletions or modifications': Impairment requirements

14. The main amendment related to impairment is the change from the incurred loss model (recognising impairment loss when there is an objective evidence of impairment) to the expected credit loss model (recognising and measuring impairment loss incorporating forward-looking information). The ASBJ considered whether 'deletions or modifications' was needed for that requirement from the viewpoints of fundamental thinking on accounting standards and difficulties in practice described in paragraph 6, considering the matters mentioned in the following paragraphs.

(Fundamental thinking on accounting standards)

15. The ASBJ assessed the amended impairment requirements as a whole from the perspectives of the objective and characteristics of the expected credit loss model, because the amendments introduced a model in which individual requirements are closely related to each other.

16. The expected credit loss model was developed to address the problem of delayed recognition of impairment losses under the incurred loss model in IAS 39 *Financial Instruments: Recognition and Measurement*, which arose during the global financial crisis. Its objective is considered to be recognising impairment losses earlier by incorporating the forecasts of future economic

conditions. Japanese standards also require an entity to record the losses which are expected to emerge in future, provided that the cause of the losses has already occurred by the year end. Based on such observation, the ASBJ concluded that the expected credit model in IFRS 9 (2014) should not be denied and, accordingly, the ASBJ decided that 'deletions or modifications' are not necessary.

17. One characteristic of the expected credit loss model is that it adopts an approach of determining whether the expected credit losses for a financial instrument should be lifetime expected credit losses or not depending on whether the credit risk has increased significantly since initial recognition (the so-called 'relative approach').

The aim of this relative approach is to categorise the financial instrument on which the credit risk has significantly increased since initial recognition as that for which the lifetime expected credit losses should be measured, in the light of the fact that an entity takes into account the initial expected credit losses in determining the terms and conditions of the financial instruments (including interest rates) and that those terms and conditions are not adjusted for changes in the expected credit losses in subsequent periods.

This approach differs from Japanese standards, in which receivables are categorised according to the debtor's financial position and operating results at the time of measurement (the so-called 'absolute approach'). Thus, under the relative approach, receivables from the same debtor, which have the same source of cash flows, may have different levels of loss allowances according to when they were originated. However, given that the difference in credit risk due to the difference of the timing of recognition would be reflected in the terms and conditions such as interest rates, the approach which determines whether the lifetime expected losses should be measured on the basis of changes in credit risk since initial recognition is considered to have some rationale. Accordingly, the ASBJ decided that 'deletions or modifications' are not necessary in this respect.

(Difficulties in practice)

18. In order to take into account the forecasts described in paragraph 16 above, the expected credit loss model requires incorporating forward-looking information, that is, the estimate of the expected credit losses should reflect reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

In addition, the relative approach described in paragraph 17 above requires an entity to determine whether the credit risk has increased significantly since initial recognition in categorising financial instruments into those for which lifetime expected credit losses should be measured and those for which 12-month expected credit losses should be measured.

19. For the two aspects mentioned in the previous paragraph, Japanese constituents expressed

concerns from the viewpoint of difficulties in practice during the development of IFRS 9 (2014), which was confirmed through the work related to paragraph 9(d), because they are not necessarily consistent with the current practice in Japan. Accordingly, the ASBJ examined those aspects in this endorsement process in the light of the practices of financial institutions.

20. For the requirements for incorporating forward-looking information, the ASBJ has been informed of difficulties in practice because of incremental costs arising from collecting and maintaining the information that need to be newly incorporated due to the difference from the current practice in Japan. We have conducted surveys to some Japanese banks, and those banks noted that they were still considering which economic indicators they should use, how to collect and maintain necessary data and how to reflect information in the estimates.

21. For the relative approach, the ASBJ has been informed of difficulties in practice (for example, setting the criteria and threshold for ‘significant increase in credit risk’, and making necessary data available to manage receivables individually) because it was not necessarily consistent with the credit risk management methodologies under current practice in Japan. We have conducted surveys to some Japanese banks, and those banks noted that they were at a preparatory or research phase for the implementation of the approach and were still considering how to deal with the new approach.

22. As described in paragraphs 20 and 21, Japanese banks are still considering how to deal with the difficulties in practice and, therefore, it is not necessarily easy to assess the level of the difficulties in practice at this moment. However, in other regions including Europe, no serious concerns were expressed for either of the two aspects described above and there was no discussion at the IASB that would lead to reconsideration of IFRS 9 (2014) in those respects. In such a circumstance, in the light of the nature of the endorsement process for JMIS, there was no sufficient reason specific to Japan to conclude that those aspects in IFRS 9 (2014) were considered unacceptable from the viewpoint of difficulties in practice. Consequently, the ASBJ decided that those aspects would not lead to ‘deletions or modifications’.

Endorsement process on other Standards

23. For the other Standards (paragraph 4(b)), the ASBJ considered whether ‘deletions or modifications’ were needed in the light of the criteria shown in paragraphs 6 and 7, based on the comparison with Standards that have already been endorsed and with the treatments under Japanese standards.

24. As a result of such consideration, it was determined that those other Standards primarily provide transition requirements or clarifications to existing requirements. Therefore, the ASBJ concluded that ‘deletions or modifications’ are not necessary from the viewpoints in paragraph 6.

Amendments to “Japan’s Modified International Standards (JMIS):

Accounting Standards Comprising IFRSs and the ASBJ Modifications"

Amendments to the "Application of 'Japan's Modified International Standards'"

25. As a result of the considerations described above, this Exposure Draft proposes to amend Appendix 1 *Standards Issued by the IASB and Adopted by the ASBJ* of the *Application of "Japan's Modified International Standards"* and Appendix 2 *ASBJ Modification Accounting Standards* of the *Application of "Japan's Modified International Standards*".

Amendments to "ASBJ Modification Accounting Standards"

26. As mentioned above, the ASBJ proposes no 'deletions or modifications' in the endorsement process for this round. However, it proposes amendments to ASBJ Modification Accounting Standard No.1 *Accounting for Goodwill* and ASBJ Modification Accounting Standard No.2 *Accounting for Other Comprehensive Income* to reflect mainly the amendments made by IFRS 9 (2014).

Effective date

27. *Application of "Japan's Modified International Standards"* proposes that the revised JMIS should apply to consolidated financial statements for annual periods beginning on or after its issuance date, as in the previous versions.

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(For Reference Purpose Only) The ASBJ's future policy for the endorsement process on the Standards issued by the IASB

The ASBJ's future policy for the endorsement process on the Standards issued by the IASB is as follows:

(a) For major Standards, such as IFRS 16 and IFRS 17, the endorsement process will be undertaken individually.

(b) For the Standards other than (a) above, reference dates will be specified (30 June and 31 December). For the Standards issued by the IASB during the six-month period, the Exposure Draft for the endorsement process on those Standards will be issued during the next six-month period and the resulting amendments to the JMIS will be finalised within the following six months. Nevertheless, the Standards for which the interval between the issuance date and the effective date is short may be dealt with separately considering the length until the effective date.

(c) To the extent that timeliness is maintained, the proposed amendments to JMIS resulting from the endorsement process described in (a) above and the proposed amendments to JMIS resulting from the endorsement process described in (b) above will be issued as a single combined Exposure Draft, whenever possible.