Accounting Standards Board of Japan (ASBJ)

Fukoku Seimei Building 20F, 2-2, Uchisaiwaicho 2-chome, Chiyoda-ku, Tokyo 100-0011, Japan
Phone +81-3-5510-2737 Facsimile +81-3-5510-2717 URL http://www.asb.or.jp/

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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

Comments on Exposure Draft of Proposed Amendments to IFRS 3 "Business Combinations" and Proposed Amendments to IAS 27"Consolidated and Separate Financial Statements"

Accounting Standards Board of Japan (ASBJ) is pleased to comment on the Exposure Draft of Proposed Amendments to IFRS 3 "Business Combinations" and IAS 27 "Consolidated and Separate Financial Statements". The views expressed in this letter are those of International Issues Standing Committee of ASBJ.

Ⅰ General view

1. Parent entity view （IAS 27－Question 1）

There have been arguments about choice between the parent entity view and the economic entity view as the basic concept for preparation of consolidated financial statements. We support the parent entity view from the viewpoint of usefulness of the information provided to investors. In our view, the purpose of consolidated financial statements is to report net income, that is, changes in equity attributable to owners of the parent entity other than changes arising from direct transactions with shareholders. We believe that interests of owners of the parent entity and minority interests are not equivalent and they should be treated differently in determining net income. Therefore, we disagree with the proposal of IAS 27 that changes in the parent's ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders, which results in no gains or losses on such changes being recognized in profit or loss forever.

The reasons are as follows:

- The primary objective of financial reporting is to disclose information that provides the basis for assessment of corporate value, in other words, operating results of the entity to help equity holders (including potential investors) in assessing the investment value by forecasting future cash flows. Consolidated financial statements can contribute to assessment of the investment value to the owners of the parent entity, not to minority shareholders of subsidiaries. From such viewpoint of investors, we cannot find the reason why owners of the parent entity and minority shareholders should be

treated equivalently.

- Owners of the parent entity control the entire group, whereas minority shareholders have only interests in a particular subsidiary. Minority shareholders do not have interests in the parent entity and therefore they bear risks of the group in a different degree from owners of the parent entity. In this regard, minority shareholders are not equivalent to owners of the parent entity.
- We understand that, as stated in paragraph BC5, the IASB adopted the proposed approach to ensure consistency with the previous decision that non-controlling interests are a separate component of equity because they do not meet the definition of a liability in the "Framework for the Preparation and Presentation of Financial Statements". We agree that non-controlling interests should be presented as equity because they do not meet the definition of a liability. However, we do not believe that controlling interests and non-controlling interests should be treated equivalently in determining net income. It is not appropriate to reach the conclusion that controlling interests and non-controlling interests should be treated equivalently without full consideration of the argument about choice between the parent entity view and the economic entity view. In our opinion, just because IAS 1 provides that minority interests be presented within equity, it does not mean that the argument about the basic concept for consolidated financial statements has already arrived at conclusion.
- IAS 33 "Earnings per Share" provides that earnings per share should be calculated based on profit or loss attributable to ordinary equity holders of the parent entity. Although it conflicts with the proposed approach in this Exposure Draft that treats controlling interests and non-controlling interests equivalently, we prefer the existing IAS 33 because of consistency with the parent entity view. Furthermore, we believe that IAS 1, under which profit or loss for the period should include profit or loss attributable to minority interest, should be amended to be consistent with IAS 33.

2. Step acquisition to obtain control / decreases in parent's ownership interest in subsidiaries with loss of control (IFRS 3 - Question 10 and IAS 27 - Question 2)

(1) Treatment of the equity method

We disagree with the proposal to remeasure the non-controlling equity investment to fair value at the date of obtaining or losing control. We understand that, as noted in paragraphs BC151 of the proposed amendments to IFRS 3 and BC7 of the proposed amendments to IAS 27, the IASB decided that the proposed approach was appropriate because obtaining or losing control in a business is a significant economic event that should trigger remeasurement and it is a significant change in the nature of the economic circumstances surrounding the investment. In our understanding, this proposal applies even if there is significant influence over the investee before obtaining control or after losing control. Therefore, according to the proposal, when an investment in a subsidiary becomes an investment in an associate due to changes in the parent's ownership interest, any remaining non-controlling equity investment would be remeasured to fair value and then the equity method would be applied. And when an investment in an

associate becomes an investment in a subsidiary, the non-controlling equity investment previously accounted for by the equity method would be remeasured to fair value.

However, we believe such remeasurement is inappropriate for the following reasons:

- We consider that the nature of the investment has not changed and the investment is continuing in these cases. Therefore, we disagree with remeasurement of the equity investment and recognition of resultant gains or losses in the income statement in such cases.
- The proposal is based on the IASB's view that the nature of the investment critically changes on the date of obtaining or losing control. However, such view neglects the fact that an investment in subsidiaries and an investment in associates are measured in the same way in consolidated financial statements. The equity method, as sometimes called as "one-line consolidation", has the same effect as consolidation on net income (attributable to owners of the parent entity) and net asset, with the only difference being the method of presentation. We believe that remeasurement of investment at the time of changes between consolidation and the equity method is inappropriate, because it would deny the continuity of measurement between them as mentioned above. It seems that the logic underlying the proposed approach implies denial of the meaning of the equity method itself.
- The proposed accounting treatment, in effect, assumes fictitious disposal and repurchase transactions contrary to actual transactions. We consider that such fictitious assumption would not reflect the substance of the transactions.

Additionally, when available-for-sale securities become an investment in subsidiaries in step acquisitions, we believe that the cost should be the aggregate of the fair values of the considerations for each exchange transaction. Therefore, we do not consider it appropriate to remeasure the available-for-sale securities at the date of obtaining control and recognize resultant gains or losses in profit or loss even though they have not been sold.

(2) Clarification of the requirement

According to paragraph BC13 of the proposed amendments to IAS 27, the IASB concluded that the accounting for the loss of control of a subsidiary should be extended to the loss of significant influence over an associate and thus, upon the loss of significant influence, any retained investment would be remeasured to fair value and a gain or loss would be recognized in profit or loss. And, to be consistent with the above, we suppose that remeasurement to fair value would be also required when significant influence is obtained through additional acquisition. If the proposed approach is adopted, such treatments should be described in the main text rather than Basis for Conclusions.

Under such approach, remeasurement to fair value would be required both when significant influence is obtained and when control is obtained through step acquisition (this also applies to loss of control and significant influence in gradual decrease in the ownership interest). We doubt that it is appropriate to remeasure the investment to fair value twice in the process of obtaining (or losing) control.

3. Full goodwill method and application guidance for fair value measurement (IFRS 3-Question 3 and 4)

We disagree with the full goodwill method proposed in this Exposure Draft. Instead, we support the purchased goodwill method in the existing IFRS 3.

The reasons why we disagree with the full goodwill method are as follows:

- The objective of accounting information is to provide information that helps users to estimate the corporate value, not to present the market's evaluation of the corporate value including internally generated goodwill. We believe that the goodwill attributable to non-controlling interests is internally generated goodwill and therefore should not be recognized.
- In our opinion, the issue pointed out in paragraphs BC15 is not inconsistency at all.

  As noted in paragraph BC15, in a business combination in which the acquirer obtains control of a 100 per cent interest in the acquiree, the acquirer recognizes all of the goodwill, whereas in a business combination in which the acquirer obtains control of less than all of the equity interests of the acquiree, the acquirer recognizes all of the acquiree's identifiable assets and liabilities but only its portion of the goodwill.

  However, as noted in paragraphs AV3 and AV6 as alternative views, goodwill is different from other assets by its nature, because it is a component of the value of the business as a whole, after recognizing identifiable intangible assets, rather than having a separate existence. In addition, it is difference between the fair value of the consideration paid by the parent entity for the subsidiary and its share of the fair value of the identifiable net assets of the subsidiary. On the other hand, identifiable assets and liabilities are separable and can be disposed on the parent entity's will. Taking such difference between goodwill and identifiable assets and liabilities into consideration, it is not inconsistency that the acquirer recognizes all of the acquiree's identifiable assets and liabilities but only its portion of the goodwill in a business combination in which the acquirer obtains control of less than all of the equity interests of the acquiree. Under the purchased goodwill method, the goodwill attributable to the parent entity is recognized because it is a part of the cost of investment in a business combination. And the goodwill attributable to non-controlling interests is not recognized, because it does not represent the amount invested by the acquirer.
- We understand that the acquisition method in business combinations is based on the view that a business combination is an extension of investment in real assets. From such perspective, we believe that accounting for business combinations should based on the actual transaction and that recognition of goodwill attributable to non-controlling interests is inappropriate because it is not based on the actual transaction of the parent entity.
- As noted in paragraphs AV4-AV7 as alternative views, in a business combination in which the acquirer obtains control of less than all of the equity interests of the acquiree, it is often impracticable to measure the fair value of the acquiree as a whole. In particular, it would be often impossible to

distinguish between overpayments and control premiums. The examples in paragraphs A8-A26 do not deal with cases where it is difficult to measure the fair value of the acquiree as a whole. Furthermore, given the entity-specific nature of control premiums, it seems inconsistent the acquiree as a whole should be measured at fair value rather than the entity-specific value.

4. Fundamental principles underlying the Exposure Draft

According to paragraphs BC15-BC17, the primary rationale for the revision of IFRS 3 is necessity to eliminate the following inconsistencies:

(a) In a business combination in which the acquirer obtains control of a 100 per cent interest in the acquiree, the acquirer recognizes all of the goodwill, whereas in a business combination in which the acquirer obtains control of less than all of the equity interests of the acquiree, the acquirer recognizes all of the acquiree's identifiable assets and liabilities but only its portion of the goodwill.

(b) The amount of goodwill recognized in a business combination achieved in stages and in a business combination achieved in a single transaction is not the same.

However, in our view, these points are not inconsistencies at all. As mentioned in section 3 above, we believe that the matter (a) is not inconsistency. With regard to the matter (b), the IASB decided that the measurement objective in accounting for business combinations should be the fair value of the acquiree on the acquisition date rather than the costs incurred in a business combination, as mentioned in BC17. In our view, the matter (b) is not inconsistency either, considering that the acquired asset, i.e. goodwill, is a non-financial asset, not a financial asset. It is quite natural and no inconsistency that the costs of non-financial assets acquired in stages and those acquired in a single transaction are not the same. We do not believe that such a result needs any corrective measure. It seems that the IASB's proposed approach views business combinations as transactions similar to financial investments[1].

We view business combinations as a form of non-financial investments. From this viewpoint, the cost of step acquisition should be the accumulated cost, deeming each transaction until control is obtained composes one "unit of account". Therefore, we support the acquisition method in the existing IFRS 3, under which a business combination is recognized at its cost and that cost is measured as the aggregate of the fair values of the considerations at the date of each exchange plus any cost directly attributable to the business combination. From this viewpoint, it is quite natural and no inconsistency that the amount of goodwill differs depending on whether the business combination is achieved in stages or in a single transaction.

As stated above, from our viewpoint, the issues pointed out in BC15-BC17 are not inconsistencies at all.

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[1] In our view, assets are classified into financial investments and non-financial (business) investments according to the purpose of the investment. Non-financial investments are investments aimed at obtaining the results through operating the business and financial investments are investments aimed at obtaining gains from changes in the market price.

Therefore, we cannot find the reason why the existing IFRS 3 should be revised.

Ⅱ Detail issues in the proposed amendments to IFRS 3

1. Measurement date for equity securities issued as consideration - Question5

The draft revised IFRS 3 carries forward the requirement in IFRS 3 that equity interests issued by the acquirer as consideration in a business combination should be measured at the acquisition date. On the other hand, the existing FASB standard measures them by reference to the market price around the agreement date. We believe that they should be measured based on the market price for a reasonable period before and after the date that the terms of the acquisition are agreed to and announced.

The reasons are as follows:

- The combining entities usually have agreed on the terms of the business combination, in particular, the exchange ratio by reflecting the business value of each entity.
- Fluctuations in share price after the public announcement may include factors that do not relate to the proper value of the acquiree's business.

2. Acquisition-related costs – Question 7

We disagree with the proposal that acquisition-related costs should be accounted for separately from the business combination. We believe that the fees paid to external advisors that are directly attributable to the acquisition should be accounted for as a part of the cost of the acquisition, considering consistency with IAS 2 "Inventories"[2] and IAS 16 "Property, Plant and Equipment"[3]. We consider that a business combination is a form of non-financial investments, as mentioned above, and therefore accounting treatment of acquisition-related costs should be consistent with other non-financial investments.

3. Bargain purchase and overpayment – Question 11 and 12

According to paragraphs BC173 and BC178, both a bargain purchase and an overpayment occur when the business combination is not an exchange of equal values. In the case of a bargain purchase, the Exposure Draft provides that the difference between the fair value of the acquiree as a whole and the fair value of the transferred consideration be accounted for as a gain at the last result. On the other hand, IASB concluded that it might not be possible to identify and measure reliably an overpayment at the acquisition date, as noted in paragraph BC178. Such asymmetry treatment seems to be inconsistent. Furthermore, the conclusion about an overpayment seems to conflict with the presumption underling the full goodwill method that the fair value of the acquiree as a whole can be reliably measured.

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[2] Paragraph 11 provides that the costs of purchase of inventories comprise transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services.

[3] Paragraph 16 provides that the cost of property, plant and equipment comprises direct incidental costs, and, furthermore, paragraph 17(f) gives an example for them as professional fees.

Ⅲ Detail issues in the proposed amendments to IAS 27

Guidance for preventing from structuring of transactions – Question 3

As mentioned in I-1 above, we disagree with the proposal to account for transactions between controlling interests and non-controlling interests as equity transactions. Paragraph 30F of the proposed amendment to IAS 27 would be unnecessary under the parent entity view we support.

However, we would like to note that the provision of paragraph 30F would be insufficient if the proposed approach is adopted, because the accounting result intended by the entity could be achieved if the closing date comes before the structured multiple transactions are completed.

We hope that our comments will contribute to the work of the IASB in arriving at its final decision.

Best Regards,

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