ASBJ Statement No. 7

Accounting Standard for Business Divestitures

ASBJ Guidance No. 10

Guidance on Accounting Standard for Business Combinations and Accounting Standard for Business Divestitures

December 27, 2005

Accounting Standards Board of Japan

Remarks on the Release

Taking advantage of the publication of the "Accounting Standard for Business Combinations" (hereinafter referred to as "the Business Combinations Standard") by the Business Accounting Council in October 2003, the Accounting Standards Board of Japan (ASBJ) has discussed and deliberated the accounting treatments applied to the combining entities concerned in reorganization of a business structure, the accounting treatments applied to an entity divesting its business to another entity by divestiture (divesting entity) and the accounting with respect to shareholders of combining entities concerned. The Board has also carried out discussions to develop practical guidance in applying these standards.

The ASBJ published for public comment the exposure draft for the accounting standard and the guidance on July 29, 2005. The ASBJ reviewed the comments it received and amended part of the proposed standard and guidance to reflect the comments it reviewed. On December 20, 2005, at the 95th meeting, the ASBJ approved ASBJ Statement No. 7 (hereinafter referred to as "the Business Divestitures Standard") and ASBJ Guidance No. 10 (hereinafter referred to as "the Guidance") for public release.

Outline of the Business Divestitures Standard and the Guidance

1. The Business Divestitures Standard

I Objective (see paragraphs 1 and 2)

The Business Combinations Standard has set forth accounting treatments for transactions which are business combinations by combining entities concerned, in particular by combining entities. The Business Divestitures Standard provides for requirements with respect to the accounting by an entity divesting its business (divesting entity) in the divestiture of a business or the assignment of a business (whether to recognize profit or loss for transfer) and with respect to shareholders of combining entities concerned in a business combination such as a merger or exchange of shares (whether to recognize profit or loss on exchange).

II Concepts for accounting treatments based on the Business Combinations Standard (see paragraphs 67 to 73)

1. Concepts for continuance of interests and accounting for the divesting entity and for accounting with respect to shareholders of combining entities concerned

The concept of "continuance or termination of interests" for the purpose of the Business Combinations Standard applies not merely to accounting for business combinations alone. Rather, it is consistent with the concept for continuance or liquidation of investments in generally measuring the results of business, which leads to the realization concept. Thus, in consistent with concept for accounting for combining entities in a business combination, accounting for reorganization of business structure which includes a divesting entity and the shareholders of combining entities concerned should also be, in principle, implemented under the same concept.

2. Relationship between the concept for accounting for a divesting entity and that for shareholders of combining entities concerned

Since the economic effect for the divesting entity in a business divestiture and that for the shareholders of the entity combined which is their wholly owned subsidiary in a business combination are the same, it is appropriate to make the accounting treatments for both transactions consistent. Furthermore, when the shareholder of the entity combined is the parent company, consistent accounting standards should be applied irrespective of whether the parent company holds all of the shares of the entity

combined (in cases where the entity combined is a wholly owned subsidiary) or not (the entity combined is a subsidiary other than a wholly owned subsidiary).

III Accounting for a divesting entity (see paragraphs 10 to 26)

1. Concept underlying the accounting treatment for a divesting entity

The Business Divestitures Standard consider the accounting treatment for the divesting entity from the perspective of whether to recognize profit or loss based on the concept of continuance or liquidation of investments in generally measuring the results of business (see II 1 above). As with the recognition of profit or loss on general sales or exchange, profit or loss for transfer may or may not be recognized by the divesting entity, depending on whether the investment in the divested business continues or is liquidated. In such a case, in light of consistency with other accounting standards, observable practical requirements relate to types of consideration, i.e., whether the consideration is different from the business transferred.

2. Accounting for a divesting entity

(1) Cases where investments in the transferred business are deemed to have been liquidated

The difference between the fair value of assets received as the consideration for the transfer of the business to the successor entity and the net assets at the accurate book value of the assets and liabilities related to the transferred business immediately before the transfer should be recognized as profit or loss for transfer, and a new investment is considered to have been made at the fair value of the consideration received. When a divesting entity receives an asset, such as cash, which is clearly different from the business transferred as a consideration, such investment is usually deemed to have been liquidated.

(2) Cases where investments in the transferred business are deemed to continue

The acquisition cost of assets received through the transfer of the business to the successor entity should be determined based on the net assets at the accurate book value of the assets and liabilities related to the transferred business immediately before the transfer, without recognizing any profit or loss for transfer. When a divesting entity receives as a consideration only the shares of the successor entity which becomes the subsidiary or affiliate, the investment in the business is deemed to continue since

the divesting entity is considered to continue its investment in the transferred business through such shares.

(Chart 1) Summary of accounting for the divesting entity

A Where the consideration received relates only to the different assets such as cash

Successor entity	Separate financial statements			Consolidated financial statements			Example
	Recognition of profit or loss for transfer			Accounting for the purpose of consolidation			
	(*1)	Standard	Guidance		Standard	Guidance	
Subsidiary	○1	Para. 14 (1)	Para. 95 (para. 223)	(*2)	Para. 14 (1)	Para. 95 (para. 223)	[Example 26-1]
Affiliate	○2	Para. 15(1)	Para 96 (1)	(*2)	Para. 15(2)	Para 96 (2)	
Others (No share holding or other investees)	○2	Para.16	Para 96 (1)	N/A	N/A	N/A	

(*1) To recognize profit or loss for transfer (to recognize-○, not to recognize-x)

○1 Difference between the accurate book value of the assets received such as cash prior to the transfer and the net assets based on the accurate book value of assets and liabilities of the transferred business immediately prior to the transfer (the amount corresponding to the owners' equity of the transferred business)

○2 Difference between the fair value of the assets received such as cash and the net assets based on the accurate book value of assets and liabilities of the transferred business immediately prior to the transfer (the amount corresponding to the owners' equity of the transferred business)

(*2) Profit or loss for transfer is in principle accounted for in accordance with the elimination of unrealized profit or loss under the Accounting Standards for Consolidated Financial Statements (hereinafter the "Consolidation Standards").

B Where the consideration received relates only to the shares of the successor entity

Successor entity		Separate financial statements			Consolidated financial statements			Example
		Recognition of profit or loss for transfer			Accounting for the purpose of consolidation			
(Before divestiture)	(After divestiture)	(*1)	Standard	Guidance		Standard	Guidance	

No shareholding	Subsidiary	×	Para. 17(1)	Para. 98 (1)	(*2)	Para. 17(2)	Para. 98 (2)	[Example 11-1] [Example 11-2]
Affiliate or other investees			Para. 18 (1)	Para.99		Para. 18 (2)	Para.99	[Example 11-3]
Subsidiary			Para 19(1)	Para.99 (following “Meanwhile”)(para.226)		Para 19(2)	Para.99 (following “Meanwhile”)(para.229)	[Example 26-2]
No shareholding	Affiliate	×	Para. 20 (1)	Para. 100 (1)	(*2)	Para. 20 (2)	Para. 100 (2)	[Example 12-1]
Other investees			Para. 21 (1)	Para. 101		Para. 21 (2)	Para. 101	[Example 12-2]
Affiliate			Para. 22 (1)	Para. 102		Para. 22 (2)	Para. 102	[Example 12-3]
Others	Other investees	○	Para. 23	Para. 103	N/A	N/A	N/A	

(*1) To recognize profit or loss for transfer (to recognize-○, not to recognize-×)

(*2) To recognize “goodwill” arising from the acquisition of the successor entity and “changes in the ownership interests” of the transferred business

C Where the consideration received relates to the different assets such as cashand the shares of the successor entity

Successor entity (after divestiture of a business)	Separate financial statements			Consolidated financial statements			Example
	Recognition of profit or loss for transfer			Accounting for the purpose of consolidation			
	(*1)	Standard	Guidance		Standard	Guidance	
Subsidiary	○1	Para. 24 (1)	Para. 104 (para. 230)	(*2)	Para 24 (2)	Para. 104 (para. 232)	[Example 26-3] [Example 26-4]
Affiliate	○2	Para. 25 (1)	Para. 105 (1)	(*2)	Para. 25 (2)	Para. 105 (2)	[Example 13]
Other investees	○3	Para. 24 (1)	Para. 24 (1)	N/A	N/A	N/A	

(*1) To recognize profit or loss for transfer (to recognize-○, not to recognize-x)

○1 Difference when the accurate book value of the assets received such as cash determined prior to the transfer exceeds the net assets (the amount corresponding to the owners’ equity of the transferred business) based on the accurate book value of assets and liabilities of the transferred business immediately prior to the transfer

○2 Difference when the fair value of the assets received such as cash exceeds the net assets (the amount corresponding to the owners’ equity of the transferred business) based on the accurate book value of assets and liabilities of a transferred business immediately

prior to the transfer

○3 Difference between the fair value of the assets received such as cash and the fair value of the shares of the successor entity, and the net assets (the amount corresponding to the owners' equity of the transferred business) based on the accurate book value of assets and liabilities of the transferred business immediately prior to the transfer

(*2) Profit or loss for transfer is in principle accounted for in accordance with the elimination of unrealized profit or loss under the Consolidation Standards. Also, "goodwill" arising from the acquisition of the successor entity and "changes in the ownership interests" of the transferred business should be recognized.

IV Accounting for a transferring entity in a contribution in kind of assets (see paragraph 31)

When a transferring entity receives any shares of the successor entity, the transferring entity should account for such transaction in a manner similar to the accounting for the divesting entity in the business divestiture.

V Accounting with respect to the shareholders of combining entities concerned (see paragraphs 32 to 52)

1. Concept of accounting with respect to the shareholders of the combining entities concerned

The Business Divestitures Standard considers the requirements for accounting treatment with respect to shareholders of the entity combined in addition to the accounting for the divesting entity. When the shares of the entity combined held are exchanged for the different assets such as cash and shares of the combining entity, profit or loss on exchange may or may not be recognized, depending on whether such investment is considered to continue or to have been liquidated(see Chart 2).

The accounting with respect to the shareholders of the combining entity should be implemented to be consistent with the accounting for shareholders of the entity combined (see Chart 3).

2. Accounting with respect to the shareholders of the entity combined

(1) When the investment in the entity combined is considered to have been liquidated

The difference between the fair value of the assets received as a consideration in

exchange for the shares of the entity combined and the accurate book value of the shares of the entity combined immediately prior to the business combination should be recognized as profit or loss on exchange, and a new investment is considered to have been made at the fair value of the consideration received. When any assets clearly different from shares of the entity combined such as cash are received as a consideration, the investment is generally deemed to have been liquidated.

(2) When the investment in the entity combined is considered to continue

The acquisition cost of assets received in exchange for the shares of the entity combined should be determined based on the accurate book value of the shares of the entity combined without recognizing any profit or loss on exchange. When an entity combined is a subsidiary or affiliate and the shareholders of the entity combined receive only the shares of the combining entity which become the shares of the subsidiary or affiliate as a consideration, the investment in the entity combined is deemed to continue since the shareholders of the entity combined is considered to continue its investment in the entity combined (subsidiary or affiliate) through the shares of the combining entity exchanged.

This includes cases where shares of the entity combined do not continue to become the shares of the subsidiary or affiliate (from available-for-sale securities to available-for-sale securities) in a business combination in which an investee other than a subsidiary or affiliate is the entity combined.

(Chart 2) Summary of accounting with respect to the shareholders of an entity combined

A When the consideration received relates only to different assets such as cash

Combining entity concerned		Separate financial statements			Consolidated financial statements			Example
		Recognition of profit or loss on exchange			Accounting for the purpose of consolidation			
Entity combined	Combined entity	(*1)	Standard	Guidance		Standard	Guidance	
Subsidiary	Subsidiary	○[1]	Para. 35 (para. 14(1))	Para. 268 (para. 244)	(*2)	Para. 35 (para. 14(2))	Para. 268 (para. 245)	[Example 29-1]
	Affiliate	○[2]	Para. 35 (para. 15(1))	Para. 269(1)		Para. 35 (para. 15(2))	Para. 269(2)	

	Other investees		Para. 35 (para. 16)		N/A	N/A	N/A	
Affiliate	Subsidiary or affiliate	○2	Para. 36(1)	Para. 270(1)	(*2)	Para. 36(2)	Para. 270(2)	
	Others				N/A	N/A	N/A	
Other investees	Subsidiary or affiliate	○2	Para. 37(1)	Para. 270(1)	(*2)	Para. 37(2)	Para. 270(2)	
	Other investees				N/A	N/A	N/A	

(*1) To recognize profit or loss on exchange (to recognize-○, not to recognize-x)

○1 Difference between the accurate book value of the assets received such as cash prior to the transfer and the accurate book value of the shares of the entity combined

○2 Difference between the fair value of the assets received such as cash and the accurate book value of the shares of the entity combined

(*2) Profit or loss on exchange is in principle accounted for in accordance with the elimination of unrealized profit or loss under the Consolidation Standards.

B When the consideration received relates only to the shares of a combining entity

Combining entity concerned		Separate financial statements			Consolidated financial statements			Example
		Recognition of profit or loss on exchange			Accounting for the purpose of consolidation			
Entity combined	Combined entity	(*1)	Standard	Guidance		Standard	Guidance	
Subsidiary	Subsidiary	×	Para.38 (para 17(1), para 18 (1), para. 19(1))	Para.273 (1), para. 274(para. 248)	(*2)	Para.38 (para 17(2), para 18 (2), para. 19(2))	Para.273 (2), para. 274(para. 249)	[Example 29-2]
			Para. 39	Para. 274 (para. 248)		Para. 39	Para. 274 (para.249)	
	Affiliate		Para 38 (para.20 (1), para 21(1), para.22 (1))	Para.275 (1)		Para 38 (para.20 (2), para 21(2), para.22 (2))	Para.275 (2)	
	Other investees	○	Para.38 (para.23)	Para.276 (1)	(*3)	—	Para.276 (2)	
Affiliate	Subsidiary or affiliate	×	Para.40 (1)	Para.277 (1)	(*2)	Para.40 (2)	Para.277 (2)	[Example 30]
			Para.42	Para.279 (1)		Para.42	Para.279 (2)	
	Other investess	○	Para.41 (1)	Para.278 (1)	(*3)	Para.41 (2)	Para.278 (2)	

Other investees	Subsidiary or affiliate	×	Para.44	Para.281 (1)	(*2)	Para.44	Para.281 (2)	
	Other investees		Para.43	Para.280	N/A	N/A	N/A	

(*1) To recognize profit or loss on exchange (to recognize-○, not to recognize-x)

(*2) To recognize "goodwill" arising from the increased ownership interests and "changes in the ownership interests" arising from the decreased ownership interests.

(*3) To evaluate the shares at the carrying book value in the separate balance sheet (the fair value of shares of the combined entity or the fair value of shares of the entity combined)

C When the consideration received relates to the different assets such as cash and the shares of a combining entity

Combining entity concerned		Separate financial statements			Consolidated financial statements			Example
Entity combined	Combined entity	Recognition of profit or loss on exchange			Accounting for the purpose of consolidation			
		(*1)	Standard	Guidance		Standard	Guidance	
Subsidiary	Subsidiary	○1	Para.45(para.24 (1)), After "Meanwhile" in para.45 (para.39)	Para.282(1) (para.252)	(*2)	Para.45(para.24 (2)), After "Meanwhile" in para.45 (para.39)	Para.282(1) (para.253)	[Example 29-3] [Example 29-4]
	Affiliate	○2	Para.45(para.25 (1))	Para.282(2) (para.105 (1))		Para.45(para.25 (2))	Para.282(2) (para.105 (2))	[Example 31]
	Other investees	○3	Para.45(para.26)	Para.282(2) (para.106))	(*3)	—	Para.282(3)	
Affiliate	Subsidiary or affiliate	○2	Para.46(1) After "Meanwhile" in para.46 (para.42)	Para.283(1) —	(*2)	Para.46(2) After "Meanwhile" in para.46 (para.42)	Para.283(2) —	
	Other investees	○3	After "Also" in para.46 (para.36(1) and para.41(1))	—	(*3)	After "Also" in para.46 (para.36(2) and para.41(2))	—	
Other investees	Subsidiary or affiliate	○4	After "Meanwhile" in para.47 (para.44)	—	(*2)	After "Meanwhile" in para.47 (para.44)	—	
	Other investees		Para.47	Para.284	N/A	N/A	N/A	

(*1) To recognize profit or loss on exchange (to recognize-○, not to recognize-x)

○1 The difference when the accurate book value of the assets received such as cash prior to the transfer exceeds the accurate book value of the shares of the entity combined

◯2　The difference when the fair value of the assets received such as cash exceeds the accurate book value of the shares of the entity combined

◯3　The difference between the fair value of the assets received such as cash and shares of the entity combined, and the accurate book value of the shares exchanged of the entity combined

◯4　The difference between the fair value of the different assets received such as cash and the book value of the derecognized component (the amount allocated of the book value of the shares of the entity combined immediately prior to the derecognition based on the fair value of the different assets such as cash corresponding to the derecognized component and the fair value of the shares of residual part of combining entity)

(*2) Any profits or losses on exchange should be accounted for in accordance with the elimination of unrealized profits and losses under the Consolidation Standards. The “goodwill” arising from the increased ownership interests and “changes in the ownership interests” arising from the decreased ownership interests should be recognized.

(*3) To evaluate the shares at the carrying book value in the separate balance sheet (the fair value of shares of the combined entity or the fair value of shares of the entity combined).

(Chart 3)　　Accounting for shareholders of a combining entity

<table>
<tr><th colspan="2" rowspan="2">Combining entity concerned</th><th colspan="3">Separate financial statements</th><th colspan="3">Consolidated financial statements</th><th rowspan="2">Example</th></tr>
<tr><th colspan="3">Recognition of profit or loss</th><th colspan="3">Accounting for the purpose of consolidation</th></tr>
<tr><th>Entity combined</th><th>Combined entity</th><th>(*1)</th><th>Standard</th><th>Guidance</th><th></th><th>Standard</th><th>Guidance</th><th></th></tr>
<tr><td rowspan="4">Subsidiary</td><td rowspan="2">Subsidiary</td><td rowspan="3">×</td><td>Para.48(2)①
(para.38)</td><td>Para.286
(para.248)</td><td rowspan="3">(*2)</td><td>Para.48(2)①
(para.38)</td><td>Para.286
(para.249)</td><td>[Example 29-2]</td></tr>
<tr><td>Para.48(1)①
(para.39,42,44)</td><td>Para.286
(para.248)
Para.287</td><td>Para.48(1)①
(para.39,42,44)</td><td>Para.286
(para.249)
Para.287(2)</td><td></td></tr>
<tr><td>Affiliate</td><td>Para.48(1)①
(para.42,44)</td><td>Para.287(1)</td><td>Para.48(1)①
(para.42,44)</td><td>Para.287(2)</td><td></td></tr>
<tr><td>Other investees</td><td>○</td><td>Para.48(1)①</td><td>Para.288(1)</td><td>(*3)</td><td>Para.48(1)①</td><td>Para.288(2)</td><td></td></tr>
<tr><td rowspan="3">Affiliate</td><td rowspan="2">Subsidiary or affiliate</td><td rowspan="2">×</td><td>Para.48(2)①
(para.38,40)</td><td>Para.291(1)</td><td rowspan="2">(*2)</td><td>Para.48(2)①
(para.38,40)</td><td>Para.291(2)
(para.273(2), 275(2),277(2))</td><td>[Example 30]</td></tr>
<tr><td>Para.48(1)①
(para.42,44)</td><td>Para.289(1)</td><td>Para.48(1)①
(para.42,44)</td><td>Para.289(2)</td><td></td></tr>
<tr><td>Other investess</td><td>○</td><td>Para.48(1)①</td><td>Para.290(1)</td><td>(*3)</td><td>Para.48(1)①</td><td>Para.290(2)</td><td></td></tr>
</table>

Other investees	Subsidiary or affiliate	×	Para.48(2)① (para.38,40)	Para.293(1)	(*2)	Para.48(2)① (para.38,40)	Para.293(2) (para.273(2), 275(2),277(2))	
	Other investees		Para.48(1)② Para.48(2)②	Para.292	N/A	N/A	N/A	

(*1) To recognize profit or loss (to recognize-○, not to recognize-x)

(*2) To recognize the "goodwill" arising from the increased ownership interests and "changes in the ownership interests" arising from the decreased ownership interests.

(*3) To evaluate the shareholders at the carrying book value in the separate balance sheet (the fair value of shares of the combined entity or the fair value of shares of the entity combined)

VI Timing of application

The Business Divestitures Standard should be effective for annual periods beginning on or after April 1, 2006.

2. The Guidance (except for issues described in 1 above)

I Objective (see paragraphs 1 and 2)

The objective of the Guidance is to set forth appropriate guidelines on the application of the Business Combinations Standard and the Business Divestitures Standard. This Guidance has in principle been structured so that accounting in separate financial statements and consolidated financial statements can be implemented according to each category of business combinations (acquisition, combining of interests, formation of a jointly controlled entity and transactions under common control) and also to each representative form of reorganizations of business structure reorganizations (merger, divestiture of a business, exchange of shares, transfer of shares, etc.).

Others / Form of reorganization of business structure	Acquisition of entity or business		Party to receive considerations		Type of consideration	
	Direct acquisition (Single entity on a legal basis)	Indirect acquisition (acquisition of shares of another company)	Entity combined	Shareholders of an entity combined	Shares of a combining entity	Different assets such as cash
Merger	○			○	●	○
Divestiture of a business	○		○	*(Divestiture of a business)	●	○
Assignment of a business	○		○		○	●
Contribution in kind (business)	○		○		●	
Exchange of shares		○		○	●	○
Transfer of shares		○		○ (Shareholders of a wholly owned subsidiary by transfer of shares)	●	○
(Reference) Acquisition of shares		○		○	○	○

○ When falling under the category

● Accounting treatment primarily provided by this Guidance

II. Criteria for identification of acquisition or combining of interests (see paragraphs 6 to 28)

1. Criteria for identification of acquisition or combining of interests

A business combination other than a formation of a jointly controlled entity and a transaction under common control must be identified as either an acquisition or a combining of interests. An acquisition or a combining of interests should be identified based on determining the following criteria listed in sequence: criterion for consideration, criterion for voting rights ratio, and control criteria other than the voting rights ratio. Only when all the criteria are met, such a business combination should be determined to be a combining of interests. However, when any one of the three criteria is not met, such a business combination should be determined as an acquisition.

2. Criterion for voting rights ratio

The date when the voting right ratio criterion is determined should be the agreed-upon date of a business combination.

With respect to any shares which are potential shares on the agreed-upon date of a business combination but are replaced with shares with voting rights pursuant to the intention of the combining entities between the period from the date following the agreed-upon date of the business combination to the day preceding the business combination date, they should be included in the shares for re-determining the voting right ratio criterion.

3. Control criteria other than the voting rights ratio

The determination as to whether any of the control criteria other than voting rights ratio apply to cases where large premiums arise should be made when the voting right ratio determined based on the exchange ratio calculated based on the average stock price stays outside the range from 45% to 55%. If the corporate values of both combining entities, determined by a reasonable evaluation technique common to them, are approximately equal, such controlling criteria do not fall under such case.

III. Accounting for an acquisition (see paragraphs 29 to 126, and with respect to Item 1, see paragraphs 89 to 109)

1. Summary of accounting for an acquisition

When the business combination is determined to be an acquisition, the purchase method should apply. The purchase method is an approach used to analyze a business combination from the viewpoint of the acquiring entity, and the acquiring entity should

allocate the acquisition cost to identifiable assets acquired and liabilities assumed, including those not recognized by the acquired entity, on the business combination date. The difference between the acquisition cost and the allocated amount of the acquisition cost is goodwill (or negative goodwill), and such goodwill (or negative goodwill) should be regularly amortized over the period when the goodwill (or negative goodwill) has an effect within 20 years (or over the appropriate period based on the substance of the acquisition within 20 years), by using a reasonable method.

2. Identification of the acquiring entity

In consistency with the criteria for identification of an acquisition or a combining of interests, the following entity should be determined to be acquiring entity.

A When a business combination is determined to be an acquisition in accordance with the consideration criterion, the entity paying consideration;
B When a business combination is determined to be an acquisition in accordance with voting rights ratio criterion, the combining entity which is determined to have a larger voting rights ratio (in case there is any shareholder controlling the combined entity (parent), the combining entity concerned which has been controlled by the shareholder from before the business combination (subsidiary)); or
C When a business combination is determined to be an acquisition in accordance with the controlling criteria other than voting rights ratio, the combining entity concerned which is determined to have acquired control.

3. Method to allocate the acquisition cost

(1) Determination of the allocated amount of the acquisition cost for the purpose of simplicity

The amounts of the acquisition cost allocated to identifiable assets and liabilities are calculated on the basis of the fair value on the business combination date. However, when the acquired entity determines the accurate book value of the assets and liabilities in accordance with the generally accepted accounting standards and the difference between such accurate book value so determined and the fair value of the assets and liabilities on the business combination date is expected to be immaterial, the allocation of the acquisition cost can be determined on the basis of the accurate book value of the acquired entity.

(2) Allocation of the acquisition cost to intangible assets

When the acquisition of legal rights, or separable and transferable intangible assets is one of the objectives of a business combination and a reasonable valuation amount of such intangible assets has been deliberated by a decision-making body of the entity, such as its board of directors, the separate value of intangible assets in such acquisition is considered to be calculated in a reasonable way, and in principle, the acquiring entity should allocate the acquisition cost to intangible assets as identifiable assets.

(3) Allocation of the acquisition cost to research and development expenses

Cases where an acquiring entity allocates a part of the acquisition cost to research and development expenses refers to cases where the use of identifiable assets acquired in the business combination by the acquiring entity meets the criteria for accounting for the identifiable assets as the research and development expenses in accordance with the accounting standard for research and development expenses. The amount allocated to the identifiable assets is accounted for as research and development expenses and is expensed for the fiscal year when the business combination takes place.

(4) Allocation of the acquisition cost to provision incurred from a business combination

With respect to expenses or losses expected to occur shortly after the acquisition, when the probability of such occurrence has been reflected in the consideration for the acquisition, the liability (provision incurred from a business combination) should be recognized.

(5) Tentative accounting treatment

The allocation of the acquisition cost must be made within one year following the business combination date. Unless the allocation has completed at the interim or annual balance sheet date subsequent to the business combination date, a tentative accounting treatment is made based on the information reasonably available at that time, and the allocation amount should be finalized based on the additionally available information. The items subject to such tentative accounting treatment

are limited to the items whose allocation amounts are difficult to determine in practice, including deferred tax assets and liabilities; land, intangible assets, provisions for contingent liabilities, and others. In addition, if the allocation amount of the acquisition cost is adjusted by the finalization or review of the tentative accounting treatment, such adjustment should be accounted for as the adjustment of the amount of goodwill (or negative goodwill) on the business combination date.

(6) Tax effect accounting of an acquiring entity

In the case of a merger or a divestiture of a business directly acquiring another business, the acquiring entity must recognize the tax amount relating to the temporary difference arising from the acquired entity or acquired business on the business combination date as deferred tax assets or liabilities, excluding the amount which is not expected to be recovered or be paid future fiscal years.

(7) Accounting for goodwill

Note that in amortizing goodwill, the acquiring entity may not account for all the amount of goodwill as expense unless the amount of the goodwill is immaterial, and that the amortized cost is accounted for as sales and general administrative cost and cannot be recognized as the extraordinary loss due to reasons other than accounting for impairment.

4. Accounting for an increase in the owners' equity of an acquiring entity

When an acquiring entity issues new shares as a consideration for a business combination, the paid-in capital (share capital or capital surplus) should be increased. The line items to be increased in the paid-in capital (share capital, capital legal reserve, or other capital surplus) should be determined by the acquiring entity in accordance with the requirements of the Corporate Law.

IV Accounting for a combing of interests (see paragraphs 127 to 174)

1. Application of the pooling-of-interests method

When a business combination is determined to be a combining of interests, the pooling-of-interests method is applied to the business combination and the assets, liabilities, and net assets of all the combining entities concerned should be taken over at

the respective accurate book values.

(1) Merger

When a consideration for a merger relates to new shares, the existing entity by absorption takes over the line items of share capital, capital legal reserve, other capital surplus, earned legal reserve, and other earned surplus of the extinguished entity by absorption on the day preceding the date of merger, except in the accounting treatment of treasury shares. The existing entity also takes over the accurate book value of valuation and translation adjustments in net assets and subscription rights to shares of the extinguished entity by absorption on the day preceding the merger.

When a combined entity prepares the consolidated financial statements, it should prepare them as if the merger were effected on the deemed combination date (that is, the first date of the fiscal year in which the merger date falls). And for the purpose of the separate financial statements, the merger is accounted for on the merger date. When no consolidated financial statements are prepared, the combined entity accounts for the merger on the merger date with certain footnote disclosures.

When an extinguished entity by absorption holds treasury shares, the book value of such treasury shares should be derecognized in lieu of the takeover thereof by the existing entity by absorption. Items in the owners' equity to be decreased corresponding to the derecognition of treasury shares should be deducted from the surplus (other capital surplus or other earned surplus) taken over from the extinguished entity by absorption, and when no deduction is possible, such amount should be deducted from the surplus (other capital surplus or other earned surplus) of the existing entity by absorption. The line items to be decreased in the owners' equity (other capital surplus or other earned surplus) are decided by a decision-making body of the existing entity by absorption, such as its board of directors. In the accounting for the shares of the extinguished entity by absorption held by the existing entity by absorption (tie-in shares), the book value thereof should be derecognized and the line items to be decreased in the owners' equity corresponding to the derecognition of such tie-in shares should be decided in a manner similar to that noted above.

(2) Exchange of shares or transfer of shares

For the purpose of consolidated financial statements, the exchange of shares or transfer of shares is deemed to have been made on the deemed combination date. For the purpose of separate financial statements, the exchange of shares or transfer of shares is accounted for on the date of such exchange of shares or transfer of shares. The valuation of shares of a subsidiary, meanwhile, is the amount of owners' equity based on the accurate book value of the wholly owned subsidiary by the exchange of shares or by the transfer of shares, and its parent company increases the paid-in capital.

2. Application of accounting similar to the pooling-of-interests method

Out of the business combinations determined to be combining of interests, the divestiture of a business and the business combination by contribution in kind should be accounted for under a method similar to the pooling-of-interests method (under a method basically the same as the pooling-of-interests method in all respects but the methods of takeover of separate line items in the owners' equity and the requirements for the preparation of consolidated financial statements for the fiscal year in which the business combination falls).

The successor entity in a divestiture of a business which is determined to be a combining of interests should, when the consideration relates to new shares, account for the amount (the amount corresponding to the owners' equity of the transferred business) derived by deducting a) from b) below as the paid-in capital (share capital or capital surplus):

a) valuation and translation adjustments in the net assets and subscription rights to shares of the business transferred to the successor (valuation and translation adjustments related to the transferred business)
b) the difference between the assets and liabilities of the business transferred to the successor entity at the accurate book values immediately prior to the transfer.

The successor entity takes over valuation and translation adjustments in net assets of the transferred business at the accurate book value of the divesting entity.

V Determination of and accounting for the formation of a jointly controlled entity (see paragraphs 175 to 199)

1. Determination criteria for the formation of a jointly controlled entity

When all of the following criteria are met, such business combination is determined to be the formation of a jointly controlled entity (a business combination wherein several independent entities form an entity which they jointly control under a contract or other arrangements)

(1) The investing companies which become the jointly controlling investing companies are composed of several independent entities (independent entity criterion);
(2) The investing companies which become the jointly controlling companies have entered into a contract by which they become the jointly controlling entities (contract criterion);
(3) In principle, the consideration paid for the business combination consists exclusively of shares with voting rights (consideration criterion); and
(4) No facts representing control relationships other than the above exist (other control criterion)

For the contract criterion, the contract should be documented and provide for the business objectives of the jointly controlled entity and also provide for material roles in the execution of business implemented by respective investing companies and stipulate that a decision of material management items relating to the management policy and financial affairs is made subject to the consent of all the jointly controlling entities.

2. Accounting for the formation of a jointly controlled entity

When the business combination is determined to be the formation of a jointly controlled entity, the accounting similar to the pooling-of-interests method should apply.

VI Transactions under common control, etc. (see paragraphs 200 to 264)

1. Scope of transactions under common control

Transactions under common control are defined as business combinations in which all the combined entities are finally controlled by an identical entity before or after the business combination (including mergers of a parent and subsidiary or mergers of subsidiaries under the control of a parent) and such control is not temporary. Moreover, the identical entity acting as the principal in relation to control may include an

individual, and any individual so included is treated as the identical shareholder.

2. Accounting when a parent merges with its subsidiary

(1) The subsidiary closes its accounts to evaluate the assets or liabilities and net assets at the accurate book value on the day preceding the merger date.
(2) Assets and liabilities received at the accurate book value determined on the day preceding the merger date should be included in the separate financial statements of the parent.
(3) Any difference between the assets and liabilities received from the subsidiary should be split into the amounts corresponding to the parent's interests and minority interests in proportion to the interest ratio immediately before the merger date. The difference between the amount corresponding to the parent' interests and the carrying book value of the shares of subsidiary held by the parent (tie-in shares) immediately before the merger should be accounted for as the extraordinary profit or loss. The difference between the amount corresponding to minority interests and the consideration for the acquisition (the fair value of the shares delivered to the minority interest holder) added by the expenditures incurred directly for the acquisition should be accounted for as goodwill (or negative goodwill). Any increase in owners' equity of the parent through the merger should be accounted for as paid-in capital.

3 Accounting when a parent makes its subsidiary a wholly owned subsidiary by exchange of shares

When a parent makes its subsidiary a wholly owned subsidiary by exchange of shares, for the purpose of separate financial statements of the parent, the acquisition cost of the shares of the subsidiary through the exchange of shares additionally acquired by the parent should be determined by adding the consideration for the acquisition (the fair value of the shares delivered to the minority interest holder) to the expenditures incurred directly for the acquisition (the extent to the expenditures that are in the nature of consideration paid for the acquisition), and the owners' equity of the parent to be increased by the exchange of shares should be accounted for as the paid-in capital.

4. Accounting when a parent transfers its business to a subsidiary by the divestiture of a business concurrently in which the shareholders of the parent receive the shares of the subsidiary

When a parent transfers its business by the divestiture of a business concurrently in which the shareholders of the parent receive the shares of the subsidiary, such divestiture of a business is considered to relate to two transactions of the divestiture of a business in which the parent receives the shares of the successor entity (conventional divestiture of a business) and the distribution of the shares of the successor entity received at such divestiture of a business. Thus, the parent decreases its owners' equity by the acquisition cost of the shares of the subsidiary received and does not recognize any profit or loss. The line items to be decreased in the owners' equity of the parent should be decided by a decision-making body of the parent, such as its board of directors.

The subsidiary recognizes the assets and liabilities received from the parent at the accurate book value determined on the day preceding the date of the divestiture of a business, and accounts for the difference between them as the paid-in capital. However, when the subsidiary delivers only its shares as the consideration for the assets and liabilities received, the subsidiary may recognize the consideration at the amount derived by appropriately allocating the line items of the owners' equity recognized by the parent. In such case, the allocated amount of the particulars of the owners' equity should be identical to the amount of the particulars of the owners' equity decreased by the parent.