Accounting Standards Board of Japan
Kowa Building No.9,
1-8-10, Akasaka, Minato-ku, Tokyo
107-0052
Japan

Tel: +81-3-5561-8449
Fax: +81-3-5561-9624

http://www.asb.or.jp

May 16, 2003

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David,

Comments on the Business Combinations (Phase 2) project

The Accounting Standards Board of Japan (ASBJ) respects IASB's continuing effort to conduct the Business Combinations (Phase 2) project. The International Issues Standing Committee of ASBJ has considered this project monthly as a liaison standard setter, and has some concern on tentative decisions made by IASB to date. We hope that IASB will take the following issues into consideration in this project.

Best Regards,

Ikuo Nishikawa

Chairman, International Issues Standing Committee
Vice Chairman, Accounting Standards Board of Japan

Accounting for Minority Interest and Presentation

1. In the Business Combinations (Phase 2) project, IASB discussed accounting for minority interest and its presentation in the following points.
   (1) Presentation of minority interest both in the consolidated balance sheet (treated in IAS Improvement project) and in the consolidated income statement.
   (2) Accounting treatments related to minority interest

2. We believe that accounting for minority interest and its presentation should be discussed in the light of the purpose of consolidated financial statements. There have long been a lot of arguments about the purpose of consolidated financial statements, that is, controversy between the parent company concept and the economic unit (or entity) concept. In the IASB's tentative decisions to date, IASB seems to take it for granted that the economic unit (or entity) concept should be adopted. However, in our understanding, the purpose of consolidated financial statements has not been discussed at the IASB meeting. We believe that IASB should fully discuss it and reach a consensus about what approach to adopt.

3. The consequence of such discussion would have a significant impact on various aspects, including the scope for consolidation and accounting treatments for elimination of internal profit or loss. We have a concern that if IASB would reach a conclusion without such consideration, consistency of the accounting treatment of consolidated financial statements could not be maintained as a whole.

Presentation of Minority Interest

4. In the Improvement project, IASB proposed in the ED of Amendment to IAS 27 that minority interest should be presented within equity in the consolidated balance sheet, and in the Business combination (Phase 2) project, IASB tentatively agreed that net profit or loss attributable to minority interest should be displayed under the net profit or loss in the consolidated income statement, consistent with the presentation of them in the consolidated balance sheet. With regard to the presentation of minority interest in the consolidated balance sheets, according to the analysis of comment letters to the ED, more than half of commentators supported such proposal.

5. We note that the reason for such changes in presentation is that minority interest does not meet the definition of liability under the IASB framework. However, we believe that it is not appropriate to amend only the presentation of minority interest without discussion of the purpose of consolidated financial statements, which closely relates to its presentation.

Accounting for minority interest

Accounting for subsequent increases/ decreases in ownership of a subsidiary, which do not result in a loss of control

6. In the Business combinations (Phase 2) project, IASB tentatively agreed that difference between carrying amount of minority interest and cash flows arising from subsequent increases (acquisitions) / decreases (disposal) in ownership interests in a subsidiary, arising after a parent obtains control of it and do not loss of control, should be accounted for as increases/ decreases of additional paid in capital. We note that the reasons for such decision are that minority interest holders are equity holders to the group and should be treated as owners of the parent company, and that it is consistent with the tentatively agreed presentation of minority interest in the consolidated balance sheet.

7. We do not agree with treating minority interest holders the same as owners of the parent company, because they do not have any rights to the parent company. Since shares traded by investors are those issued by the parent company, we believe that the purpose of consolidated income statement is to disclose the result of operation of such investment. Therefore, we believe that increases and decreases in interest of owners should be recognised in profit or loss, except for those arising on transactions with owners of the parent company.

Step acquisitions to obtain a control / Accounting for subsequent decreases in ownership of a subsidiary, which results in a loss of control

8. In the Business combinations (Phase 2) project, IASB tentatively decided that in a business combination achieved by step acquisitions, the difference between the carrying amount of its previous investment in the acquiree and its fair value on the date of acquisition of control should be recognised in profit or loss for the period. IASB also tentatively decided that if an entity loses its control of a subsidiary, any gain or loss should be recognised in profit or loss for the period, for the difference between the proceeds from the sale of ownership interests in the subsidiary and the parent's share of the carrying amount of the subsidiary's net assets in the consolidated financial statements, less the fair value of any investment remaining in the former subsidiary. In these arguments, it seems to us that there is no distinction between investments accounted for the equity method and those classified as available for sale securities before an acquisition of control or after a loss of control.

9. In the current accounting treatment for consolidation, the equity method should be applied if an entity does not have control but has a significant influence to the investee company. Based on the current model, we believe that it is necessary to distinct

between the cases that an entity has a significant influence or not before an acquisition or after a loss of control. While IASB does not take such distinction into consideration in the project, we believe that it is necessary to discuss consistently not only accounting for minority interest but also consolidation procedures and the scope of consolidation, including an application of the equity method at the same moment.

Full goodwill method

Recognition of goodwill- minority interest portion

10. In the Business combinations (Phase 2) project, IASB tentatively agreed that the full goodwill method should be used to recognise goodwill in the acquisition of less than 100 percent controlling interest in an acquiree. The reasons for adoption of such treatments are explained as follows.
    (1) Goodwill positively meets the definition of an asset, similarly to other classes of assets.
    (2) Users of an entity's financial statements are provided with useful information about the entity's financial position when that information reflects the assets under control of the entity, acquired by the entity in business combinations, regardless of the extent of ownership interests held.
    (3) It is consistent with the control concept for consolidation.

11. We believe that goodwill is by nature different from other classes of assets, such as land or buildings. It is true that goodwill meets the definition of assets since it contributes to generate cash inflows in conjunction with other assets. However, goodwill has critically different natures from other identifiable assets in that it lacks legal basis and is not separable from other assets.

12. A portion of goodwill attributable to minority interest is meaningless from the viewpoint of owners of the parent company because they do not control it at all. On the other hand, from the viewpoint of minority interest holders (non-control owners), it is none other than internally generated goodwill and its recognition is inconsistent with the current accounting model which prohibits recognition of internally generated goodwill. Therefore, from either viewpoint, it is not appropriate to recognise goodwill attributable to minority interest. We believe that the purpose of calculation for net profit or loss is to measure the returns on investments. In the light of this view, to recognise full amount of goodwill, which is neither ensured by cost for transaction nor based on funding, is not consistent with such purpose, that is, to measure the returns on investments. In general, we believe that valuation of the entity value, including internally generated goodwill, is a role of investors and the management of the entity should not reveal their own valuation.

Measurement for full goodwill

13. In the Business combinations (Phase 2) project, IASB tentatively agreed that the full goodwill should be measured at fair value of an acquiree's business, based on the fair value of consideration paid by an acquirer or measured directly, less the fair value of net identifiable assets acquired in the business combinations. The measurement for the fair value of the combination is inferred from the consideration paid if any control premium paid by the acquirer is identifiable and measurable with sufficient reliability, or is measured directly using valuation techniques if any control premium paid by the acquirer cannot be measured with sufficient reliability. In addition, expected synergies and other benefits from combining the businesses of both the acquiree and the acquirer should be measured at fair value and included in the full goodwill, based on assumptions which are not contrary to the market participants' view.

14. We believe that neither the measurement of control premium nor that of expected synergies can be measured apart from other components of goodwill in reality, because goodwill, unlike other classes of assets, can be measured only difference. This is clearly stated in paragraph BC 101 of IFRS ED 3 and paragraph B124 of FAS 141. We doubt whether the recognition and measurement of such information in the financial statements are relevant to users and leads to representational faithfulness.

15. With regard to the treatment of "overpayment/ underpayment" in the business combinations, IASB tentatively agreed that, if there is clear evidence to suggest that the business combination is not an exchange of equal values after reassessment, an excess of the consideration paid over the fair value of the acquirer's interest in the net assets acquired should be recognised in profit or loss, while an excess of the latter over the former should be first recognised as a reduction in the full amount of goodwill until the goodwill is reduced to zero and any remaining excess should be recognised in profit or loss. However, we cannot understand what kind of transaction is not an exchange of equal values. Furthermore, we cannot understand the ground for such asymmetric treatment for "overpayment" and "underpayment". We believe that there is theoretical inconsistency and that IASB should make it clear in the project.

Cc: Keith Alfredson, AASB
Paul Cherry, AcSB
Antoine Bracchi, CNC
Liesel Knorr, DRSC
Tony van Zijl, FRSB
Mary Keegan, ASB
Bob Herz, FASB
Kevin Stevenson, IASB
Annette Kimmitt, IASB
Galina Ryltsova, IASB