Accounting Standards Board of Japan
Financial Accounting Standards Foundation

Research Paper No. 3

June 2017

Analyst Views on Financial Information Regarding Goodwill

Accounting Standards Board of Japan

Key Findings

- All analysts interviewed by the ASBJ staff conducted their analyses based on cash flow information. Although the way they used cash flow information varied, those who adjusted accounting profit to determine cash flows added back amortisation and impairment losses.
- However, the fact that analysts added back amortisation and impairment losses did not necessarily mean that their intention was to avoid using accounting profits that amortised goodwill in their analyses. All analysts conducted analyses from multiple perspectives; in addition to analyses based on cash flow information, analysts considered accounting profit and net asset information.
- Although how accounting profit and net asset information were used varied among analysts, the ASBJ staff observed that the analysts could be classified broadly into two groups: (i) those who placed more significant importance on analyses based on cash flow information to achieve comparability at the global level, and (ii) those who placed significant importance on analyses based on accounting profit and net asset information as much as on analyses based on cash flow information, considering the impact of such information on stock prices and the lending behaviour of financial institutions.
- Within the analysts who placed more significant importance on analyses based on cash flow information, some supported the non-amortisation of goodwill because the signal of the failure in the investment should be provided by recognising goodwill impairment when the value of goodwill had become lower than the initial amount recognised as goodwill, whereas others were indifferent between amortisation and non-amortisation of goodwill because neither affected cash flows.

- Within the analysts who placed significant importance on analyses based on accounting profit and net asset information as much as on analyses based on cash flow information, some supported the amortisation of goodwill for the following reasons:
  - the value of goodwill cannot be maintained permanently;
  - the non-amortisation of goodwill may induce imprudent business combinations;
  - impairment losses better represent the failure in the investment when goodwill impairment was recognised when the value of goodwill had become lower than the carrying amount of goodwill after amortisation; and
  - the amortisation of goodwill achieves equal footing between growth by means of business combinations and organic growth.
- At the same time, other analysts supported the non-amortisation of goodwill due to the costs to conduct their analyses because there was no alternative but to converge with the approach that was most widely used internationally, for the purpose of achieving comparability at the global level.
- Some analysts thought that information regarding the management's estimate of the period for which expected future cash flows would increase due to the business combination was useful. These analysts thought that, by amortising goodwill based on such period, profit or loss would be calculated by matching the increases in income due to the business combination with the amortisation expense determined based on the management's estimates and thus provides useful information.
- Regardless of how cash flow information and accounting profit and net asset information were used, many analysts thought that impairment losses on goodwill

were recognised later than when they thought the deterioration in the value of goodwill had occurred. These analysts said that they incorporated the deterioration in the value of goodwill in their analyses before the impairment losses on goodwill were recognised.

- In recent international discussions regarding the subsequent accounting for goodwill, arguments such as “analysts believe that goodwill amortisation would not provide relevant information” or “all analysts ignore goodwill amortisation and adjust profit or loss in order to eliminate the effect of goodwill amortisation” are often heard. Based on the interviews, it was confirmed that the method of analyses varied among analysts, and how they conducted analyses based on cash flow information and accounting profit and net asset information depended on the objectives of their analyses. It was also confirmed that their views on the amortisation of goodwill varied.

Implications for standard setting

- The ASBJ staff thinks that, in order to reflect the analyst views in the process of developing accounting standards, it is necessary to interpret their views in the context of setting standards.
- As stated in the "Key Findings" section, the analysts interviewed by the ASBJ staff can largely be classified into those who place more significant importance on cash flow information, and those who place significant importance on accounting profit and net asset information as much as on analyses based on cash flow information, and their views on the amortisation of goodwill varied.
- Within the various views expressed by the analysts, the ASBJ staff focuses on two views. One view, expressed by more than one analyst from the perspective of conducting analyses based on accounting profit and net asset information, is that goodwill should be amortised. The other view, expressed by more than one analyst from the perspective of conducting analyses based on cash flow information, is that they were indifferent between amortisation and non-amortisation of goodwill.
- The ASBJ staff thinks that these two views have different implications for accounting standard setting.

  The former view implies that accounting profit and net asset information, which are determined in accordance with accounting standards that require the amortisation of goodwill, provide relevant information because information provided under the amortisation and impairment approach is more informative than the impairment only approach.

The latter view implies that the relevance of financial information is basically unaffected, even if goodwill is amortised, because neither the amounts of amortisation nor impairment losses are meaningful.

Taking these views into account, for the subsequent accounting for goodwill, to reflect the analyst views in the process of developing accounting standards, the relevance of financial information for more analysts would be improved by placing more significance on the views of analysts who support the amortisation and impairment approach.

- The ASBJ staff hopes that the results and the implications of this Research Paper contribute to the international discussions related to the accounting for goodwill.

I. Objective of the Research Paper

1. The objective of this Research Paper is to provide a basis for discussions regarding the IASB's research project on "Goodwill and Impairment" and the FASB's Research Agenda "Subsequent Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities."

2. The non-amortisation of goodwill was first introduced in U.S. GAAP by FASB Statement No. 142, *Goodwill and Other Intangible Assets*, issued in June 2001 (hereinafter referred to as "Statement 142"). The Basis for Conclusions of Statement 142 stated that "in addition to the many analysts that ignore goodwill amortisation expense in their analyses, many entities ignore goodwill amortisation expense in measuring operating performance for internal reporting purposes" (paragraph B90).

3. In June 2015, the IASB published the Report and Feedback Statement, "Post-implementation Review of IFRS 3 *Business Combinations*" (hereinafter referred to as "the Report"). The Report indicated that investors held mixed views on the subsequent accounting for goodwill; some investors supported the existing requirements under IFRS (that is, the non-amortisation of goodwill) whereas other investors supported the amortisation of goodwill.

4. On the other hand, in recent international discussions regarding the subsequent accounting for goodwill, arguments such as "analysts believe that goodwill amortisation would not provide relevant information" or "all analysts ignore goodwill amortisation and adjust profit or loss in order to eliminate the effect of goodwill amortisation" are often heard.

5. The staff of the Accounting Standards Board of Japan (hereinafter referred to as the "ASBJ staff") conducted in-depth interviews with prominent analysts in Japan with the aim of understanding their current views on goodwill and impairment more thoroughly. This Research Paper summarises the results of those in-depth interviews.

6. It should be noted that this Research Paper intends to share the various views of analysts in Japan and, therefore, does not intend to provide analyses of the proportion (or the number) of the different views. Furthermore, it should be noted

that this Research Paper summarises the views of analysts to assure the anonymity of their responses, although it might have been easier to understand the analyst views had their views been described separately. When the views of more than one analyst was summarised as a single view, this Research Paper indicates such fact, but it does not indicate the number of the analysts, because those views were not necessarily identical. The number of the views included in this Research Paper and the number of the analysts who expressed those views do not necessarily match, because one analyst may have expressed more than one view from different perspectives on the same subject.

II. Scope and Methodology of the In-Depth Interview

7. The ASBJ staff conducted in-depth interviews with eleven prominent analysts in Japan. The ASBJ staff selected analysts with outstanding experience and knowledge in business valuation or credit quality assessment, with the assistance of the Securities Analysts Association of Japan (SAAJ). The ASBJ staff also considered the balance of views from buy-side equity analysts, sell-side equity analysts, and credit analysts. When selecting analysts whose work focused on a specific industry, the ASBJ staff selected industries where business combination transactions were more common.

8. The analyst type, employer type, and industry focus of the eleven analysts who were interviewed can be summarised as follows[1]:

	Analyst Type	Employer Type	Industry Focus
1	Buy-side equity	Investment management company	All industries
2	Buy-side equity	Asset management company	All industries
3	Buy-side equity	Asset management company	All industries
4	Buy-side equity	Asset management company (Non-Japanese)	All industries
5	Buy-side equity	Asset management company (Non-Japanese)	All industries
6	Sell-side equity	Securities company	All industries
7	Sell-side equity	Securities company	Telecommunication Services
8	Sell-side equity	Securities company	Food, Beverage, and Tobacco
9	Sell-side equity	Securities company	Retail
10	Sell-side equity	Securities company (Non-Japanese)	Health Care
11	Credit	Credit agency	All industries

9. All eleven analysts analysed financial statements which were prepared in accordance with three types of accounting standards, namely Japanese GAAP, IFRS, and U.S. GAAP. The ASBJ staff thought that it would be meaningful to report the views of analysts who analysed the financial statements of Japanese entities applying Japanese GAAP, because such analysts were the only analysts who currently analysed financial statements that were prepared in accordance with accounting standards that required the amortisation of goodwill in addition to the impairment of goodwill (Among the accounting standards used in major capital markets, only Japanese GAAP currently requires the amortisation of goodwill). All eleven analysts had experience in analysing financial statements that were prepared in accordance with IFRS or U.S. GAAP, when they conducted business valuations or credit quality assessments of Japanese entities that have adopted IFRS or U.S. GAAP, or when they analysed financial statements of non-Japanese peer entities.

10. The ASBJ staff interviewed each of the eleven analysts using a common questionnaire. The questionnaire included the following questions:

- How do you use financial information regarding business combinations that is provided in the entity's financial statements when conducting business valuations or credit quality assessments?
- What type of disclosures are useful as disclosures related to goodwill?
- What is the most appropriate as the subsequent accounting for goodwill, impairment only, systematic amortisation with impairment testing, or direct write-off?

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[1] Some analysts had experience as a buy-side equity analyst as well as a sell-side equity analyst. Regarding analysts who have experienced more than one analyst type or employer type, the list shows the analyst type or employer type when the interview was conducted (when the analyst referred to a specific analyst type or employer type, the list shows that specific analyst type or employer type). Moreover, some analysts expressed their own personal views while others expressed collective views of analysts working for the same employer.

III. Findings

Classification of the responses from analysts

11. All eleven analysts the ASBJ staff interviewed stated that, in their process of business valuations or credit quality assessments, they conducted analyses based on cash flow information in one way or another. Analysts calculated cash flow information by adding back amortisation and impairment losses to accounting profit.

12. At the same time, all eleven analysts conducted analyses from multiple perspectives, and used accounting profit and net asset information in one way or another.

13. How cash flow information and accounting profit and net asset information were used in their analyses varied among analysts. The ASBJ staff observed that the responses from equity analysts could be classified broadly into two groups:

    - Equity analysts who placed more significant importance on analyses based on cash flow information; and
    - Equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as on analyses based on cash flow information.

14. The credit analyst placed more significant importance on analyses based on accounting profit and net asset information, although he also conducted analyses based on cash flow information.

Views of equity analysts who place more significant importance on analyses based on cash flow information

How financial information is used

15. Some equity analysts stated that they placed more significant importance on analyses based on cash flow information, although they also stated that they conducted analyses based on accounting profit and net asset information.

16. More than one buy-side equity analyst stated that they placed more significant importance on analyses based on cash flow information. These buy-side equity analysts analysed financial statements of a relatively large number of entities to

determine the composition of the portfolios of stocks they would hold. They raised the following examples regarding how analyses were conducted in the context of determining the composition of the portfolio of stocks they would hold:

- Regarding the analyses based on cash flow information, the “fair” stock price based on the Discounted Cash Flows (DCF) method or the Return on Investment Capital (ROIC) was calculated for each entity, and the prices or ratios were compared among entities.
- Regarding the analyses based on accounting profit and net asset information, ratios such as the Price Earnings Ratio (PER), the Return on Equity (ROE) ratio, and Earnings Per Share (EPS) were calculated for each entity, and the ratios were compared among entities or with industry standards.

17. Equity analysts gave the following reasons for placing more significant importance on analyses based on cash flow information:

- More than one buy-side equity analyst stated that cash flow information was necessary for comparison among entities at the global level, because cash flow information was unaffected by the differences in accounting standards.
- One buy-side equity analyst stated that they used cash flow information calculated by adjusting profits for the purpose of projecting the long-term performance of the entity, because such information was more sustainable than unadjusted profits for the year which might be affected by specific activities such as restructuring.

Impact of business combinations on their analyses

18. Many equity analysts who placed more significant importance on analyses based on cash flow information stated that they analysed the appropriateness of the acquisition price and the premium included in the acquisition price when they evaluated the impact of a business combination on their analyses at the timing of announcement or execution.

19. One buy-side equity analyst stated that he made projections regarding the increase in ROIC by the business combination at the timing of announcement or execution and continuously monitored whether the actual increase in ROIC met his projections.

20. More than one equity analyst thought that impairment losses on goodwill were recognised later than when they thought the deterioration in the value of goodwill had occurred. Regarding how to reflect the risk of goodwill impairment in their analyses, these equity analysts raised the following examples:

- One buy-side equity analyst stated that he would increase the hurdle rate to be compared with ROIC in order to reflect the risk of goodwill impairment.
- One buy-side equity analyst stated that he would reflect the risk of goodwill impairment in the determination of the final rating (for example, downgrading the final rating from “buy” to “hold” to reflect the risk of goodwill impairment).

Subsequent accounting for goodwill

21. Equity analysts who placed more significant importance on analyses based on cash flow information were divided in their views on the subsequent accounting for goodwill:

- One buy-side equity analyst supported non-amortisation because, for analyses based on ROIC, it was inappropriate to recognise expenses for the amortisation of goodwill based on a predetermined schedule, as it would distort the amount of the original investment which was included in total assets (that is, the denominator in the calculation of ROIC). This analyst also thought that a mechanical amortisation of goodwill made managements less conscious of the capital cost and thus obscured the accountability of the results of business combinations assessed in the context of capital cost.
- One buy-side equity analyst emphasised that amortisation of assets should be required only when there was sufficient evidence for the amortisation period and argued that non-amortisation was better than mechanical amortisation over a period without evidence. This analyst also noted that the signal of the failure in the investment should be provided by recognising goodwill impairment when the value of goodwill had become lower than the initial amount recognised as goodwill and that the amortisation of goodwill would weaken this effect.
- One buy-side equity analyst stated that the amortisation of goodwill created inconsistencies with cash flows, and the non-amortisation of goodwill would lead to recognising some value on the balance sheet permanently and, accordingly,

experience showed that both approaches have problems. He thought that one theoretical solution to resolve this contradiction was to directly write off goodwill.

- One buy-side equity analyst stated that, from the perspective of conducting analyses based on cash flow information, they were indifferent between amortisation and non-amortisation because they did not affect cash flows.

Disclosures

22. Some buy-side equity analysts who placed more significant importance on analyses based on cash flow information stated the following views on disclosures related to goodwill:

    - When an entity recognises goodwill impairment, disclosures of information regarding how management determined when to recognise goodwill impairment (for example, how the business environment or management strategy has changed, and how such changes affected the inputs for estimating the value in use, including the expected future cash flows or discount rates, before and after the recognition of impairment losses) would be useful.

Views of equity analysts who place significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information

How financial information is used

23. Some equity analysts stated that they placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information.

24. Equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information included buy-side equity analysts who used financial statements to determine the composition of the portfolio of stocks they would hold as well as sell-side equity analysts who analysed financial statements when they estimated stock prices of their target entities in specific industries.

25. Examples raised by buy-side equity analysts regarding how to conduct the analyses based on cash flow information and accounting profit and net asset information are summarised in paragraph 16.

26. Sell-side equity analysts raised the following examples regarding how analyses were conducted in the context of conducting business valuations of their target entities:

- Regarding the analyses based on cash flow information, stock prices were estimated based on the DCF method or the Earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA) multiples.

- Regarding the analyses based on accounting profit and net asset information, ratios such as the PER, the ROE ratio, and EPS were calculated, and the trends in the ratios were analysed, the ratios were compared among entities or with industry standards, and the stock prices were estimated based on "fair" ratios.

27. Equity analysts gave the following reasons for placing significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information:

- More than one equity analyst, including both buy-side and sell-side equity analysts, stated that they placed significant importance on analyses based on publicly reported financial information as a predictor of stock-price fluctuations, because such financial information had impact on the short-term stock-price fluctuations.

- More than one equity analyst, including both buy-side and sell-side equity analysts, stated that they used accounting profit and net asset information in order to predict future cash flows, because they thought such information affected management behaviour (for example, management may be reluctant to make new investments considering the impact on accounting profit, or impairment may trigger management to aggressively promote restructuring activities).

- One sell-side equity analyst stated that the precision of future cash flow predictions varied among industries and that, for business valuations of entities in an industry where the precision of future cash flow predictions is low, it is more likely that analyses would be based more on accounting profit information such as using the PER.

- More than one equity analyst, including both buy-side and sell-side equity analysts, stated that they usually did not conduct analyses based on a single method or a single index but conducted analyses from multiple perspectives using multiple indices that were calculated using more than one method.

Impact of business combinations on their analyses

28. Similar to those who placed more significant importance on analyses based on cash flow information (see paragraph 18), many equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information stated that, when they evaluated the impact of a business combination on their analyses at the timing of announcement or execution, they analysed the appropriateness of the acquisition price and the premium included in the acquisition price and considered the impact of those transactions on stock prices based on the DCF method or indices such as the PER or EPS.

29. Similar to those who placed more significant importance on analyses based on cash flow information (see paragraph 20), many equity analysts thought that impairment losses on goodwill were recognised later than when they thought the deterioration in the value of goodwill had occurred. Equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information stated that they identified the deterioration in the value of goodwill by observing reduced profitability and incorporated the deterioration in the value of goodwill in their analyses before impairment losses on goodwill were recognised. They raised some examples of how to incorporate the deterioration in the value of goodwill, such as reflecting the decrease in profitability in the estimation of future cash flows (for example, reflecting the decrease in the growth rate) and reducing the amount of goodwill included in net assets or total assets to be used in their analyses.

30. Equity analysts shared the following implications of their understanding that impairment losses on goodwill were recognised later than their analyses:

    - More than one sell-side equity analyst stated that they placed little value on the information regarding the recognition of goodwill impairment and the amount of the impairment losses, because they thought that the judgments made by management that goodwill was impaired was arbitrary and that in many cases they came later than when analysts had identified such impairment.

- More than one sell-side equity analyst stated that their estimated stock prices may be reduced when sufficient information necessary for their projections could not be obtained. These equity analysts noted that they sometimes increased their estimated stock prices or observed increases in actual stock prices in response to the recognition of goodwill impairment or sufficient disclosure.
- One sell-side equity analyst stated that the grouping used to perform impairment tests was problematic. This analyst stated that some entities avoided recognising goodwill impairment by undergoing restructuring activities for the purpose of enlarging the unit used to perform the impairment test.
- One buy-side equity analyst thought that, as indicated by the fact that goodwill impairment was often recognised at the timing of management changes, the late recognition of goodwill impairment was a matter of management or audit and not a matter of accounting standards.

Subsequent accounting for goodwill

31. Equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information were divided in their views on the subsequent accounting for goodwill:

Views in favour of the amortisation and impairment approach

32. Some equity analysts stated views in favour of the amortisation and impairment approach:

- One buy-side equity analyst emphasised that there was ambiguity in whether goodwill met the definition of an asset. This analyst thought that, if the value of goodwill could not be maintained permanently, there needed to be a mechanism that ultimately reduced the carrying amount of goodwill to zero. This analyst also stated that non-amortisation of goodwill led to the recognition of internally generated goodwill.
- More than one equity analyst, including both buy-side and sell-side equity analysts, stated that by amortising goodwill and recognising goodwill impairment when the value of goodwill had become lower than the carrying amount of

goodwill after amortisation, impairment losses better represented the failure in the investment and thus provided more relevant information.

- More than one equity analyst, including both buy-side and sell-side equity analysts, mentioned that the non-amortisation of goodwill might induce an M&A bubble, because an entity could achieve growth in both revenue and profit simply by acquiring a profitable entity. On the other hand, the amortisation of goodwill would force management to set a higher target to earn more profit from the investment than the amortised amount.

- One sell-side equity analyst thought that accounting profit that included amortisation of goodwill had a higher information value, because the accounting would be consistent with the accounting for investments in property, plant and equipment (that is, the amortisation of goodwill achieved equal footing between growth by means of business combinations and organic growth).

- One sell-side equity analyst placed significant value on the information regarding the amortisation period for goodwill, because such information represented management’s estimate of the period for which the amount of goodwill would be recouped by the increase in expected future cash flows due to the business combination.

Views in favour of the non-amortisation approach

33. Some equity analysts stated views in favour of the non-amortisation approach:

- More than one sell-side equity analyst mentioned that, given that both U.S. GAAP and IFRS require the non-amortisation of goodwill, there was no alternative but to converge with the approach that was most widely used internationally in practice for the purpose of achieving comparability at the global level. They stated that the coexistence of the amortisation approach and the non-amortisation approach incurred additional costs to conduct their analyses.

- One sell-side equity analyst stated that, in some industries, business combinations were essential for the sustainable growth of the entity operating in that industry and thus it was undesirable for management to become hesitant to make investments because the accounting required the amortisation of goodwill.

Neutral views

34. More than one sell-side equity analyst stated that, from the perspective of conducting analyses based on cash flow information, they were indifferent between amortisation and non-amortisation because they did not affect cash flows.

Amortisation period

35. Some equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information stated the following views regarding the amortisation period:

- More than one sell-side equity analyst stated that information regarding the management's estimate of the period for which expected future cash flows would increase due to the business combination was useful. These equity analysts also mentioned that, by amortising goodwill based on such period, profit or loss would be calculated by matching the increases in income due to the business combination with the amortisation expense determined based on the management's estimates and thus provides useful information.

- One buy-side equity analyst was in favour of determining the amortisation period based on the management's estimates of the period for which synergies were realised and maintained. This analyst further stated that goodwill may be amortised over a relatively long period when the synergies were expected to be realised over a long period of time.

Disclosures

36. Some equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information stated the following views on the disclosures related to goodwill:

- More than one sell-side equity analyst stated that, in order to assess individual business combinations, disclosures of the initial amount of goodwill recognised, the carrying amount of goodwill, and the accumulated amortisation and impairment amounts of goodwill are needed for each business combination.

- More than one sell-side equity analyst stated that disclosures of the expected growth rates and discount rates that management used for their estimates are important. These equity analysts also mentioned that such disclosures are necessary not only to analyse whether the amount of impairment losses recognised were sufficient but also to examine whether there were any differences in the inputs analysts used for their analyses when the entity did not recognise goodwill impairment.

- More than one sell-side equity analyst stated that the processes of stress tests conducted by the entity should be disclosed so that analysts could predict under what circumstances the entity would be recognising goodwill impairment.
- More than one equity analyst, including both buy-side and sell-side equity analysts, stated that the total of goodwill and intangible assets other than goodwill should be disclosed because the two were inter-related. These equity analysts also stated that it would be useful if the ratio of total intangible assets (that is, the total of goodwill and intangible assets other than goodwill) to net assets was disclosed, because the risk in the valuation of those assets would depend on this ratio.

Intangible assets other than goodwill

37. Although there was no specific question in the questionnaire, some equity analysts who placed significant importance on analyses based on accounting profit and net asset information as much as those based on cash flow information stated their views on the initial or subsequent accounting for intangible assets other than goodwill which an entity acquired as part of a business combination:

- Sell-side equity analysts whose industry focus were in the telecommunication services, foods, and pharmaceuticals industries stated that the valuation of intangible assets acquired as part of a business combination at fair value was often challenging. Intangible assets which may be material in amount but difficult to measure at fair value included brands, trademarks, intellectual properties, licensing agreements, and customer relationships. Some of these equity analysts further noted that it would be useful for entities to disclose how the fair values and values in use of the identified intangible assets were calculated.

Views of the credit analyst

How financial information is used

38. The credit analyst stated that, when he conducted credit quality assessments, he placed more significant importance on analyses based on accounting profit and net asset information, although he stated that he also conducted analyses based on cash flow information.

39. The credit analyst raised the following examples regarding how analyses were conducted in the context of conducting credit quality assessments of the target entities:

- Regarding the analyses based on accounting profit and net asset information, ratios related to profitability and capital structure such as the capital adequacy ratio or the net debt to equity ratio were calculated, and the trends in the ratios were analysed and the ratios were compared among entities or with industry standards.
- Regarding the analyses based on cash flow information, future cash flows were estimated in order to estimate the debt repayment period.

40. The credit analyst stated the following reason for placing more significant importance on analyses based accounting profit and net asset information:

- Analyses based on financial information is important because financial information such as accounting profit or net assets would significantly affect the creditworthiness and financial stability of the entity through the lending behavior of financial institutions.

Impact of business combinations on analyses

41. The credit analyst stated that he focused on the impact of the acquisition on the creditworthiness of the entity (for example, the impact on the amount of interest-bearing debt, the debt repayment period, the capital structure, and the capital adequacy ratio). He also noted that large-scale acquisitions rarely had a positive impact on the credit rating, because synergies or growth potentials were generally ignored in evaluating the credit rating.

42. The credit analyst stated that he paid particular attention to the recognition of goodwill impairment, because it would deteriorate the value of net assets. Similar to many equity analysts, he thought that impairment losses on goodwill were recognised later than when he thought the deterioration in the value of goodwill had occurred. He also stated that, when continuously monitoring the impact of a business combination,

in some cases, the amount of goodwill included in the net assets or total assets for analysis purposes was reduced before goodwill impairment was recognised, when he observed that accounting profits or cash flows lagged behind the original target.

Subsequent accounting for goodwill

43. The credit analyst supported the amortisation and impairment approach for the following reasons:

- Because goodwill is initially recognised as a residual (rather than being measured at fair value), it should be viewed as an acquisition cost and thus the carrying amount of goodwill should ultimately be reduced to zero via amortisation.
- Because it is difficult to measure the fair value of the goodwill accurately and the process for measuring the value of the goodwill would inevitably be subjective, even if the impairment process is improved, goodwill should be systematically amortised from the viewpoints of financial soundness and the creditworthiness of the entity.

Amortisation period

44. The credit analyst stated the following view regarding the amortisation period:

- The primary purpose of amortising goodwill is to ultimately reduce the carrying amount of goodwill to zero. The desirable amortisation period would be based on the management's estimate of the period for which the amount of goodwill would be recouped by the increase in expected future cash flows due to the business combination.

Disclosures

45. The credit analyst stated the following view on the disclosures related to goodwill:

- The initial amount of goodwill recognised, the carrying amount of goodwill, and the accumulated amortisation and impairment amounts of goodwill for each business combination were useful for the purposes of credit quality assessment.

IV. Acknowledgements

This Research Paper was prepared by ASBJ staff members Tomoyuki Tani, Nami Yamaguchi, Yuichi Yamane, and Satoshi Kasai, with Atsushi Kogasaka and Yasunobu Kawanishi as the Board advisors.

The ASBJ greatly appreciates each of the eleven analysts, with sharing their pearls of wisdom about their experiences and knowledge in business valuations or credit quality assessments.

The ASBJ would also like to express its gratitude to Mr. Makoto Kaimasu, Executive Vice President of the Securities Analysts Association of Japan, with his assistance in this project.