The Securities Analysts Association of Japan
5F, Tokyo Stock Exchange Bldg., 2-1, Nihonbashi-Kabutocho,
Chuo-ku, Tokyo 103-0026 Japan

Telephone: (03) 3666-1515
Facsimile: (03) 3666-5843
E-mail address:intl@saa.or.jp

28 December 2020

Mr. Hans Hoogervorst
Chair
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Re: Discussion Paper "Business Combinations— Disclosures, Goodwill and Impairment"

Dear Mr. Hoogervorst:

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on the Discussion Paper "Business Combinations—Disclosures, Goodwill and Impairment" (hereinafter referred to as the "DP") published in March 2020.

The SAAJ is a not-for-profit organization for professionals in the areas of investment and finance. It offers education and certification programs in these areas. Its certified members number around 27,500. The CAC is a standing committee of the SAAJ composed of 12 members, most of whom are users including equity and credit analysts, and portfolio managers, while a few are academicians and public accountants. The CAC submits comment letters to accounting standard setters, including the International Accounting Standards Board (IASB) and the Accounting Standards Board of Japan (ASBJ), and exchanges opinions with organizations including the ASBJ and the Financial Services Agency.

We would like to thank Ms. Suzuki, a member of the IASB, for holding an online seminar for pertinent members of the SAAJ on 26 August 2020 to explain the content of the DP.

General Comments

As explained in “Analyst Views on Financial Information Regarding Goodwill”[1] submitted by the ASBJ to the IASB in 2017, the views of Japanese financial statement users regarding desirable accounting treatments after the acquisition of goodwill are divided into "regular amortisation + impairment" (the same as the current Japanese standard) and "impairment only" (the same as the current IFRS Standards). In the selection of 11 analysts interviewed by the ASBJ, the SAAJ recommended candidates with sufficient insight on the subject.

In the summer of 2018, a group of researchers led by Professor Yoshihiro Tokuga of Kyoto University conducted a large-scale questionnaire survey of preparers and users of financial statements in Japan. In April 2019, the results were published as "Survey on Accounting for Goodwill."[2] On the preparers side, some 263 out of 1,379 Keidanren (Japanese Business Federation) member companies (response rate: 19.1%) and 184 out of 1,339 non-member companies (13.7%), making for a total of 447 companies (16.5%), responded. Regarding desirable accounting treatments for acquired goodwill, 15.9% answered "Impairment only," 73.4% "Regular amortisation + impairment," and 10.7% "Either."

Questionnaires were sent to 673 users, mainly active analysts belonging to the SAAJ, and 130 responded (19.3%). Regarding desirable accounting treatments for acquired goodwill, 20.0% answered "Impairment only," 62.3% "Regular amortisation + impairment," and 17.8% "Either." The total response rate selecting "Impairment only" and "Either" on the part of users was higher than that for preparers while the response rate selecting "Regular amortisation + impairment" came out top at users as it did at preparers.

According to these survey results, the majority opinion of users in Japan is "regular amortisation + impairment" which favours the need to reintroduce goodwill amortisation. We would like to express our opinions on some of the questions based on discussions about the DP at the CAC on the premise that the consensus of users in Japan favours reintroducing goodwill amortisation.

---

1 https://www.asb.or.jp/jp/wp-content/uploads/20170612_e.pdf
2 http://www.econ.kyoto-u.ac.jp/dp/papers/e-19-003.pdf

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?

Comments

We disagree with the conclusions of the IASB. The package of preliminary views includes some proposals which help improve the information provided to investors, such as enhanced disclosure of performance after goodwill acquisition. However, it also includes a lot of proposals such as providing companies with relief from having to perform an annual quantitative impairment test, which seems excessive consideration to reduce the burden on preparers. These proposals could go against resolving and in fact rather exacerbate the problem that impairment losses on goodwill are recognised as 'too late' which investors are most concerned about. Therefore, we do not think that the contents of the package of preliminary views satisfy the objective to provide investors with more useful information at a reasonable cost in paragraph 1.7.

We basically think that the IASB needs to recognise that the problem that impairment losses on goodwill are recognised as 'too little, too late' became apparent after the 2008 financial crises that happened after 2004 when the IFRS changed the accounting of goodwill to non-amortisation. In our opinion, the IASB needs to withdraw the preliminary view of "it should retain the impairment-only model and not reintroduce amortisation" in paragraph IN38 and fundamentally change its view on goodwill accounting treatments based on the premise of reintroducing amortisation.

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).

Comments

We agree with the preliminary view that new disclosure requirements about the subsequent performance of an acquisition should be added to meet investor needs. As the only information available after acquisition has been the disclosure of impairment tests, there has been a lack of information for examining how robust goodwill is as an accounting estimate. We think that current insufficient disclosure requirements undoubtedly need to be improved on in order for a chief operating decision maker (CODM) to be accountable for the acquisition of a company with a large amount of expenditure. However, we saw the following opinions in our discussion, and details of the new disclosure requirements need to be considered further.

- The new disclosure requirements do not fully satisfy the objective because the disclosure period is limited to several years after business combination.
- "Before the end of the second full year after the year of acquisition" in paragraph 2.45 (b) (iv) is too short given current corporate behaviour. For example, a company is unlikely to recognise any impairment losses within that period as it tends to recognise such losses 'too late'.
- There is a concern that the true objective of an acquisition could be difficult to understand if numerical disclosure of monitoring indicators is strongly required.
- Since such notes could increase the difficulty of auditing and the risk of litigation, there is a concern that only insufficient information might be provided despite the new disclosure requirements due to the increase in preparatory and audit costs.

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?

Comments

We agree with the preliminary view that the above two disclosure objectives in paragraph 2.59 should be added in accordance with the addition of new disclosure requirements. However, the new disclosure requirements in the preliminary view need to be reconsidered and discussed further to meet user expectations.

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?

Comments

Among the proposals in the preliminary view, we agree with that requiring a company to disclose information about its expected synergies. Investors are monitoring the achievement of synergies with post-acquisition performance. Consequently, adding such specific disclosure of information would be useful for users to understand company performance.

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?

Comments

Regarding pro forma information, there is a positive view that it would be useful for forecasting business performance and a negative one that it would be more useful to disclose detailed information on the performance of the acquired company over the past several years, rather than spending time preparing pro forma information.

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?

Comments

Based on the fact that the Board could come to no effective solution even after spending a lot of time discussing the matter, we agree with the preliminary view that it is not feasible to design a significantly more effective impairment test. However, the preliminary view may have been too easily arrived at by not giving a quantitatively and reasonably estimated cost. We are seriously concerned that the preliminary view could be a subjective judgement of the IASB.

Question 6
(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?

Comments

Overly optimistic estimates may be caused by management evasion of responsibility or arbitrariness in order to achieve the business forecast envisioned by management. However, the negative effect of overly optimistic estimates due to the above factors may not be limited to impairment losses on goodwill.

On the other hand, we are seriously concerned that it would be inappropriate to emphasise the shielding effect as a reason for the delay in recognising impairment losses on goodwill. It would be quite difficult to improve the effectiveness of impairment tests because a shielding effect is inevitable in impairment tests. Therefore, improving disclosure and simplifying impairment tests would not resolve the problem that impairment losses on goodwill are recognised as 'too late.'

We think that the IASB's proposal to improve disclosure in order to ease investor dissatisfaction and to simplify impairment tests in order to eliminate preparer dissatisfaction would be an easy compromise and would not contribute to improved accounting for goodwill. Therefore, we strongly oppose the proposal.

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?

Comments

We totally disagree with the preliminary view that amortisation of goodwill should not be reintroduced and that an impairment-only model should be retained. In principle, it is a common stance for a standard-setter that "any decisions it makes now will not be reopened again in a few years—frequent changes back and forth between the different approaches would not help any stakeholders" (paragraph 3.86). This stance should not justify not to reintroduce amortisation of goodwill. Since "the Board accepts that both accounting models for goodwill—an impairment-only model and an amortisation model—have limitations" (paragraph 3.90) and "a small majority (eight out of 14 Board members) reached a preliminary view" (paragraph 3.89), we do not think that the IASB should stick to the preliminary view in the DP.

The problem that impairment losses on goodwill are recognised as 'too little, too late' has become apparent since 2004 when the IFRS changed the accounting of goodwill to non-amortisation. The recognition of delays in impairment losses has increased the risk of change in profit and loss. Also, more companies have a large amount of goodwill on the balance sheet for a long period. These facts may have reduced the usefulness of financial statements.

In order to solve the problem that impairment losses on goodwill are recognised as 'too late' which was identified in a Post-implementation Review (PIR) of IFRS 3 and which investors are most concerned about, and in order to reduce the burden on preparers, the proposal to simplify impairment tests would be inappropriate as it would not resolve the problem. We hope that the IASB could more seriously consider reintroducing the amortisation of goodwill and setting new IFRS Standards for a "regular amortisation + impairment" approach to respond to the 'too late' problem.

Question 7	
(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?

Comments

We strongly oppose the proposals to adjust or create new management performance measures (MPMs) to add back amortisation expense. Each company should decide whether or not to add amortisation expense and impairment losses to MPMs and adopt the most suitable measures for its own MPMs. On the other hand, each user of financial statements only needs to make necessary calculations for the published MPMs in accordance with his/her objectives of use and comparative analysis method. We basically think that MPMs are defined as the most appropriate messages from management to investors. Therefore, it would be inappropriate to set an accounting standard that requires uniform treatment of MPMs.

Question 7	
(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?

Comments

According to the "Survey on Accounting for Goodwill" published in April 2019, of the users of financial statements who answered that "regular amortisation + impairment" was the most desirable, 81.5% answered “An upper limit should be set for the amortisation period” (e.g. "Be amortised within … years”), 9.9% "A uniform amortisation period should be set” (“Be amortised in just … years”), and 8.6% “No provision about amortisation period should be set.” Furthermore, of the respondents who answered “An upper limit should be set for the amortisation period,” 48.5% supported “10 years”, 31.8% “20 years”, 12.1% “15 years”, 6.1% “5 years”, and 1.5% “Other.”

In this survey, the respondents who support "regular amortisation + impairment" were asked to what extent they thought each factor was important by showing examples of the factors that are considered to be important in estimating goodwill amortisation period. Having calculated the total ratio of "Yes" and "Rather yes", “The investment-return period based on management business plans” was 76.5%, “Useful lives of related other intangible assets” 56.8%, “The time period over which synergies are expected to be maintained” 55.6%, “Useful lives of related tangible assets” 55.6%, and “Time periods over which an acquirer, on a stand-alone basis, is expected to maintain higher future cash flows" 48.2%. These results show that the most important factor for users of financial statements is management decisions.

Based on this survey, we would like to propose that the useful life of goodwill should be, in principle, the period estimated by a chief operating decision maker (CODM) at the time of acquisition, and that the upper limit of the amortisation period should be 10 years. From academic literature, 'excess returns of each company regress to the average in approximately 5 to 10 years, but this is not applied to the companies in the group with the highest rate of return and those with the lowest rate of return.' Thus, the majority opinion of "10 years" supported by 48.5% of the respondents would make a lot of sense. Ideally, the amortisation patterns should be consistent with the payback patterns of the investments, but, considering the feasibility, straight-line amortisation would be appropriate.

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?

Comments

We were divided into pros and cons of this preliminary view. Proponents value this proposal because it would enable even inexperienced users of financial statements to clearly understand the relationship between amount of goodwill and quality of equity, and because it is expected to have the effect of restraining preparers from recognising the delay in impairment losses. Opponents are of the opinion that it would be inconsistent with recognising goodwill as an independent asset, and that indicating that 'equity excluding goodwill is negative' could be misleading for companies with excessive goodwill.

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?

Comments

We agree with the preliminary view that a proposal to allow some intangible assets to be included in goodwill should not be developed. Under the current IFRS Standards, which only allows impairment of goodwill, only the portion that belongs to rational assets that must be amortised should be regarded as intangible assets. A change that allows some intangible assets to be included in goodwill would be irrational and could be an inappropriate proposal that results in an overvaluation of intangible assets.

Even if goodwill amortisation is reintroduced, we believe that the basic principle of amortising each identifiable intangible asset over an appropriate number of years remains unchanged. However, we have received a proposal that intangible assets without defined useful lives should not be recognised in order to prevent managements who do not want to amortise goodwill from arbitrarily recognising goodwill as an intangible asset. On the other hand, we have received an opinion that some intangible assets could be included in goodwill on the premise of reintroduction of regular amortisation.

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?

<u>Comments</u>

Our answers in this DP do not change depending on whether or not IFRS 3 is consistent with US GAAP. However, in the current situation where IFRS Standards and US GAAP are recognised as de facto international standards, it would undoubtedly be desirable that the difference between the two could be smaller in order to maintain comparability of financial statements with regard to important accounting treatments as in business combination. The IASB and FASB may have abandoned convergence of IFRS Standards and US GAAP, but we hope that their accounting standards could converge to "regular amortisation + impairment" for goodwill.

Sincerely yours,

S Komiyama

Satoshi Komiyama
Chair
Corporate Accounting Committee