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Comments on the Discussion Paper (DP/2020/1) *Business Combinations - Disclosures, Goodwill and Impairment*

1. The Accounting Standards Board of Japan (the "ASBJ" or we) welcome the opportunity to provide our comments to the International Accounting Standards Board (the "IASB")'s Discussion Paper (DP/2020/1) *Business Combinations - Disclosures, Goodwill and Impairment* (hereinafter referred to as the "DP").

2. Subsequent accounting for goodwill has been continuously discussed by the IASB as well as by the U.S. Financial Accounting Standards Board (the "FASB"), and our understanding is that this issue is a global issue. The publication of the DP is intended to address this global issue and we appreciate the IASB undertaking an initiative in this area. We would like to contribute to this initiative towards improving global accounting standards through the submissions of our comments on the DP.

3. There are several preliminary views in the DP that we cannot support. Our main arguments are summarised below.

(Objective of the project)

4. The DP states that the overall objective of the IASB's project is "to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make." We acknowledge that there is room for improvement in the disclosure of business combinations as suggested in the DP.

However, the high-priority issue identified through the Post-implementation Review of IFRS 3 *Business Combinations* (hereinafter referred to as the "PIR") was the subsequent accounting for goodwill and thus we disagree with the abovementioned objective because it does not focus on this issue.

In particular, one of the specific issues that was identified through the PIR was that impairment losses of goodwill were not recognised in a timely manner (that is, they were "too late") under the impairment-only approach in the existing IAS 36 *Impairment of Assets*. We think that there is also an issue that the amount of impairment losses of goodwill have been insufficient (that is, the amount was "too little") (the timeliness issue and sufficiency issue collectively are hereinafter referred to as "the 'too little, too late' issue"). In addition, as we discuss later in the following paragraphs, we support the reintroduction of the amortisation of goodwill. In this context, the "too little, too late" issue is understood as an issue related to the recognition of total expenses arising from goodwill, which includes both amortisation and impairment. We believe that this is the issue that should be addressed as the response to the feedback from the PIR, and we believe the IASB should explicitly state that this is the objective of this project.

(Impairment and amortisation of goodwill)

5. Goodwill is acquired in an acquisition in exchange for payments, and we consider goodwill to be an asset that primarily represents excess earning power and to be a wasting asset with a finite useful life. Amortisation reflects the consumption of goodwill and, by appropriately recognising income earned subsequent to the acquisition and the corresponding amortisation expense of this paid cost in net income in each period, useful information about the performance subsequent to the acquisition would be provided to users of financial statements. Accordingly, we believe that the IASB should adopt an amortisation with impairment approach.

6. Moreover, we think that the amortisation of goodwill is helpful to solve the "too little, too late" issue noted in paragraph 4 of this comment letter. Though the IASB has considered various approaches, in our view the IASB has not been successful in developing an approach that would solve this problem at a reasonable cost.

7. The DP identifies two reasons for the “too little, too late” issue: one is management over-optimism and the other is the shielding effect. In this regard, almost 15 years have passed since IFRS 3 became effective, and during that period, the balance of goodwill has been steadily increasing. This increasing trend may be partly due to the increase in the number of acquisitions, but we believe that the main cause of this trend is the accounting mechanism that creates the shielding effect. We acknowledge that the IASB was aware of the existence of the shielding effect when the IASB initially developed IFRS 3, but, after many years of application, we think that the shielding effect has proved to be more problematic than it was initially expected.

8. In this regard, when the IASB initially developed IFRS 3, it was expected that if a rigorous and operational impairment test could be devised, information that is more useful would be provided to users of financial statements under an approach that would not amortise goodwill. However, the fact that we observe the “too little, too late” issue today indicates that the existing impairment test is not sufficiently effective as initially expected.

9. For this reason, we believe that it is inappropriate to retain the existing impairment-only approach and that this issue cannot be solved without reintroducing amortisation.

10. We are aware that there are criticisms against the amortisation of goodwill. Regarding our views to these criticisms, please refer to our response to Question 7(b) in the Appendix of this comment letter for details. Here, we emphasise the following points:

    (a) Regarding the criticism that it is questionable whether goodwill is always a wasting asset with a finite useful life

    We do not think that goodwill continues to have effect indefinitely because the sources of competitive advantages in the market that are represented by goodwill erode in their effects over time, assuming there is healthy competition and that improvements and adjustments to the knowledge and the processes that generate the entity’s future returns would be needed as the surrounding environment changes and the workforce is replaced. In our view, acquired goodwill and

goodwill internally generated from the reinvestment of cash flows produced subsequently are separate items.

(b) Regarding the criticism that the useful life and amortisation pattern of goodwill generally cannot be predicted and that straight-line amortisation of goodwill over an arbitrary period fails to provide useful information

We think that the difficulty in predicting the useful life or the pattern of amortisation is not limited to goodwill – it also applies to other assets that should be depreciated or amortised. In addition, we think that it is possible to estimate the useful life of goodwill because, whenever an entity acquires a business, such an entity usually collects various types of information and conducts sufficient analyses before making the decision to acquire that business.

(c) Regarding the criticism that users of financial statements would add back the amortisation expense because the amortisation expense would not help them assess performance

The survey of Japanese analysts' views we conducted in 2017 revealed that the method of analyses varied among analysts and that there were some analysts who focused on both cash flow information and accounting profit information. It follows that users of financial statements may use information about amortisation depending on the objective of their analyses and thus it cannot simply be concluded that information about amortisation is unnecessary because analysts focus on cash flows. In addition, users of financial statements who added back amortisation expense also added back impairment losses, both of which are non-cash expenses. The fact that users of financial statements added back amortisation in itself neither indicates the superiority of the impairment-only approach nor the inferiority of the amortisation with impairment approach. Considering that those users of financial statements can adjust the amortisation expense without incurring significant costs, we think that a larger number of users of financial statements would benefit from the amortisation with impairment approach that would enhance the relevance of financial information. Under this approach, the financial performance for each period includes the

amortisation expense of goodwill, and management would be held accountable for the acquisition in light of this financial performance.

11. In addition, we think that the amortisation period should be estimated by management and should be based on "the period for which expected future net cash inflows would increase due to the business combination." This is based on the views of analysts who support amortisation, and we think that such management's estimate provides users of financial statements with relevant information regarding the acquisition. Nevertheless, we think that an upper limit to the amortisation period should be set to strike a balance with the need to solve the "too little, too late" issue, and we propose 10 years in this comment letter.

(Disclosure of subsequent performance of acquisitions)

12. Based on our outreaches to analysts, users of financial statements in Japan strongly support the proposals of disclosing the management's objective for the acquisition and its subsequent performance. These users support the proposals mainly because they are unable to obtain the information that is sufficient to assess the value of the entity under existing disclosures, and more information about the acquisition is necessary for their assessments because an entity may make extremely large investments in acquisitions or in-depth analyses on goodwill that represents excess earning power may be needed as compared to other investments such as investments in plant and equipment.

13. Although we acknowledge the expectations of those users of financial statements, we do not agree with the disclosures as currently proposed in the DP for the following reasons:

    (a) First, preparers of financial statements are deeply concerned with the disclosure proposals due to the risks that they may suffer from competitive disadvantages or the risks that users of financial statements may misunderstand that only the disclosed metrics are important. In addition, even if the information were required to be disclosed, preparers of financial statements argue that such information should be outside the financial statements, considering the nature of the proposed information. Thus, we acknowledge that there is a large disagreement between the views of users of financial statements and the views

of preparers of financial statements. Moreover, auditors are concerned about the lack of clarity regarding the boundary of financial statements and the difficulty in auditing some of the information that would be included in the financial statements, although they acknowledged the information needs of the users of financial statements. We think that these stakeholders, including users of financial statements, have reasonable bases for their views. On the other hand, we think that the DP fails to propose a set of disclosure requirements that are feasible and persuasive to all of these stakeholders.

(b) Second, focusing on the disclosure proposals may obscure the focus on the subsequent accounting for goodwill that is considered to be of high priority among the issues identified through the PIR. We think that the proposed disclosures are not intended to directly solve the "too little, too late" issue.

(c) Third, even if the proposed information were required to be disclosed, the DP does not provide sufficient reasons for including the information in the notes to the financial statements. The information relates to an entity's strategy or assessment of the performance, and we think that the information goes beyond the supplement to the information presented on the face of financial statements.

14. We acknowledge that the disclosure of information about the subsequent performance of an acquisition was one of the issues identified through the PIR. However, our understanding is that there are many stakeholders who cannot accept the disclosures as currently proposed in the DP. As we expect that a significant amount of effort is needed to consider this proposal, we suggest that the IASB discuss this issue in a constructive manner to find an acceptable level of disclosures among stakeholders concerned, apart from the efforts to solve the "too little, too late" issue so that the priority of this project is not obscured.

(Close cooperation between the IASB and the FASB)

15. Cross-border business combinations are not uncommon these days, and we believe that it is desirable that the requirements under IFRS Standards and those under U.S. generally accepted accounting principles ("GAAP") ultimately become comparable. We acknowledge that the FASB is currently discussing the reintroduction of

amortisation, and we expect that the IASB works closely together with the FASB to address the global issue of the subsequent accounting for goodwill.

For our comments on the specific questions, please refer to the Appendix of this comment letter. We hope our comments contribute to the IASB's deliberations. Please contact us if you have any questions.

Yours sincerely,

Atsushi Kogasaka
Chair

Accounting Standards Board of Japan

Appendix

Comments on the specific questions in the DP

Question 1
Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views. The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it. (a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective? (b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

Question (a)

1. We disagree with the conclusion that the package of preliminary views in the DP meet the objectives of the IASB's project if implemented, for the following reasons:

   (a) We disagree with the objective of the project proposed in the DP. The DP states that the overall objective of the IASB's project is "to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make" (paragraph 1.7 of the DP). The DP further states that better information "would help investors assess the performance of companies that have made acquisitions" and "would also be expected to help investors more effectively hold management to account for

management's decisions to acquire those businesses." (ditto) In general, we do not object to setting such an objective considering that it is obvious that the IASB should consider the balance between costs and benefits in developing accounting standards. However, the IASB has identified issues to be addressed and their priorities through the PIR and the subsequent deliberations in this project, and the IASB has particularly focused on the issue of whether an entity is recognising expenses arising from goodwill in a sufficient and timely manner (hereinafter referred to as the "too little, too late" issue). We observe that the history of this project has not been reflected in the proposed objective and we are concerned that, under this objective, the project may proceed without solving the high-priority issue identified through the PIR.

(b) In addition, regarding the proposed disclosures about the management's objective and subsequent performance of an acquisition, there is a large disagreement between the views of users of financial statements and the views of preparers of financial statements, and we do not think that a feasible set of disclosure requirements is proposed in the DP in terms of the items and the location of disclosure. As we expect that a significant amount of effort is needed to consider this proposal, we suggest in our response to Question 2 that the IASB discuss this issue in a constructive manner to find an acceptable level of disclosures among stakeholders concerned, apart from the efforts to solve the "too little, too late" issue so that the priority of this project is not obscured.

(c) Furthermore, we disagree with the following two related preliminary views:

(i) Retaining the impairment-only approach to the subsequent accounting for goodwill

(ii) Providing relief from the mandatory annual quantitative impairment test

We disagree with these preliminary views because providing relief from the mandatory annual quantitative impairment test while retaining the existing impairment-only approach to the subsequent accounting for goodwill is inconsistent with the IASB's efforts in this project to improve the effectiveness of the impairment test. We think that the IASB should provide relief from the

mandatory annual quantitative impairment test only after the IASB reintroduces the amortisation of goodwill.

Question (b)

2. We acknowledge that some of the preliminary views in the DP are interrelated and one of those examples is providing relief from the mandatory annual quantitative impairment test and the reintroduction of goodwill amortisation, as mentioned in the text of this question. Our view on these interrelated preliminary views is given in (c) of the preceding paragraph. Other examples are given in our response to other specific questions.

Question 2
Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition. (a) Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not? (b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not? (i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'. (ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40), rather than on metrics prescribed by the Board. (iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The Board should not require a company to disclose any metrics in such

cases (see paragraphs 2.19–2.20).

(iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44).

(v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44).

(vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21).

(c) Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?

(d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

(e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

Question (a)

3. We agree that the preliminary views are intended to fulfil the information needs of users of financial statements. Paragraph 2.4 of the DP states "investors have said that companies typically do not provide enough information to help investors understand the subsequent performance of an acquisition." Confirming this statement, users of financial statement in Japan have expressed positive responses to the preliminary views as follows, and we observe that they meet the needs of users of financial statements mentioned in paragraph 2.4 of the DP.

   (a) Users of financial statements have been thinking that the proposed disclosures regarding material business combinations are necessary and the lack of such information has constrained their analyses.

   (b) The disclosures would provide the basic information that helps users of financial statements assess the value of the entity and would enhance dialogue between users and preparers of financial statements. Such information would help users of financial statements understand the risks of the entity and forecast the entity's future performance.

   (c) Users of financial statements need more information about an acquisition for their assessments when compared to information about other investments, because an entity may make extremely large investments in acquisitions or in-depth analyses on goodwill that represents excess earning power may be needed as compared to other investments such as investments in plant and equipment.

Questions (b) (i) and (ii)

4. We disagree with the preliminary views as currently described in the DP regarding the disclosure of information about the strategic rationale, management's objectives for an acquisition as at the acquisition date and whether the acquisition is meeting its objectives. Our reasons are as follows:

   (a) There is a large disagreement among stakeholders and the DP has not proposed a set of disclosure requirements that is acceptable to such stakeholders.

      In our outreach to stakeholders in Japan, users of financial statements strongly supported the proposal, as described in preceding paragraph. In contrast,

preparers of financial statements are deeply concerned with the disclosure proposals in terms of the items to be disclosed, the length of the periods to be disclosed and the location of disclosure. Thus, we acknowledge that there is a large disagreement in the views on the disclosure proposals between users and preparers of financial statements. Moreover, auditors were concerned about the lack of clarity regarding the boundary of financial statements and the difficulty in auditing some of the information that would be included in the financial statements, although they acknowledged the information needs of the users of financial statements. Considering this situation, we think that the DP fails to propose a set of disclosure requirements that are feasible and persuasive to all of these stakeholders.

In this regard, paragraph 2.22 of the DP states the following three concerns regarding the proposed disclosures, which we commonly hear from stakeholders in Japan, and our understanding is that (ii) and (iii) of these concerns have not been resolved:

(i) impossible to provide because the acquired business is being integrated

(ii) commercially sensitive

(iii) forward-looking

Regarding (ii), paragraph 2.27 of the DP states that "some investors suggest the information they need to understand the management's objectives and to hold management to account against those objectives may not need to be as detailed and precise as other stakeholders initially thought." However, none of the preparers of financial statements were convinced with this statement, which did not specify the level of disclosure that would be required. Preparers of financial statements were particularly concerned that they may suffer from competitive disadvantages because other entities may take advantage of the disclosed information. This may prevent the effects of an acquisition from crystalising and may destroy the value of the entity. Preparers of financial statements were also concerned that users of financial statements may misunderstand that only the disclosed metrics are important. In addition, they indicated that information

related to employment is very sensitive because such information may affect employees' morale.

Regarding (iii), concerns with the information on the management's objectives for an acquisition along with detailed targets are related to the issue of the location of disclosure that will be discussed in (c) of this paragraph.

(b) The focus on the subsequent accounting for goodwill may be obscured.

The DP proposes to adopt an approach that considers costs and benefits of a package of the preliminary views set out in paragraph IN9 of the DP as a whole. There is a risk that the focus on the subsequent accounting for goodwill that is considered to be of high priority among the issues identified through the PIR may be obscured by giving priority to the proposal to expand disclosure.

(c) Even if the proposed information were required to be disclosed, the information should not be disclosed in the notes to the financial statements.

Paragraph 2.29 of the DP states the concerns of some stakeholders that, information about the management's objectives for an acquisition along with detailed targets could, in some jurisdictions, be considered to be forward-looking information that could risk litigation and that the information should be provided outside the financial statements. In response to this concern, paragraph 2.30 of the DP states the IASB's view that the information about the strategic rationale, objectives and related targets for an acquisition reflects the management's target at the time of the acquisition and that it is not a forecast of the expected outcome at the time the entity prepares its financial statements. Paragraph 2.32 of the DP further states the IASB's view that entities should be required to disclose such information in the financial statements to ensure that all entities provide the information on the same terms. We are not aware of other rationales in the DP for the proposal to disclose the information in the financial statements.

In this regard, we do not think that, if an entity were required to disclose the information about the management's objectives for an acquisition along with detailed targets, the entity should disclose the information in the notes to financial statements for the following reasons:

(i) Because the information relates to an entity's strategy or assessment of performance, the information may go beyond the supplement to the information provided on the face of financial statements.

Paragraph 3.3 (c) of the *Conceptual Framework for Financial Reporting* (hereinafter referred to as the "Conceptual Framework") and paragraph 7 of IAS 1 *Presentation of Financial Statements* explain the items that would be disclosed in the notes to the financial statements. Such items include the disaggregations of items presented on the face of financial statements (primary financial statements), information about the nature and risks related to recognised and unrecognised items, information about estimates of the amount presented or disclosed (the methods, assumptions and judgements used, etc.). In addition, paragraph 3.6 of the Conceptual Framework states that "Financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and strategies for the reporting entity." Accordingly, we do not think that the information about an entity's strategy and assessment of performance directly corresponds to the abovementioned items.

In particular, we think that the information about the management's objectives for an acquisition and the detailed targets are of forward-looking nature because the information provides the management's prospects after the end of the reporting period and it is likely that such prospects include the effects of the events that is beyond the reach of management's discretion. Although we do not necessarily disagree that financial statements may include forward-looking information, such information usually relates to recognised or unrecognised items at the end of the reporting period as mentioned above. Other information related to events after the end of the reporting period is very limited, such as information about non-adjusting events after the reporting period.

For this reason, we think that the proposals should have a robust rationale for including the information in the notes to the financial statements.

However, we are not convinced that such clear rationales in terms of the Conceptual Framework and accounting standards are provided in the DP.

(ii) Items similar to those proposed in the DP are noted in IFRS Practice Statement No. 1 *Management Commentary, A framework for Presentation* for the entire entity. It would be more consistent to disclose the information outside the financial statements if the objective of the disclosure is similar.

(iii) Paragraph 2.32 of the DP proposes to disclose the information in the notes to financial statements to ensure that all entities provide information on the same terms. Taking into account that there could be useful information to assess the value of the entity inside the financial statements as well as outside the financial statements, the DP has not discussed how to strike a balance between the necessity and the risk of including the information in the notes to the financial statements (such as financial statements could be less understandable, or explanation could be less flexible).

5. While we acknowledge that improvements to the existing disclosures was one of the issues identified through the PIR, our understanding is that there are many stakeholders who cannot accept the disclosures as currently proposed in the DP. As we expect that a significant amount of effort is needed to consider this proposal, we suggest that the IASB discuss this issue in a constructive manner to find an acceptable level of disclosures among stakeholders concerned, apart from the efforts to solve the "too little, too late" issue so that the priority of this project is not obscured.

6. On the other hand, if the information were required to be disclosed, we would agree that the information should be based on how management monitors and measures whether the acquisition is meeting its objectives. This is because there are various reasons for entering into acquisitions and various forms of acquisitions, and we do not think that specified disclosure items would meet the information needs of users of financial statements.

<u>Questions (b) (iii)</u>

7. We disagree with the preliminary view. If an acquisition is material to the entity, management would monitor the acquisition to a greater or lesser extent. We do not

think that the proposed disclosure requirement is necessary if the IASB expects this proposal would deter an entity from not disclosing the information. Paragraph 2.19 of the DP distinguishes between the management's monitoring against the target set at the acquisition date of the acquisition and the management's monitoring against the target as part of the business planning cycle, the latter of which the DP does not consider to be the management's monitoring of the acquisition. However, our understanding is that entities usually change how to monitor their businesses depending on their situation and, based on this understanding, we think that there are many cases where the two ways of monitoring in the DP cannot be clearly distinguished.

Questions (b) (iv)

8. We disagree with the preliminary view. It is expected that entities continue to monitor their acquired business, although the way they monitor the business may change depending on the situation. We are concerned that the disclosures may continue to be provided indefinitely because it is difficult to determine whether management continues or stops monitoring, although the extent to which management focuses on the acquired business may vary over time.

Questions (b) (v)

9. We disagree with the preliminary view. If the disclosures were to be required, setting a specific timeline such as two years may lead to misunderstandings about the relationship between (iv) and (v), that is, it may be perceived that entities could stop providing the disclosures at the end of the second full year after the year of acquisition.

Questions (b) (vi)

10. We disagree with the preliminary view. Our understanding is that management usually changes its metric to assess whether it is meeting its objectives depending on the surrounding environment. Requiring disclosures that implicitly assumes consistency over time, such as that required for accounting policies, is inconsistent with this understanding of how the business is internally managed.

Question (c)

11. We disagree with the preliminary view. Although we agree that an entity should identify an acquisition that is material to the entity worth disclosing if the disclosures were to be required, we think that whether the notion of CODM is helpful to identify such an acquisition would depend largely on the internal management mechanism within the entity. Accordingly, we are of the view that each entity should determine whether an acquisition in question is material to the entity worth disclosing.

Question (d)

12. We agree that concerns about commercial sensitivity may inhibit entities from disclosing the proposed information. Based on our outreach, stakeholders indicated that they may suffer from competitive disadvantages if other competitors take advantage of the disclosed information about financial and non-financial quantitative targets or timelines. Those respondents were concerned that the value of an entity may be destroyed as a result. Other stakeholders were concerned that users of financial statements may misunderstand that only the disclosed metrics are important. Yet other stakeholders indicated that information related to employment, such as the potential reduction in the workforce, is very sensitive because such information may affect employees' morale and the progress of integration.

Question (e)

13. We are not aware of any constraints in our jurisdiction that could directly affect an entity's ability to disclose the proposed information.

Question 3
Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand: • the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and • the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition. Do you agree with the Board's preliminary view? Why or why not?

14. Our understanding is that the proposed disclosure objectives are primarily related to improving the disclosure of the management's objective for an acquisition and its subsequent performance and the extended disclosure of expected synergies proposed in the DP and that the proposed disclosure objectives are developed to explain the main reasons why users of financial statements need the information that would be required to be disclosed, as mentioned in paragraph 2.56 of the DP. We are concerned that the relationship between the objective and the requirements is opposite to what the relationship should be. In other words, the IASB should, in principle, start from the disclosure objectives and then develop accounting requirements that would meet the disclosure objectives or require entities to consider disclosing the information that would meet the disclosure objectives if there are no specific requirements. However, in this case, the DP proposes disclosure objectives apart from the proposed disclosure requirements.

Question 4
Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals: • to require a company to disclose: ○ a description of the synergies expected from combining the operations of the acquired business with the company's business; ○ when the synergies are expected to be realised; ○ the estimated amount or range of amounts of the synergies; and ○ the expected cost or range of costs to achieve those synergies; and • to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities. Do you agree with the Board's preliminary view? Why or why not?

Proposal for extended disclosures regarding synergies

15. We disagree with the extended disclosures of expected synergies as currently proposed in the DP. This proposal is closely related to the disclosure of the

management's objective for an acquisition and its subsequent performance discussed in Question 2, because achieving synergies is often an important objective of an acquisition. In this regard, users of financial statements support providing information regarding when the synergies are expected to be realised and the estimated amount of the synergies by extending the existing disclosure requirements, while preparers of financial statements disagree with proposed disclosures stating their concerns that the information is of forward-looking nature and is likely to be commercially sensitive. Accordingly, for the reasons similar to why we disagree with the proposed disclosures of the management's objectives for an acquisition and its subsequent performance, we disagree with the extended disclosures of expected synergies as currently proposed in the DP.

<u>Liability from financing activities and defined benefit pension liabilities</u>

16. We disagree with the preliminary view. This is because it is not necessary to specify that these liabilities would always be major classes of liabilities, and it is sufficient to rely on entity's ability to specify which items are major classes depending on the situation of individual acquisitions.

Question 5
IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period. Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information. (a) Do you agree with the Board's preliminary view? Why or why not? (b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not? IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:

- to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft General Presentation and Disclosures.
- to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

(c) Do you agree with the Board's preliminary view? Why or why not?

Question (a)

17. We agree with the preliminary view. Although we acknowledge the view that such pro forma information should not be disclosed in the financial statements, we think that it is not necessary to remove the existing requirement to disclose such information because stakeholders recognise the usefulness of information and the requirement is currently applied in practice, which we think proves to be practicable.

Question (b)

18. We disagree with the preliminary view. Pro forma information is hypothetical information, and whether adjustment is necessary and to what extent the adjustment should be made should depend on the reasonable judgement of the entity.

Question (c)

(Proposal to replace profit or loss with a measure based on operating profit or loss)

19. We disagree with the preliminary view because we do not support the definition of operating profit or loss proposed in the IASB's Exposure Draft *General Presentation and Disclosure* (hereinafter referred to as the "ED").

20. We acknowledge that there may be some benefits of replacing profit or loss with a measure based on operating profit or loss as noted in paragraph 2.78 of the DP. However, we think that whether stakeholders can enjoy such benefits would depend

on the definition of operating profit or loss. In this regard, the ED proposed to define operating profit or loss as a residual category, but we suggested in our comment letter to the ED that operating profit or loss be defined directly as "income and expenses recognised in profit or loss related to activities that an entity identifies as its main operating activities." We do not support replacing profit or loss with a measure based on operating profit or loss without characterising operating profit or loss directly in the abovementioned manner.

21. As an additional note, paragraph B64 (q) (i) of IFRS 3 requires the disclosure of the amount of profit or loss of the acquiree, and paragraph B64 (q) (ii) of IFRS 3 requires disclosure of the amount of profit or loss of the combined entity. Regarding the adjustment of acquisition-related costs and integration costs when replacing profit or loss with a measure based on operating profit or loss, we think that the IASB should clarify that it is not necessary to adjust acquisition-related costs in disclosing the information required by paragraph B64(q) (i) of the IFRS 3 because the acquiree would not incur the acquisition-related costs.

(Proposal to disclose cash flows from operating activities)

22. We disagree with the preliminary view. We do not agree with expanding disclosure of pro forma information from existing requirements, because we acknowledge that some hold the view that pro forma information should not be disclosed within the financial statements.

Question 6
As discussed in paragraphs 3.2–3.52, the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 *Impairment of Assets*. The Board's preliminary view is that this is not feasible. (a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not? (b) If you do not agree, how should the Board change the impairment test? How

	would those changes make the test significantly more effective? What cost would be required to implement those changes?
(c)	Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?
(d)	Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

Question (a)

23. We agree that it is not feasible to design an impairment test that is significantly more effective in terms of timely recognition of impairment losses on goodwill at a reasonable cost. We agree that it is difficult to improve the impairment test considering the history of the project explained in paragraphs 3.31 to 3.52 of the DP. That is, the DP discusses the approach which incorporates the estimate of headroom into the design of the impairment test ('headroom approach'), but this approach has a significant application problem, which seems difficult to be solved. Accordingly, we think that it is difficult to improve an impairment test so that the test would be operational at a reasonable cost and would result in timely recognition of expense arising from goodwill.

Question (b)

24. Not applicable.

Question (c)

25. We think that the shielding effect is the main reason for the late recognition of impairment losses of goodwill. This is because the balance of goodwill in the statement of financial position has been steadily increasing from a historical perspective and widely from a geographical perspective and, accordingly, the accounting mechanism that creates the shielding effect seems to be the largest contributor to this phenomenon. Other potential contributors, such as estimation uncertainties in the measurement of value in use or fair value less costs of disposal or the possibility that the cash generating unit to which goodwill is attributed at

acquisition is larger than necessary, may contribute to some extent but we do not think they are the main contributors.

Question (d)

26. No comment.

Question 7
Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill. (a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.) (b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had? (c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not? (d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not? (e) If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft General Presentation and Disclosures.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not? (f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

Question (a)

27. We disagree with the preliminary view that the amortisation of goodwill should not be reintroduced. While we will explain our reasons with "new evidence" later in our response to Question 7(b), the particular reason related to our response to Question 6 is that, if the existing impairment-only approach is retained, the shielding effect would not be addressed under this approach. The shielding effect results in expenses arising from goodwill being recognised too little as well as too late. As noted in paragraph 23 of this Appendix, the IASB has attempted to improve the effectiveness of impairment tests but it turned out to be difficult to achieve the improvement at a reasonable cost. Accordingly, we think that the only way to solve the "too little, too late" issue is to reintroduce the amortisation of goodwill.

Question (b)

28. Our view has not changed since before 2004, and we believe that goodwill should be amortised and be tested for impairment.

(Rationale before 2004, with some evidence after 2004)

29. The main rationale for our view in the preceding paragraph before 2004 is described in paragraph 3.57(c) of the DP. That is, goodwill is acquired in an acquisition in exchange for payments, and we consider goodwill to be an asset that primarily represents excess earning power and to be a wasting asset with a finite useful life. Amortisation reflects the consumption of goodwill and, by appropriately recognising income earned subsequent to the acquisition and the corresponding amortisation expense of this paid cost in net income in each period, useful information about the performance subsequent to the acquisition would be provided to users of financial statements.

30. Some stakeholders who support retaining an impairment-only approach have criticised that amortisation would not provide useful information for the following reasons:

    (a) It is questionable whether goodwill is always a wasting asset with a finite useful life. (paragraph 3.81 of the DP)

    (b) The useful life and amortisation pattern of goodwill are generally cannot be predicted and that straight-line amortisation of goodwill over an arbitrary period

fails to provide useful information. (paragraph BC131E of IAS 36, paragraphs 3.70 and 3.72 of the DP)

(c) Users of financial statements would add back the amortisation expense because the amortisation expense would not help them assess performance (paragraph 3.74 of the DP)

31. We have the following arguments against the criticisms in the preceding paragraph, and in particular, in our view the argument against the criticism (c) presents "new evidence" which we confirmed through our survey after 2004.

    (a) Regarding the criticism that it is questionable whether goodwill is always a wasting asset with a finite useful life

    Paragraph BC313 of IFRS 3 presented the analysis of goodwill components and stated that goodwill is mainly composed of the going concern element that represents reputation or know-how of the acquiree and the synergies element that would be expected to arise from combining acquirer's and acquiree's businesses.

    The going concern element represents something that the acquirer is willing to pay to earn a return higher than the return the market expects to earn from the acquiree's individual assets. This excess return will decrease over time assuming that there is healthy competition. In addition, some stakeholders claim that the going concern element may include the entity's reputation with customers, technology and know-how that support the business and assembled workforce, and if it were possible to consider these individual factors of goodwill, the effects of the entity's reputation with customers, and the effects of technology and know-how would decrease as the surrounding environment changes and the workforce is replaced. Accordingly, improvements or adjustments would be needed to ensure that these factors continue to be effective. Thus, the goodwill originally acquired in an acquisition would decrease and would be replaced by updated reputation with customers and updated technology and know-how.

    Similarly, for the synergies element, if the element is expected to generate excess returns, similar behaviours aiming to achieve such excess returns would be

enhanced in the industry, and such excess returns would decrease over time assuming there is healthy competition.

It should be noted that some stakeholders criticise that, if goodwill is of a wasting nature, there would be a large portion of cash flows that are unexplained after the entity's resources with finite useful lives are consumed. However, we think that the cash flows generated from the resources with finite useful lives originally acquired in an acquisition and cash flows generated as a result of reinvestment of those cash flows to new resources should be considered to be separate cash flows. This cycle of reinvestment continues while the entity continues as a going concern, and accordingly the understanding that goodwill has a finite useful life is not inconsistent with the fact that the entity continuously produces cash flows from goodwill beyond such a finite useful life.

(b) Regarding the criticism that the useful life and amortisation pattern of goodwill generally cannot be predicted and that straight-line amortisation of goodwill over an arbitrary period fails to provide useful information

Considering that an entity is required to estimate the period and the pattern in which the benefits of property, plant and equipment (PPE) and intangible assets with finite useful lives are expected to be consumed, we expect that the same applies to goodwill. More information may be available in estimating the wasting period and pattern for PPE or intangible assets with finite useful lives because those assets are exposed to physical wear and tear or may have legal limits on the use of those assets. However, their useful lives are defined in terms of the assets' expected utility to the entity and technical or commercial obsolescence are considered. In this regard, goodwill is essentially no different from PPE or intangible assets. Accordingly, there is little justification that goodwill should be treated otherwise. Although we acknowledge that some may argue that the period or the pattern in which goodwill diminishes cannot be predicted reasonably, we think that it would be more reasonable to amortise goodwill on a systematic basis over a certain period rather than adopting an approach that may not recognise the decrease in the value of goodwill at all in certain periods.

In addition, because the price of an acquisition is usually high and the acquisition is usually expected to have a significant impact on the business of the acquirer, the acquirer usually makes the decision to acquire the business of the acquiree only after conducting diligent analyses. Those analyses may include identifying the advantages and disadvantages of the business of the acquiree and the types and the scale of expected synergies after being integrated into the business of the acquirer. The acquirer should generally be able to estimate a useful life of goodwill based on such analyses, together with other information. We acknowledge that some may be concerned that such estimate would include a certain level of uncertainty. However, users of financial statements who support amortisation think that information based on management's estimate was useful and, therefore, the benefit of providing the management's estimate outweighs the concerns related to estimation uncertainty.

(c) Regarding the criticism that users of financial statements would add back the amortisation expense because the amortisation expense would not help them assess performance

We conducted a survey with analysts in Japan in 2017 on how they used financial information of acquisitions in their analyses [Note 1]. The objective of this survey was to obtain in-depth understanding of the views of analysts regarding goodwill and impairment considering that arguments were often heard, 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."

As a result of the survey, the way analysts used financial information in their analyses varied. In addition, whether the analysts conducted their analyses based on cash flow information or accounting information (profit or loss that includes amortisation of goodwill) depended on the objective of their analyses. Analysts could be classified broadly into two groups: (i) those who placed more significant importance on analyses based on cash flow information and (ii) those

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[Note 1] Research Paper No.3, *Analyst Views on Financial Information Regarding Goodwill*, June 2017
https://www.asb.or.jp/jp/wp-content/uploads/20170612_e.pdf

who placed significant importance on analyses based on accounting information (profit or loss that includes amortisation of goodwill) as much as on analyses based on cash flow information. The views regarding the amortisation of goodwill varied, but those who were indifferent between amortisation and non-amortisation of goodwill were generally those classified in the former group of analysts and those who supported amortisation were generally those classified in the latter group of analysts.

Based on this survey, while users of financial statements may oftentimes add back amortisation in practice, the main objective of doing so is to obtain information that approximates cash flows, and for this objective, users of financial statements would also add back impairment losses, regardless of whether goodwill is amortised. Accordingly, the practice of adding back amortisation in itself does not demonstrate that information about amortisation is less useful.

In light of the above, to broadly summarise the analysts' views, we think that there are largely two views among analysts: one view is that goodwill should be amortised and the other view is that there is no difference between amortisation and non-amortisation. In this regard, because analysts usually would not incur significant costs in adding back amortisation, amortisation would improve the relevance of financial information to the analysts who hold the former view and would not affect the relevance of financial information to the analysts who hold the latter view. Accordingly, the reintroduction of amortisation would result in improving the relevance of financial information for more analysts.

(Rationale after 2004)

32. A reason in addition to the reasons stated in paragraph 29 of this Appendix is that the impairment test is not working as the IASB intended and expense that should arise from goodwill is not recognised in a timely manner as suggested through the PIR conducted in 2013 as mentioned in paragraph 3.57(a) of the DP.

33. Regarding the statement in the preceding paragraph, we conducted quantitative studies regarding goodwill in 2016 and 2020(Note 2). From these studies, we found that the amount of goodwill generally increased steadily and globally over time after the impairment-only approach became effective, even though there were changes in the economic environment. In addition, the average implied time to fully expense goodwill far exceeded 20 years, which was the maximum amortisation period before IFRS was revised in 2004.

34. This increasing trend may be partly due to the increase in the number of acquisitions, but we believe that the main cause of this trend is the accounting mechanism that creates the shielding effect, as mentioned in paragraph 25 of this Appendix. We acknowledge that the IASB was aware of the shielding effect when the IASB initially developed the impairment test of IFRS 3 in 2004 as mentioned in paragraph 3.75 of the DP, and the impairment test is working as intended, but we do not think that the IASB was aware at that time that the shielding effect would prove to be so problematic that the balance of goodwill could be large in the statement of financial position and its expense could be recognised too late. Stakeholders have become aware of this effect after many years of application, which was after 2004. The IASB's efforts to solve this problem have not been successful and this was confirmed after 2004.

Question (c)

35. We think that the reintroduction of amortisation will solve the main reason for the "too little, too late" issue. This is because amortisation would not be affected by the shielding effect. If the useful life can be reasonably estimated, amortisation would result in recognising a sufficient amount of expense arising from goodwill in a timely manner.

Question (d)

36. We think that acquired goodwill is separate from goodwill that is subsequently generated internally. In order to provide information about financial performance

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(Note 2) Research Paper No.2, *Quantitative Study on Goodwill and Impairment*, September 2016
https://www.asb.or.jp/jp/wp-content/uploads/20161003_01_e.pdf
Research Paper, *Goodwill: Improvements to Subsequent Accounting and an Update of the Quantitative Study*, by the Staff of Accounting Standards Board of Japan and the Staff of Hong Kong Institute of Certified Public Accountants, March 2020
https://www.asb.or.jp/jp/wp-content/uploads/20200324_e.pdf

regarding how an entity generated returns on its economic resources, it is basically necessary to distinguish between the investment and what it generates from the investment and these two should be considered to be separate.

Question (e)

37. If amortisation is reintroduced, management may add back amortisation to present a management performance measure, but we think that the main objective of this measure is to show a measure that approximates cash flows. For this objective, impairment losses would also be added back. Accordingly, adding back amortisation to present a management performance measure does not indicate that the information about amortisation is less useful.

Question (f)

38. We support the use of management's reasonable estimate in determining the useful life with a cap on it. In this regard, 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 summarised as follows:

    (a) According to interviews we conducted with analysts in Japan, those who supported the amortisation with impairment approach 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" would provide useful information. Even though managements' reasonable estimate may result in different outcomes as a result of management judgement, we think that such estimates provide relevant information to users of financial statements.

    (b) On the other hand, we think that it is appropriate to set a maximum on the amortisation period considering that (i) it is necessary to address the "too little, too late" issue and (ii) goodwill is calculated as a residual and its components cannot necessarily be disaggregated in monetary terms. Setting a maximum on the amortisation period will ensure that the carrying amount of goodwill will be reduced within this maximum period.

Although it is not easy to logically set an appropriate maximum amortisation 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 acquisitions to continue more than 10 years, (ii) the fact that the amortisation requirement under International Financial Reporting Standards for Small and Medium Sized Entities (IFRS for SMEs) and the amortisation option provided for private companies under U.S. GAAP set 10 years as the maximum on the amortisation period and that such amortisation period are applied in practice, and (iii) the results of academic studies (Please refer to the Supplement to this Appendix).

39. As shown in the preceding paragraph, our preference is to determine the amortisation 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 amortised over 10 years, or less than 10 years if the entity demonstrates that another useful life is more appropriate. We believe that this approach eliminates the subjectivity in estimating the amortisation period and, at the same time, ensures a certain degree of reasonableness by leaving room for judgement regarding the use of an amortisation period that is shorter than 10 years.

40. In addition, we think that the amortisation pattern should reflect the pattern in which the future economic benefits of goodwill are expected to be consumed by the entity, and if that pattern cannot be determined reliably, the straight-line method should be used. This is because goodwill should be treated in the same way as other intangible assets with finite useful lives.

Question 8
Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance

sheet (see the Appendix to this Discussion Paper).
(a) Should the Board develop such a proposal? Why or why not?
(b) Do you have any comments on how a company should present such an amount?

Question (a)

41. We disagree with the preliminary view. If an entity is required to present in the statement of financial position the amount of total equity excluding goodwill, this would imply that goodwill is not an asset or that goodwill is negative equity, and we think neither is appropriate. Paragraph IN41 of the DP states that this presentation "would be expected to enhance investors' understanding of a company's financial position." However, for this purpose, we think that the accounting for goodwill should be improved and the reintroduction of amortisation is our response to such improvement as mentioned in paragraph 27 of this Appendix. Paragraph IN41 of the DP also explains the reason for limiting the item that would be excluded from total equity to goodwill but we question whether this limitation is consistent with the abovementioned purpose of this disclosure.

Question (b)

42. No comment.

Question 9
Paragraphs 4.32–4.34 summarise the Board's preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use. (a) Should the Board develop such proposals? Why or why not? (b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not. (c) In your view, would the proposals make the impairment test significantly less

robust (see paragraphs 4.22–4.23)? Why or why not?

Question (a)

43. We disagree with the preliminary view to remove the requirement to perform a quantitative impairment test every year unless amortisation is reintroduced. As described in paragraphs 3.31 to 3.52 of the DP, this project has been making efforts to improve the effectiveness of the impairment test for goodwill, and we think that providing relief from the mandatory annual quantitative impairment test while retaining the existing impairment-only approach to the subsequent accounting for goodwill is inconsistent with those efforts in this project.

44. As explained in paragraph 4.9 of the DP, the annual quantitative impairment test was introduced when the IASB decided to eliminate the requirement to amortise goodwill and was intended to make the impairment test robust. In this regard, paragraph 4.23 of the DP notes the following views that imply that the removal of the annual quantitative impairment test affects little robustness of the impairment test:

    (a) there may be little difference in the outcome of recognising impairment losses depending on whether a quantitative impairment test is required annually because an entity would still need to assess at the end of each reporting period whether there is any indication that there may be an impairment;

    (b) performing an annual impairment test cannot remove the shielding effect resulting from unrecognised headroom.

    However, based on our understanding that the "too little, too late" issue exists, we do not think that it is desirable to make an amendment that may exacerbate the issue.

Question (b)

45. We are of the view that the effects of cost savings from removing the annual quantitative impairment tests would vary significantly among entities because such cost savings would depend on the volumes of businesses that have been acquired by an entity and on the extent to which information that is used to assess the businesses for internal management purposes can also be used for the impairment tests.

46. In addition, paragraph 4.34 of the DP states that the IASB plans to assess whether it needs to update the list of indicators in paragraph 12 of IAS 36 because moving to an indicator-based approach would place more reliance on identifying the indicators of impairment. If the list of indicators is extended and, as a result, indicators are identified more frequently, we question whether the expected effects of cost savings can be achieved.

<u>Question (c)</u>

47. We have learned that entities regularly monitor their businesses for internal management purposes, and we are not aware of any views that the removal of the annual quantitative impairment test would significantly reduce the robustness of the impairment test. However, based on our understanding that the "too little, too late" issue exists, we think that this amendment may exacerbate the issue. We also note that there was a view expressed in a recent international forum that the removal of the annual quantitative impairment test may affect the robustness of the impairment test because there are cases where it is difficult to identify individual indicators of impairment.

Question 10
The Board's preliminary view is that it should develop proposals: • to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (see paragraphs 4.35–4.42); and • to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52). The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information. (a) Should the Board develop such proposals? Why or why not? (b) Should the Board propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of

this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates of value in use, and why.

Question (a)

(Removal of the restriction in IAS 36 that prohibits entities from including certain cash flows in estimating the value in use)

48. We disagree with the preliminary view. We think that there is no need to reconsider this part of the standard because we think that the impairment framework under IAS 36 is not broken.

49. The issue discussed in paragraphs 4.40 to 4.42 of the DP is whether sufficient discipline would work against the over-optimism that could occur if the proposal was implemented. In this regard, the proposal would change the concept of value in use, that is, “value in use for the asset in its current condition” (paragraph BC72(a) of IAS 36), and we think that whether to make this conceptual change is a more significant issue. We do not think that such a conceptual change should be made as part of a simplification initiative.

(Allowing the use of after-tax cash flows and after-tax discount rates when estimating the value in use)

50. We agree with the preliminary view. This is because we do not think that it is necessary to restrict cash flows and discount rates to those of either pre-tax or post-tax basis if both provide the same outcome.

Question (b)

51. Not applicable.

Question 11
Paragraph 4.56 summarises the Board’s preliminary view that it should not further simplify the impairment test. (a) Should the Board develop any of the simplifications summarised in paragraph

	4.55? If so, which simplifications and why? If not, why not?
(b)	Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

Question (a)

52. We agree with the preliminary view. We think there is no need to reconsider this part of the standard because we think that the impairment framework under IAS 36 is not broken.

Question (b)

53. We do not have any suggestions.

Question 12
Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill. (a) Do you agree that the Board should not develop such a proposal? Why or why not? (b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced? (c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

Question (a)

54. We agree with the preliminary view. This is because we have heard both positive and sceptical views on this preliminary view from Japanese stakeholders and we have not obtained solid basis that would support changing the existing requirements to provide more useful information. Examples of positive views include the view that separating identifiable intangible assets from goodwill would enhance transparency,

and the view that items that should be amortised would be identified in many cases. Examples of sceptical views include the view that there are many cases where intangibles lack sufficient reasons to be recognised or lack sufficient support for the amount to be recognised, and the view that the estimates of the fair values of intangible assets are highly uncertain and such items would not provide very useful information when they are recognised as individual items.

Question (b)

55. Not applicable.

Question (c)

56. When reintroducing the amortisation of goodwill, we think it may be worth considering whether to include some intangible assets in goodwill. If goodwill is to be amortised, certain intangible assets that are currently amortised may be included in goodwill from a cost-benefit perspective.

Question 13
IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB). Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

57. We expect that the IASB works closely together with the FASB in developing their respective accounting standards so that their resulting accounting standards become comparable. Our expectations to both boards are explained in our response to each question in this comment letter, and do not depend on whether the outcome is consistent with U.S. GAAP as it exists today or consistent with U.S. GAAP as it may be after the FASB's current work.

Supplement to the Appendix

Academic studies referenced by the ASBJ regarding amortisation period

The ASBJ reviewed academic studies including the following:

- Dickinson, V. and G. A. Sommers (2012). Which competitive efforts lead to future abnormal economic rents? Using accounting rations 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. (In Japanese. The titles of the paper and the book are tentative translations 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. (In Japanese. The title of the book is tentative translation by the ASBJ staff.)
- 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. (In Japanese. The titles of the paper and the book are tentative 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.