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Comments on IFRS Exposure Draft No. 3 "Business Combinations," Amendments to IAS 36 "Impairment of Assets," and Amendments to IAS 38 "Intangible Assets"

I. IFRS Exposure Draft No. 3 "Business Combinations"

Question 2 – Method of accounting for business combinations

The Exposure Draft proposes to eliminate the use of the pooling of interests method and require all business combinations within its scope to be accounted for by applying the purchase method (see proposed paragraphs 13-15 and paragraphs BC18-BC35 of the Basis for Conclusions).
Is this appropriate? If not, why not? If you believe the pooling of interests method should be applied to a particular class of transactions, what criteria should be used to distinguish those transactions from other business combinations, and why?

It is not appropriate.
There is no theoretical superior-inferior relationship between the purchase method and the pooling of interests method; with respect to "true mergers," the application of the pooling of interests method is appropriate. In cases in which it is difficult to identify which company is the acquirer, unreasonably identifying one company as the acquirer and applying the purchase method raises the risk of abuse by means of arbitrary revaluation, and therefore it is not appropriate to make the purchase method the only accounting method for business-combination transactions. With respect

to the fresh start method, since it requires accounting on the basis of fictitious liquidation, there is similarly a risk of abuse by means of arbitrary revaluation.

Question 5 – Provisions for terminating or reducing the activities of the acquiree

Under IAS 22, an acquirer must recognise as part of allocating the cost of a business combination a provision for terminating or reducing the activities of the acquiree (a 'restructuring provision') that was not a liability of the acquiree at the acquisition date, provided the acquirer has satisfied specified criteria. The Exposure Draft proposes that an acquirer should recognise a restructuring provision as part of allocating the cost of a business combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets (see proposed paragraph 40 and paragraphs BC55-BC66 of the Basis for Conclusions).
Is this appropriate? If not, what criteria should an acquirer be required to satisfy to recognise a restructuring provision that was not a liability of the acquiree as part of allocating the cost of a combination, and why?

It is not appropriate.
When negative goodwill arises, in most cases costs of the acquisition price are determined after factoring in costs that may arise in the future. If an amount equal to a restructuring provision is factored into the consideration for an acquisition, it should be recognized as a liability. If, as suggested in Question 9, negative goodwill is recognized immediately in profit, an amount equal to a restructuring provision relating to loss after the business combination will be recognized at the date of the business combination, prior to the actual occurrence of loss, and that is not appropriate.

Question 7 – Measuring the identifiable assets acquired, and liabilities and contingent liabilities assumed

IAS 22 includes a benchmark and an allowed alternative treatment for the initial measurement of the identifiable net assets acquired in a business combination, and therefore for the initial measurement of any minority interests. The Exposure Draft

proposes requiring the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree will be stated at the minority's proportion of the net fair values of those items. This proposal is consistent with the allowed alternative treatment in IAS 22 (see proposed paragraphs 35 and 39 and paragraphs BC88-BC95 of the Basis for Conclusions).
Is this appropriate? If not, how should the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of a business combination be measured when there is a minority interest in the acquiree, and why?

It is not appropriate.
With respect to minority interests, we object to the thinking of the Exposure Draft, which proposes they be measured based on the minority's proportion of the net fair values. That accounting treatment is not consistent with FAS 141. The benchmark and the alternative treatment in IAS 22 should be maintained.

Question 8 – Goodwill

The Exposure Draft proposes that goodwill acquired in a business combination should be recognised as an asset and should not be amortised. Instead, it should be accounted for after initial recognition at cost less any accumulated impairment losses (see proposed paragraphs 50-54 and paragraphs BC96-BC108 of the Basis for Conclusions).
Do you agree that goodwill acquired in a business combination should be recognised as an asset? If not, how should it be accounted for initially, and why? Should goodwill be accounted for after initial recognition at cost less any accumulated impairment losses? If not, how should it be accounted for after initial recognition, and why?

We do not agree.
If, as stated in BC107, it is considered that goodwill acquired in a business combination is consumed and replaced by internally generated goodwill, there are few grounds for making goodwill non-amortizable. Furthermore, we are doubtful about the idea that the asset value of goodwill acquired in a business combination will continue in perpetuity.

In addition, as stated in BC96, goodwill measured and recognized as a balance includes elements of error and excess payment similar to the origins of negative goodwill. It is extremely difficult to measure only the amount of goodwill acquired purely from the business combination after eliminating the influence of these, and the measurement of fair value each term would not be sufficiently reliable. In view of this, the profit or loss in each term in which impairment losses are recognized would include an amount equivalent to the amortization of goodwill deemed to have been consumed in the preceding fiscal years, making it impossible to obtain a proper measure of profit and loss during the term.

Accordingly, despite the possibility of "arbitrary estimate" and "amortization over an arbitrary period of time" about which concern is expressed in the Exposure Draft (Basis for Conclusions), from the standpoint of the usefulness of information, an approach involving straight-line amortization over a fixed period after estimating the amortization period, with impairment carried out as necessary, is preferable to an impairment-only approach because the elements of negative goodwill are neither able to be identified individually nor able to be measured with sufficient reliability. In addition, amortization of this kind is consistent with the current accounting methods for fixed assets.

Question 9 – Excess over the cost of a business combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities

In some business combinations, the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of the combination exceeds that cost. The Exposure Draft proposes that when such an excess exists, the acquirer should:

(a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and

(b) recognise immediately in profit or loss any excess remaining after that reassessment.

(See proposed paragraphs 55 and 56 and paragraphs BC109-BC120 of the Basis for Conclusions.)

Is this treatment appropriate? If not, how should any such excess be accounted for, and why?

It is not appropriate.
Negative goodwill arises because the acquisition cost is determined by including items such as losses arising in the future. In order to reflect these in future profit and loss as they arise, the treatment that should be applied is either to reduce the values of fixed assets or to recognize them as a liability item and amortize them over a certain period.

Other items

Paragraphs 23-26: Cost of a business combination

With respect to equity instruments issued as the cost of a business combination, it is proposed that the cost be measured as the fair value of these at the date of exchange. However, it should be measured by using the most recent fair value at the date on which a business combination by means of the exchange of shares was agreed. Changes in share prices after the date of agreement are unrelated to decision-making by the managers, and therefore the cost should be measured as the fair value at the date of exchange only in cases in which there is no substantial difference from the most recent fair value at the date of agreement.

Paragraph 46: Acquiree's contingent liabilities

In the Exposure Draft, with respect to contingent liabilities measured initially at their fair values, subsequent changes in fair value are recognized in profit and loss. However, because it is difficult to measure the fair value of contingent liabilities with sufficient reliability, we object to this thinking. Changes in the fair values of contingent liabilities from initial recognition should not be recognized in profit and loss; in the event that the factors underlying contingent liabilities actually occur, they should be treated as separate liabilities; or in the event that the factors are eliminated, they should be treated as profit.

II. Exposure Draft of Proposed Amendments to IAS 36 "Impairment of Assets"

Question 1 – Frequency of impairment tests

Are the proposals relating to the frequency of impairment testing intangible assets with indefinite useful lives and acquired goodwill appropriate (see proposed paragraphs 8 and 8A and paragraphs C6, C7 and C41 of the Basis for Conclusions)? If not, how often should such assets be tested for impairment, and why?

An impairment test is required at the end of each annual reporting period. However, from a practical standpoint it would be appropriate to permit an impairment test to be conducted at a certain time each year, not confined to the fiscal year-end, as is the case in FAS 142.

Question 2 – Intangible assets with indefinite useful lives

The Exposure Draft proposes that the recoverable amount of an intangible asset with an indefinite useful life should be measured, and impairment losses (and reversals of impairment losses) for such assets accounted for, in accordance with the requirements in IAS 36 for assets other than goodwill (see paragraphs C10-C11 of the Basis for Conclusions).
Is this appropriate? If not, how should the recoverable amount be measured, and impairment losses (and reversals of impairment losses) be accounted for?

We have the same comment as that made to Question 8 regarding the IFRS Exposure Draft No. 3 "Business Combinations."

Question 7 – Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

The Exposure Draft proposes requiring a variety of information to be disclosed for each segment, based on an entity's primary reporting format, that includes within its carrying amount goodwill or intangible assets with indefinite useful lives (see proposed paragraph 134 and paragraphs C69-C82 of the Basis for Conclusions).

(a) Should an entity be required to disclose each of the items in proposed paragraph 134? If not, which items should be removed from the disclosure requirements, and why?

(b) Should the information to be disclosed under proposed paragraph 134 be disclosed separately for a cash-generating unit within a segment when one or more of the criteria in proposed paragraph 137 are satisfied? If not, why not?

The separate disclosure of information concerning future assumed numerical values (market share, growth rates, etc.) that form the basis for the computation of the value in use of goodwill, etc., for each segment or for each cash-generating unit within segments when certain conditions apply, constitutes overdisclosure, and is disproportionate relative to the level of disclosure of other financial information. The usefulness of the disclosed information is also doubtful, and thus its disclosure is inappropriate, and from the perspective of cost-benefit the items specified below should be removed.

With respect to the proposed requirement for the disclosure of items relating to business forecasts, whether they are for individual segments or for cash-generating units within segments, it can be assumed that there will be cases in which the relevant numerical values could constitute important information for a company's competitiveness, the disclosure of which could have an adverse impact on that competitiveness. In view of this, we object to this strongly.

Items to be removed from the disclosure requirements

Paragraph 134: Remove (d) and (e) (i)-(v) entirely
Paragraph 137: Remove entirely

III. Exposure Draft of Proposed Amendments to IAS 38 "Intangible Assets"

Question 5 – Non-amortization of intangible assets with indefinite useful lives

The Exposure Draft proposes that an intangible asset with an indefinite useful life should not be amortised (see proposed paragraphs 103 and 104 and paragraphs B36-B38 of the Basis for Conclusions).

Is this appropriate? If not, how should such assets be accounted for after their initial recognition?

We have the same comment as that made to Question 8 regarding the IFRS Exposure Draft No. 3 "Business Combinations."

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