

Accounting Standards Board of Japan (ASBJ)

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Technical Director

Financial Accounting Standards Board

401 Merritt 7, P.O. Box 5116

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Re: Comments on the FASB's Invitation to Comment

Identifiable Intangible Assets and Subsequent Accounting for Goodwill

1. The Accounting Standards Board of Japan (the 'ASBJ' or 'we') welcome the opportunity to provide comments on the FASB's Invitation to Comment, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill* (hereinafter referred to as 'the ITC').
2. Our understanding is that the subsequent accounting for acquired goodwill is a global issue, because the issue is currently discussed not only by the FASB but also by the International Accounting Standards Board (IASB). Under such circumstances, we would like to contribute to the initiatives to improve global accounting standards by submitting our comments to the ITC.
3. We believe that acquired goodwill is an asset whose value deteriorates. We also believe that acquired goodwill is a cost that would be expensed corresponding to the effects of excess earning power that are expected to crystalize after the business combination. Accordingly, we believe that acquired goodwill should be amortized over a certain period to provide relevant information about the entity's performance after the business combination.

We acknowledge that the carrying amount of acquired goodwill has accumulated globally and that concerns over the so-called "too little, too late" issue are increasingly shared among stakeholders. We believe that it is extremely challenging to respond to this issue by improving existing impairment tests and, therefore, believe that fundamental improvements, such as reintroducing the amortization of acquired goodwill, are needed.

4. If acquired goodwill were to be amortized, we believe that the amortization period should be based on management's estimates, with a maximum period of 10 years.

The management's estimates should be based on the period for which future net cash inflows are expected to increase as a result of the business combination.

However, we acknowledge that there are diverse views based on the international discussions that have been held in the past. Accordingly, if it would lead to reaching global consensus, we are willing to accept, as the second best alternative, that goodwill shall be amortized over 10 years, or less than 10 years if the entity demonstrates that another useful life is more appropriate.

5. Cross-border business combinations are not uncommon these days, and we believe that it is desirable that the requirements under U.S. GAAP and those under IFRS Standards ultimately become comparable. During the process of achieving the ultimate goal, we expect that both the FASB and the IASB work closely together in developing their respective accounting standards.
6. For our comments on the specific questions, please refer to the Appendix. We hope that our comments are helpful for the FASB's deliberations in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read "A. Kogasaka". The signature is fluid and cursive, with a large initial "A" and a long, sweeping underline.

Atsushi Kogasaka

Chair

Accounting Standards Board of Japan

Comments on the Specific Questions in the ITC

Question 1

What is goodwill, or in your experience what does goodwill mainly represent?

1. The core elements of acquired goodwill are considered to be the synergies expected from combining the businesses and the “going-concern” element of the acquiree (as described in the ITC). These elements largely depend on the expectations of future cash flows, and may be difficult to calculate in monetary terms, but nevertheless, we believe that acquired goodwill forms part of the investment made in a business combination and should be recognized as a cost to be expensed over time, corresponding to the effects of excess earning power that are expected to crystalize after the business combination.
2. We believe that acquired goodwill is an asset whose value deteriorates over time and that their effects do not last forever.

Question 2

Do the benefits of the information provided by the current goodwill impairment model justify the cost of providing that information? Please explain why or why not in the context of costs and benefits.

3. Under the current impairment-only model, an entity assesses impairment at the reporting unit level, which results in the so-called shielding effect (that is, the impairment of acquired goodwill is obscured because the impairment test takes into account the effects of unrealized gains of the acquirer that existed at the time of acquisition and internally generated goodwill that is generated after the acquisition). Based on how the current impairment test is structured, we believe that it is difficult to identify the impairment of acquired goodwill in a timely manner. We also believe that it is difficult to improve the current impairment-only model to address the shielding effect.

In addition, we think that the benefits of the information provided under the current impairment-only model regarding the entity’s performance after the business combination is limited when compared with the benefits provided under goodwill

amortization with impairment testing. In this regard, please refer to our comments to Question 3.

4. Furthermore, the costs of applying the current impairment-only model is high because there are only a limited number of applicable and observable inputs to conduct the impairment test, and it requires a lot of time in each period to ensure that the estimates are reliable.
5. Considering these circumstances, we do not think that the benefits of providing information under the current impairment-only model justify the costs of providing such information.

Question 3

On a cost-benefit basis, relative to the current impairment-only model, do you support (or oppose) goodwill amortization with impairment testing? Please explain why in your response.

6. We have compared both models and support goodwill amortization with impairment testing. Our reasons are summarized as follows:
 - (a) Acquired goodwill is an asset that represents excess earning power and its value deteriorates over time. Amortization of acquired goodwill reflects such deterioration and avoids recognition of internally generated goodwill.
 - (b) Acquired goodwill forms part of the investment made in a business combination and should be recognized as a cost to be expensed over time, corresponding to the effects of excess earning power that are expected to crystalize after the business combination. By reflecting the amortization of the acquired goodwill in net income in each reporting period, an entity can appropriately present its performance after the business combination, and provide investors with relevant information.
 - (c) Amortization of acquired goodwill is expected to contribute to reducing the costs incurred by preparers. That is, although preparers may incur the costs of determining the amortization period, there would be fewer situations where the calculation of the impairment losses would be required due to amortization (especially when a maximum is set on the amortization period – please refer to

paragraph 8 of the Appendix regarding our view on the maximum on the amortization period) and, accordingly, the costs and complexities of performing the impairment test would be reduced.

7. In addition to the above, we acknowledge the growing concerns over the “too little, too late” issue. In recent years, stakeholders are concerned that the carrying amount of acquired goodwill has been steadily increasing, and they suspect that it is because the current impairment-only model may not be effective (that is, impairment losses may not be recognized in a timely manner). Such concerns should be addressed in a timely manner and we think that goodwill amortization with impairment testing is a practical and effective approach to address this issue.

Question 4

If the Board were to decide to amortize goodwill, which amortization period characteristics would you support? Please include all that apply in your response and explain why you *did not* select certain characteristics.

- a. A default period
- b. A cap (or maximum) on the amortization period
- c. A floor (or minimum) on the amortization period
- d. Justification of an alternative amortization period other than a default period
- e. Amortization based on the useful life of the primary identifiable asset acquired
- f. Amortization based on the weighted-average useful lives of identifiable asset(s) acquired
- g. Management’s reasonable estimate (based on expected synergies or cash flows as a result of the business combination, the useful life of acquired processes, or other management judgments).

8. We support the characteristics of “g. Management’s reasonable estimate” and “b. A cap (or maximum) on the amortization period.” We think that the management’s estimate should be based on “the period for which future net cash inflows are expected to increase as a result of the business combination,” with a maximum period of 10 years. Our reasons are summarized as follows:
 - (a) According to interviews we conducted with Japanese analysts, those who supported amortization with impairment testing supported the use of management's reasonable estimates, stating that “the period for which the future net cash inflows are expected to increase as a result of the business combination”

provided useful information. Even though “g. Management reasonable estimate” may result in different outcomes as a result of management judgement, we think that such estimates provide relevant information to investors.

- (b) On the other hand, we think that it is appropriate to set a maximum on the amortization period considering financial soundness because (i) acquired goodwill is calculated as a residual and its components cannot necessarily be disaggregated in monetary terms and (ii) management may expect the effects to last for a long time. Accordingly, we support the characteristic of “b. A cap (or maximum) on the amortization period.” Setting a maximum on the amortization period will ensure that the carrying amount of acquired goodwill will be reduced within this maximum period, and will be an effective way to address the “too little, too late” issue, as mentioned in paragraph 7 of this Appendix.

Although it is not easy to logically set an appropriate maximum on the amortization period, we propose 10 years as the maximum period because it seems to be acceptable to most stakeholders. Our proposal is based on (i) the understanding that there are views in the international community that it is unlikely to expect the effects of business combinations to continue more than 10 years, (ii) the fact that the amortization option provided for private companies under U.S. GAAP and the amortization requirement under International Financial Reporting Standards for Small and Medium Sized Entities (IFRS for SMEs) set 10 years as the maximum on the amortization period and are applied in practice, and (iii) the results of academic studies^(Note 1).

9. As shown in the previous paragraph, our preference is to determine the amortization period based on management's estimates and to set 10 years as the maximum period. However, based on the international discussions that have been held in the past, we acknowledge that there are diverse views. Accordingly, if it would lead to reaching global consensus, we are willing to accept, as the second best alternative, that goodwill shall be amortized over 10 years, or less than 10 years if the entity demonstrates that another useful life is more appropriate (“d. Justification of an alternative amortization period other than a default period” and the equivalent of “b. A cap (or maximum) on the amortization period” in terms of setting the maximum period of 10 years).

We believe that this approach eliminates the subjectivity in estimating the amortization period and, at the same time, ensures a certain degree of reasonableness by leaving room for judgement regarding the use of an amortization period that is shorter than 10 years.

Question 5

Do your views on amortization versus impairment of goodwill depend on the amortization method and/or period? Please indicate yes or no and explain.

10. As mentioned above, we believe that acquired goodwill is an asset whose value deteriorates over time and that their effects do not last forever. We believe that setting the amortization period is an important consideration in developing accounting standards when reintroducing amortization.

Question 6

Regarding the goodwill amortization period, would equity investors receive decision-useful information when an entity justifies an amortization period other than a default period? If so, does the benefit of this information justify the cost (whether operational or other types of costs)? Please explain.

11. We believe that the usefulness of information would be enhanced by setting a default amortization period as well as allowing the acquirer to justify amortization periods shorter than the default period, consistent with paragraph 9 of this Appendix, because this leaves room for reflecting the differences in the characteristics of each business combination. Also, such justification is made only when the acquirer considers it to be appropriate, so the acquirer would not incur costs that it believes are not worth incurring. For this reason, we believe that the usefulness of information would justify the cost.

Question 9

Relative to the current impairment model, how much do you support (or oppose) removing the requirement to assess goodwill (qualitatively or quantitatively) for impairment at least annually? Please explain why in your response.

12. The annual impairment test assessment was established to avoid the delayed

recognition of impairment losses that could result from the removal of amortization. Removal of the annual impairment test should be considered together with the reintroduction of amortization. In other words, the annual impairment test is necessary unless acquired goodwill is amortized, and impairment tests should be conducted only when triggering events occur if acquired goodwill is amortized.

Question 10

Relative to the current impairment model, how much do you support (or oppose) providing an option to test goodwill at the entity level (or at a level other than the reporting unit)? Please explain why in your response.

13. We agree with the observation in the ITC that the option to conduct an impairment test at the corporate level is inappropriate because increased internally generated goodwill in some reporting units may obscure the impairment of acquired goodwill in other reporting units.

Question 12

The possible approaches to subsequent accounting for goodwill include (a) an impairment-only model, (b) an amortization model combined with an impairment test, or (c) an amortization-only model. In addition, the impairment test employed in alternative (a) or (b) could be simplified or retained as is. Please indicate whether you support the following alternatives by answering “yes” or “no” to the questions in the table below. Please explain your response.

	Do You Support the Indicated Model? Yes/No	Do You Support Requiring an Impairment Assessment Only upon a Triggering Event? Yes/No	Do You Support Allowing Testing at the Entity Level or a Level Other Than the Reporting Unit? Yes/No
Impairment only			
Amortization with impairment			
Amortization only		Not applicable	Not applicable

14. Our response to this question is as follows:

	Do You Support the Indicated Model?	Do You Support Requiring an Impairment Assessment Only upon a Triggering Event?	Do You Support Allowing Testing at the Entity Level or a Level Other Than the Reporting Unit?
	Yes/No	Yes/No	Yes/No
Impairment only	No	No	No
Amortization with impairment	Yes	Yes	No
Amortization only	No	Not applicable	Not applicable

Question 18

As it relates to Approach 2 (a principles-based criterion), please comment on the operability of recognizing intangible assets based, in part, on assessing whether they meet the asset definition.

15. We reserve our comments because of our lack of sufficient understanding of the proposed revised definition of an asset, which are currently discussed in the FASB's Conceptual Framework project, and of the applicable unit of account for intangible assets.

Question 19

Approaches 1–3 assume that subsuming additional items into goodwill would necessitate the amortization of goodwill. Do you agree or disagree? Please explain why.

16. We agree that Approach 1 to Approach 3 are based on the premise that acquired goodwill is required to be amortized. We acknowledge that the recognition of intangible assets in business combinations and the amortization of acquired goodwill are two fundamentally different topics. However, if intangible assets with finite useful lives are subsumed in acquired goodwill and the acquirer effectively amortizes such intangible assets over the amortization period of acquired goodwill, it is likely that the cost of the intangible assets would be expensed faster than when acquired

goodwill is not amortized. Accordingly, it is justifiable to subsume intangible assets in acquired goodwill from the viewpoint of cost-benefit considerations.

Question 25

Please describe the implications on costs and benefits of providing PBEs with an option on how to account for goodwill and intangible assets and the option for the method and frequency of impairment testing (described previously in Sections 1 and 2).

17. As mentioned in paragraph 6 of this Appendix, we believe that acquired goodwill is an asset whose value deteriorates over time and should be amortized over a period based on management's reasonable estimates.
18. However, based on the international discussion that have been held in the past, we acknowledge that there are diverse views and it would be difficult to reach global consensus on the subsequent accounting for acquired goodwill. Some of the views that are observed include: (i) the view that the value of acquired goodwill does not diminish, (ii) the view that it is only necessary to confirm whether an entity maintain the value of the acquired goodwill and the value of internally generated goodwill in total, and (iii) the view that an entity should not rely on amortization even if the value of acquired goodwill deteriorates because the amortization period is indefinite.
19. With regard to providing public business entities with an option of the subsequent accounting for acquired goodwill, we acknowledge that such an option may reduce the comparability among entities and impose additional burdens on users of financial statements. However, we think that management have diverse views regarding whether amortization is useful from the perspective of discharging their accountability and, accordingly, providing an option has the advantage of allowing management to select accounting models that they believe are useful, which in turn will enable more effective communication between preparers and investors.

In addition, we acknowledge that there are growing concerns about the "too little, too late" issue, and it would be inappropriate to maintain the status quo just because it is difficult to reach global consensus regarding the subsequent accounting for acquired goodwill. In this context, although it may not be ideal, we think that it is worth exploring the option as a potentially realistic approach.

We recommended this optional approach at the Accounting Standards Advisory

Forum meeting held in July 2017. For our detailed recommendations in the meeting, please refer to the following website:

<https://www.asb.or.jp/en/discussions/papers/2017-0612-2.html>

20. Regarding the option, there are additional issues, such as the unit for which the entity may make its choice (that is, whether an entity chooses an accounting model for all of its business combinations as an accounting policy or whether an entity is allowed to determine the accounting model for each business combination). In this regard, we believe an entity should be required to adopt an accounting model for all of its business combinations as its accounting policy for the following reasons:
- (a) If the same model were not applied to all of the reporting entity's business combinations consistently, the carrying amount of goodwill would include both goodwill that is amortized and goodwill that is not amortized. It is difficult to justify this amount from the perspective of providing relevant information to users of financial statements.
 - (b) By applying either model for all of the entity's business combinations consistently as the entity's accounting policy, the entity's management can align the subsequent accounting for goodwill with its views on how to discharge its accountability regarding the results of the entity's business combinations.
21. In addition, regarding the concerns related to the reduction in the comparability among entities caused by the option, we think that such concerns could be alleviated to a certain extent by adding disclosure requirements to supplement the information that is necessary to make comparisons among entities.

Question 26

To what extent does noncomparability in the accounting for goodwill and certain recognized intangible assets between PBEs reporting under GAAP and PBEs reporting under IFRS reduce the usefulness of financial reporting information? Please explain your response.

22. It is difficult to describe the extent to which usefulness would be reduced. Cross-border business combinations are not uncommon these days, and we believe that it is desirable that the requirements under U.S. GAAP and those under IFRS Standards

ultimately become comparable. During the process of achieving the ultimate goal, we expect that both the FASB and the IASB work closely together in developing their respective accounting standards.

Question 29

Would you be interested and able to participate in the roundtable?

23. The topics discussed in this ITC are topics that have an impact on global accounting standards trends and thus we are interested in participating in the roundtable.

(Note 1) The ASBJ reviewed academic papers including the following:

- Dickinson, V. and G. A. Sommers (2012). Which competitive efforts lead to future abnormal economic rents? Using accounting ratios to assess competitive advantage. *Journal of Business Finance and Accounting*, 39(3) & (4), 360-398.
- Healy, P., Serafeim, G., Srinivasan, S. and Yu, G. (2011). Market competition, government efficiency, and profitability around the world. Working paper, Harvard Business School. Available at SSRN 1865878.
- Muramiya, K. (2010) Characteristic analysis of financial ratios that constitute residual income model. In Sakurai, H. ed., *Empirical analysis of enterprise valuation*, Section 9, 230-269, Chuokeizai-sha, Inc. (the titles of the paper and the book are not official ones but tentative translation by the ASBJ staff.)
- Nissim, D. and Penman, S. H. (2001). Ratio analysis and equity valuation. *Review of Accounting Studies*, 6, 109– 154.
- Obinata, T. (2013). Sustainability and mean reversion of profitability. Chuokeizai-sha, Inc.
- Palepu, K. G. and Healy, P. M. (2012). *Business analysis and valuation 5th edition - International edition*, Cengage learning.
- Sakurai, T. (2010) Sustainability of residual income and enterprise valuation. In Sakurai, H. ed., *Empirical analysis of enterprise valuation*, Section 10, 270-315, Chuokeizai-sha, Inc. (the titles of the paper and the book are translations by the ASBJ staff.)

Palepu and Healy showed the empirical research results that excess operating returns on equity diminished within 5 to 10 years. Nissim and Penman explored the period of the mean reversion for decile portfolios formed on excess operating profit and found that excess operating profit for the highest decile remained over 10 years.