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Sir David Tweedie, Chairman, International Accounting Standards Board (IASB)

Mr. Keith Alfredson, Chairman, Australian Accounting Standards Board (AASB)

Mr. Antoine Bracchi, Chairman, Conseil National de la Comptabilite (CNC)

Mr. Paul Cherry, Chairman, Canadian Accounting Standards Board (AcSB)

Professor Hans Havermann, Chairman, German Accounting Standards Board (DRSC)

Ms. Liz Hickey, Chair, New Zealand Financial Reporting Standards Board (FRSB)

Mr. Edmund Jenkins, Chairman, Financial Accounting Standards Board (FASB)

Ms. Mary Keegan, Chair, Accounting Standards Board (ASB)

Dear Chairs of National Standard Setters,

Subject: Our position on the accounting for business combinations

It was a great pleasure for me to be with you all at the meeting of IASB with national standard setters in September. I enjoyed meeting with people engaged in setting accounting standards in each jurisdiction a great deal.

While we discussed Business Combinations at that time, I expressed my concern about the deletion of the pooling of interest method. So that I can help you more fully understand what I tried to express, I am sending you our thoughts on this matter as attached. I would be grateful if you could inform me of any observations and/or comments on this letter.

Yours faithfully,

Shizuki Saito, Chairman

Accounting Standards Board of Japan

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Our position on the accounting for business combinations

This letter intends to make clear our position on the accounting for business combinations, which we discussed at the meeting of the International Accounting Standards Board with National Standard Setters, held on 10-11 September 2001.

The selection between the pooling method and the purchase method

We, ASBJ, are opposed to the elimination of the pooling method and the unification of the accounting for business combinations to the purchase method.

1. Under the purchase method, regardless of whether the purchase consideration is cash or shares, business combinations are regarded as the same as real investments made by cash by a continuing entity. For this reason, assets acquired and liabilities assumed are recognized at fair value at the date of acquisition, while the original assets and liabilities of the acquiring entity remain at their carrying amounts. This accounting treatment is based on the notion that the investing entity maintains its continuity.

2. On the other hand, the fresh-start method is based on the fictitious assumption that both combining entities are liquidated and a new entity emerges at the date of combination. Under this method, both entities are deemed to have lost their continuity. Thus, the fresh-start method is incompatible with the purchase method in that it denies the continuity of the investing entity, because the purchase method is based on the notion that a business combination is one of the forms of real investments by a continuing entity.

3. Accordingly, the fresh-start method, by nature, cannot be an alternative in the accounting standard that requires the purchase method in principle. If the fresh-start method were applied to the accounting for the business combinations as a general rule, not just limited to the business combinations in which an acquirer cannot be identified, even an entity which has not lost its continuity would be allowed to revalue its own assets and liabilities at fair value continuously by splitting itself into a number of entities and then combining them again. Also, the adoption of the fresh-start method can result in a consequence that an entity, which is a party of the contracts that are similar to business combinations, such as significant business alliances or even

significant new investments in capital outlays, can revalue its assets and liabilities at fair value, even if it is not a business combination. The fresh-start method is inconsistent with the current accounting model based on the premise of continuity, because it is based on a fictitious assumption of liquidation of both entities that are not actually liquidated.

4. Consequently as described above, under the accounting standards where the purchase method is adopted as a primary rule and the fresh-start method is logically inapplicable, the pooling method is necessarily the only alternative to the purchase method for the business combinations in which an acquirer cannot be identified. If the application of the purchase method is forced in such cases in which it is difficult to identify an acquirer, it might provide an opportunity for arbitrary selection of an acquirer with relatively low costs, because it is easy to change the form of the combination when the ownership percentage of the combining companies are nearly equal. As a result, two identical business combinations can be transformed into accounting information which are quite different from each other and the comparability of accounting information would be damaged. While most IASB members are concerned about abuse through the use of the pooling method, we are also afraid of abuse of revaluation through the use of the purchase method (and the fresh-start method, if any).

Accounting for goodwill

The issue of accounting for goodwill, especially non-amortization of goodwill, has not been discussed internationally, even in the G4+1 paper. Accordingly, we recommend that IASB should start with issuance of a discussion paper to discuss this issue thoroughly, rather than hastily preparing an exposure draft of IFRS. We believe that this is the only way to meet due process requirements.

We are opposed to non-amortization of goodwill for the following reasons, and we believe that goodwill should be amortized within a certain period and be subject to impairment when necessary.

1. We agree to the rejection of the immediate write off because goodwill includes some components which do not diminish immediately, such as the value of excess earning power of the acquired entity. However, we are opposed to the non- amortization method,

since the value of such power usually diminishes as the competition intensifies. Even where the value of excess earnings does not appear to decline, this happens because the value is maintained and complemented by the additional investment or other efforts made by the acquirer after the business combination. Therefore, we believe that non-amortization is virtually equal to the capitalization of internally generated goodwill and inconsistent with the current accounting model.

2. Some argue to deny the amortization of goodwill because expenses related to goodwill are "doubling-up" when the income statement is charged for amortization of goodwill and expenses for creating internally generated goodwill. However, the amortization of goodwill represents the diminishment of goodwill that is the reflection of value created by the acquired entity prior to the business combination. On the other hand, current expenses are the results of additional expenditure to maintain the excess earning power by the combining entity. Those are entirely different by nature and it does not lead to "double counting". If such expenses were considered as "doubling-up", the current accounting for property, plant and equipment would also be reconsidered, because depreciation costs and expenses for maintenance and repair would also be regarded as "doubling-up" as well.

3. Some also argue to deny the amortization of goodwill because users of accounting information, such as analysts, ignore or exclude goodwill amortization expense in their analyses. However, the same ignorance happens on restructuring costs, interest expenses, research and development costs and so on, for their respective purposes. We need the same treatment for these costs as logical extension.

4. We consider that IASB's intention to set up the accounting standard for goodwill by uncritical reference to the new standard in the United States is too hasty. This new standard has only just been issued in July 2001 and, in particular, the appropriateness of non-amortization approach and validity of impairment tests have not yet been verified at all. The IFRS, as an internationally accepted accounting standard, should be carefully established with discretion and we believe that verification of the effectiveness of the new US standard is necessary even if we are merely referring to it.