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12 July 2024

International Accounting Standards Board
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Comments on the Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment (Proposed amendments to IFRS 3 and IAS 36)*

To the IASB Board Members:

The Japanese Institute of Certified Public Accountants (JICPA) appreciates the continued efforts of the International Accounting Standards Board (IASB) to develop high quality accounting standards and welcomes the opportunity to comment on the Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment (Proposed amendments to IFRS 3 and IAS 36)* (Exposure Draft).

The IASB's standard-setting project was originally aimed to address the issue of not being able to recognise impairment losses on goodwill on a timely basis (i.e. the 'too little, too late' issue) due to a structural deficiency in the impairment test for goodwill based on IAS 36, further causing an issue of overstatement in the carrying amount of goodwill included in the financial statements. We respect the IASB's thought process, concluding that because it is not feasible to design a different impairment test that would be significantly more effective than the impairment test in IAS 36 at a reasonable cost, it should take a different approach to provide better information about the performance of a business combination on a timely basis, and thereby responding to users' need for useful information.

That said, although we understand the importance of providing such information, further clarification is required on various issues that may arise in practice, including the following, when disclosing the proposed information in the financial statements:

- While the assurance level provided by auditors can be very limited for the reasonableness of the additional information disclosed by entities, including targets set by management and quantitative information on expected synergies, expectation gap may arise from stakeholders such that reasonableness of those targets and synergies are assured through audit.
- We expect audit procedures and involvement of experienced auditors will significantly increase, causing a rise in audit costs.
- There are certain areas in the Exposure Draft that need further clarity, including the following, which may cause diversity in practice and reduce comparability and reliability of information disclosed:
  - Does the Exposure Draft indicate that cases where entities can apply the exemption from disclosing information is extremely rare? In other words, in which cases can entities apply the exemption? (See comment to Question 3)
  - What is the definition of 'review' when an acquirer is required to disclose 'information reviewed by the acquirer's key management personnel' about the performance of a business combination? (See comment to Question 4)
  - What is the definition and scope of expected synergies to be disclosed? (See comment to Question 5)
  - When would a future restructuring or asset improvement or enhancement be associated with the current potential of the asset? (See comment to Question 7)

We expect the IASB to carefully consider the above-mentioned concerns and obtain sufficient understanding and support from stakeholders when finalising the Exposure Draft.

Please see the detail of our concerns and comments to the Questions in the following pages.

Question 1—Disclosures: Performance of a business combination (proposed paragraphs B67A–B67G of IFRS 3)
In the PIR of IFRS 3 and in responses to the Discussion Paper the IASB heard that: ・ users need better information about business combinations to help them assess whether the price an entity paid for a business combination is reasonable and how the business combination performed after acquisition. In particular, users said they need information to help them assess the performance of a business combination against the targets the entity set at the time the business combination occurred (see paragraphs BC18–BC21). ・ preparers of financial statements are concerned about the cost of disclosing that information. In particular, preparers said the information would be so commercially sensitive that its disclosure in financial statements should not be required and disclosing this information could expose an entity to increased litigation risk (see paragraph BC22). Having considered this feedback, the IASB is proposing changes to the disclosure requirements in IFRS 3 that, in its view, appropriately balance the benefits and costs of requiring an entity to disclose this information. It therefore expects that the proposed disclosure requirements would provide users with more useful information about the performance of a business combination at a reasonable cost. In particular, the IASB is proposing to require an entity to disclose information about the entity's acquisition-date key objectives and related targets for a business combination and whether these key objectives and related targets are being met (information about the performance of a business combination). The IASB has responded to preparers' concerns about disclosing that information by proposing: to require this information for only a subset of an entity's business combinations—strategic business combinations (see question 2); and ・ to exempt entities from disclosing some items of this information in specific circumstances (see question 3). (a) Do you agree with the IASB's proposal to require an entity to disclose information about the performance of a strategic business combination, subject to an exemption? Why or why not? In responding, please consider whether the proposals appropriately balance the benefits of requiring an entity to disclose the information with the costs of doing so. (b) If you disagree with the proposal, what specific changes would you suggest to provide users with more useful information about the performance of a business combination at a reasonable cost?

Comment:

We basically agree with the IASB's proposal, provided that the following concerns are properly addressed:

According to paragraph BC145(b) of the Exposure Draft, the IASB expects auditors to obtain information on management's assessment for the achievement of key objectives and related targets of a strategic business combination, and to verify whether there is adequate explanation and sufficient evidence supporting the information. However, as each business combination is unique in having different nature, we assume key objectives and related targets will have to be individually set by management, which means audit procedures to be performed by auditors also have to be individually determined. Further, it is possible that non-financial information, such as market share and the number of increasing customers, could be included in metrics used by management to measure the achievement of key objectives and related targets, indicating that such non-financial information will also be subject to audit going forward. We expect the proposed disclosure requirements, if implemented, would cause a significant increase in audit procedures and involvement of experienced auditors. Accordingly, we highly recommend the IASB reconsider whether such proposed disclosures should be required as part of financial statements from a view point of striking the right balance between benefits and costs, including auditing costs. Upon finalising the proposed disclosure requirements, we highly recommend the IASB obtain an understanding on increasing costs from both users and preparers of financial statements.

Another point from the perspective of auditing financial statements is that when the proposed disclosures are made by management, we consider auditors can only check the consistency of such information with valuation reports and internal approval documents but cannot assess the reasonableness of the information. ISA 200 *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing* defines financial statements as "structured representation of historical financial information". Therefore we believe that assurance on the target and performance of a business combination might be out of the scope of financial statement audits. That said, if such information is included in the notes to the financial statements to which an audit report is attached, it can mislead the users of financial statements, who may, for example, believe that evaluating the expectation on performance of a business combination is part of the scope of assurance.

Therefore, if the proposed disclosure requirements were to be introduced, we suggest the IASB require additional disclosures to be made in the notes to the financial statements, describing that the disclosure information is based on the acquisition-date expectation of management and its subjective evaluation on the performance of the business combination in order to prevent users of financial statements from having undue expectation gaps. The IASB can also include an explanation in the Basis for Conclusions,

pointing out that auditors do not provide assurance on the reasonableness of such information. This treatment aligns with paragraph 122 of IFRS 18 *Presentation and Disclosure in Financial Statements*, which requires entities to explicitly state that Management-Defined Performance Measures (MPMs) are measurement metrics defined and used by management to provide management's view of financial performance, and thus are not always comparable with those used by other entities.

As business combinations are usually conducted for various purposes, it will be useful if more illustrative examples are provided in addition to paragraph IE72, which lays out a case where an entity tries to expand its sales market through business combinations, in order to supplement the proposed disclosure requirements. For instance, an illustrative example could be given for business combinations carried out under a plan to diversify businesses through step acquisitions. We believe such illustrative examples would make it easier for preparers to provide information in a consistent manner and also contribute to maintain a desirable level of disclosures required by users.

Last but not least, we recommend the IASB to consider how the proposed disclosure requirements should be treated under IAS 34 *Interim Financial Reporting*. If an entity were to comply with paragraph 16A of IAS 34, it would be required to disclose information about the performance of a business combination, including information in subsequent periods as described in paragraph B67A(b), in the interim financial report. It is doubtful, from a cost-benefit perspective, whether an entity should be truly required to include such disclosure information in the interim financial report.

Question 2—Disclosures: Strategic business combinations (proposed paragraph B67C of IFRS 3)
The IASB is proposing to require an entity to disclose information about the performance of a business combination (that is, information about the entity's acquisition-date key objectives and related targets for the business combination and whether these key objectives and related targets are being met) for only strategic business combinations—a subset of material business combinations. A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy. The IASB is proposing that entities identify a strategic business combination using a set of thresholds in IFRS 3—a business combination that met any one of these thresholds would be considered a strategic business combination (threshold approach) (see paragraphs BC56–BC73). The IASB based its proposed thresholds on other requirements in IFRS Accounting Standards and the thresholds regulators use to identify particularly important transactions for which an entity is required to take additional steps such as providing

more information or holding a shareholder vote. The proposed thresholds are both quantitative (see paragraphs BC63–BC67) and qualitative (see paragraphs BC68–BC70).

(a) Do you agree with the proposal to use a threshold approach? Why or why not? If you disagree with the proposal, what approach would you suggest and why?

(b) If you agree with the proposal to use a threshold approach, do you agree with the proposed thresholds? Why or why not? If not, what thresholds would you suggest and why?

Comment:

Instead of using a threshold approach, we suggest taking a holistic approach by first defining what a strategic business combination is and then providing a list of considerations to be made to determine whether or not a business combination meets the definition.

The IASB proposes using a threshold which represents the absolute amount of the acquiree's operating profit or loss being 10 per cent or more of the absolute amount of the acquirer's consolidated operating profit or loss in the most recent annual reporting period before the acquisition date. Our first point is that an acquirer's operating profit or loss could fluctuate year-on-year due to various reasons. For example, a non-recurring, one-time loss, such as an impairment loss, could diminish the amount of an acquirer's consolidated operating profit in one year. Or the consolidated operating profit or loss of some acquirers could be more volatile compared to others. We are afraid this would cause inconsistency in identifying strategic business combinations. In some cases, if an acquirer's consolidated operating profit or loss is unusually small in one year, it is possible that almost all of its business combinations in the following year could be considered as 'strategic business combinations,' including those that are not strategically material enough. In other cases, the same size of business combinations could or could not be considered as 'strategic business combinations' in different reporting periods. Further, if business combinations that are not strategically material are subject to disclosures, it could not only add undue burden to preparers but also not provide useful information to investors because immaterial information could obscure material information.

Secondly, if an entity were to apply the proposed quantitative threshold approach, it would need to obtain an acquiree's financial information of the most recent annual reporting period. However, the acquiree may not adopt IFRS Standards or it may not have its financial information audited in the most recent annual reporting period. Under such circumstances, a quantitative threshold approach or other closed list approaches may

cause difficulty for auditors to determine the completeness and accuracy of strategic business combinations.

According to paragraph BC54, the IASB decided to identify a business combination for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy as a strategic business combination. We recommend such description should be included in the main text of the Standard, instead of the Basis for Conclusions, with quantitative and qualitative thresholds provided as illustrative examples. In this way, entities can take a more holistic approach to determine whether or not a transaction should be identified as a strategic business combination.

Included in those examples can be illustrating a method of taking an average of operating profit or loss over certain periods to smooth out volatility when using a quantitative threshold. We also recommend giving more clarity to the qualitative threshold in paragraph B67C, which states that a business combination is a strategic business combination 'if the business combination resulted in the acquirer entering a new major line of business or geographical area of operations.' The paragraph does not clearly explain what kind of metrics should be used to determine whether the new line of business or geographical area of operations is major or not for the acquirer. For example, should the judgement be based on the current or future market volume, or should it be a relative or absolute judgement used by each entity in determining whether it is major or not? We can also argue that strategically material business combinations are not limited to a new line of business or geographical area of operations, but can also include the expansion of existing businesses, such as products and markets. We recommend the IASB reflect these points when providing a guidance for qualitative thresholds in order to encourage entities to make comprehensive considerations and mitigate the risk of inconsistent practices.

Question 3—Disclosures: Exemption from disclosing information (proposed paragraphs B67D–B67G of IFRS 3)
The IASB is proposing to exempt an entity from disclosing some of the information that would be required applying the proposals in this Exposure Draft in specific circumstances. The exemption is designed to respond to preparers' concerns about commercial sensitivity and litigation risk but is also designed to be enforceable and auditable so that it is applied only in the appropriate circumstances (see paragraphsBC74–BC107). The IASB proposes that, as a principle, an entity be exempt from disclosing some information if doing so can be expected to prejudice seriously the achievement of any of the entity's acquisition-date key objectives for the business combination (see paragraphs BC79–BC89). The IASB has also proposed application guidance (see

paragraphs BC90–BC107) to help entities, auditors and regulators identify the circumstances in which an entity can apply the exemption.

(a) Do you think the proposed exemption can be applied in the appropriate circumstances? If not, please explain why not and suggest how the IASB could amend the proposed principle or application guidance to better address these concerns.

(b) Do you think the proposed application guidance would help restrict the application of the exemption to only the appropriate circumstances? If not, please explain what application guidance you would suggest to achieve that aim.

Comment:

We agree with the IASB's proposal to introduce an exemption; however, it is essential to obtain understanding of the stakeholders that such exemption would be likely to increase the relevant disclosure workload including the audit thereof. Moreover, further clarification is needed for the exemption requirement.

If management wants to consider applying the exemption, it would become quite burdensome for auditors to evaluate whether or not disclosing certain information can prejudice seriously the achievement of any of the entity's key objectives for the business combination. In evaluating the appropriateness of applying the exemption, auditors would need to discuss with management and perform additional audit procedures, which require involvement of experienced auditors. Therefore, upon developing the IFRS Standard, the IASB should put effort into consulting with preparers and users of financial statements to obtain their understanding of the expected increased costs associated with additional work including audit related.

We also suggest that further clarification be made for the exemption requirement, as it does not provide specific cases where the exemption can be applied. Practical and detailed examples should be added to application guidance, including cases where the exemption can be applied in practice, cases where the exemption cannot be applied in spite of similar circumstances, and cases where aggregation is appropriate. Although we find the current proposed application guidance and explanations in the Basis for Conclusions to be informative, we believe having more detailed examples would better help understanding among constituents, thereby contributing to an appropriate, consistent application of the exemption.

Further, we note the IASB referred to the exemption in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in developing the proposed exemption. As we understand the application of the exemption in IAS 37 is extremely rare, the intent of the

IASB is not clear in the Exposure Draft. In particular, disclosures about strategic business combinations whose contracts are signed or initial integration processes are completed do not seem to prejudice seriously the achievement of any of the entity's key objectives for the business combination at the acquisition date, which indicates that the proposed exemption cannot be applied in most cases. If this understanding is correct, we recommend the Board to clarify the intent.

Question 4—Disclosures: Identifying information to be disclosed (proposed paragraphs B67A–B67B of IFRS 3)
The IASB is proposing to require an entity to disclose information about the performance of the entity's strategic business combinations (that is, information about its acquisition-date key objectives and related targets for a strategic business combination and whether these key objectives and related targets are being met) that is reviewed by its key management personnel (see paragraphs BC110–BC114). The IASB's proposals would require an entity to disclose this information for as long as the entity's key management personnel review the performance of the business combination (see paragraphs BC115–BC120). The IASB is also proposing (see paragraphs BC121–BC130) that if an entity's key management personnel: · do not start reviewing, and do not plan to review, whether an acquisition-date key objective and the related targets for a business combination are met, the entity would be required to disclose that fact and the reasons for not doing so; · stop reviewing whether an acquisition-date key objective and the related targets for a business combination are met before the end of the second annual reporting period after the year of acquisition, the entity would be required to disclose that fact and the reasons it stopped doing so; and have stopped reviewing whether an acquisition-date key objective and the related targets for a business combination are met but still receive information about the metric that was originally used to measure the achievement of that key objective and the related targets, the entity would be required to disclose information about the metric during the period up to the end of the second annual reporting period after the year of acquisition. (a) Do you agree that the information an entity should be required to disclose should be the information reviewed by the entity's key management personnel? Why or why not? If not, how do you suggest an entity be required to identify the information to be disclosed about the performance of a strategic business combination? (b) Do you agree that: (i) an entity should be required to disclose information about the performance of a business combination for as long as the entity's key management personnel review that information? Why or why not?

(ii) an entity should be required to disclose the information specified by the proposals when the entity's key management personnel do not start or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period? Why or why not?

Comment:

Although we agree with the IASB's proposal, clarity should be given to the definition of 'review' so that we can assess whether the entity's key management personnel are reviewing information as required.

According to proposed paragraphs B67A and B67B of IFRS 3, an acquirer is required to disclose information reviewed by its key management personnel for the performance of a business combination. Further, in paragraph BC111, the IASB is concluding that defining management is an easier way to make this distinction than defining in detail what reviewing a business combination's performance means. As there are various types of information provided to management, it would be difficult, in practice, to clearly determine what kind of information management reviews that falls into the scope of 'review' referred to in the Exposure Draft. For example, information provided could be a piece of data included in regular reports to management, or it could be information scrutinised by management for its decision-making purposes. We strongly suggest a practical guidance be provided to clarify how and when we can say that a 'review' is properly conducted or not.

Question 5—Disclosures: Other proposals

The IASB is proposing other amendments to the disclosure requirements in IFRS 3.

These proposals relate to:

New disclosure objectives (proposed paragraph 62A of IFRS 3)

The IASB proposes to add new disclosure objectives in proposed paragraph 62A of IFRS 3 (see paragraphs BC23–BC28).

Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)

The IASB proposes:

- to require an entity to describe expected synergies by category (for example, revenue synergies, cost synergies and each other type of synergy);
- to require an entity to disclose for each category of synergies:

- the estimated amounts or range of amounts of the expected synergies;
- the estimated costs or range of costs to achieve these synergies; and
- the time from which the benefits expected from the synergies are expected to start and how long they will last; and

- to exempt an entity from disclosing that information in specific circumstances.

See paragraphs BC148–BC163.

The strategic rationale for a business combination (paragraph B64(d) of IFRS 3)

The IASB proposes to replace the requirement in paragraph B64(d) of IFRS 3 to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination (see paragraphs BC164–BC165).

Contribution of the acquired business (paragraph B64(q) of IFRS 3)

The IASB proposes to amend paragraph B64(q) of IFRS 3 to improve the information users receive about the contribution of the acquired business (see paragraphs BC166–BC177). In particular, the IASB proposes:

- to specify that the amount of profit or loss referred to in that paragraph is the amount of operating profit or loss (operating profit or loss will be defined as part of the IASB's Primary Financial Statements project);
- to explain the purpose of the requirement but add no specific application guidance; and
- to specify that the basis for preparing this information is an accounting policy.

Classes of assets acquired and liabilities assumed (paragraph B64(i) of IFRS 3)

The IASB proposes to improve the information entities disclose about the pension and financing liabilities assumed in a business combination by deleting the word 'major' from paragraph B64(i) of IFRS 3 and adding pension and financing liabilities to the illustrative example in paragraph IE72 of the Illustrative Examples accompanying IFRS 3 (see paragraphs BC178–BC181).

Deleting disclosure requirements (paragraphs B64(h), B67(d)(iii) and B67(e) of IFRS 3)

The IASB proposes to delete some disclosure requirements from IFRS 3 (see paragraphs BC182–BC183).

Do you agree with the proposals? Why or why not?

Comment:

Although we generally agree with the IASB's proposal, we strongly recommend the Exposure Draft should clarify the definition and scope of expected synergies subject to disclosures. The scope of expected synergies to be assured should also be clarified to avoid any expectation gaps.

We are concerned that diversity in disclosures may arise as the definition and scope of expected synergies are not clear enough in the Exposure Draft. As a result, we may see more information disclosures with a lack of comparability and reliability, and also information that is difficult to audit (or information that may cause an expectation gap toward an audit).

For example, while an acquisition price is determined at the time of acquiring a business, the Exposure Draft does not clarify whether the scope of expected synergies should only include synergy effects reflected in the acquisition price, or can also include those not reflected in the acquisition price. When an acquisition price is negotiated, an acquirer does not always provide a counterparty with detailed information on synergy effects in accordance with its business strategy. Instead, in many cases, an acquisition price is determined through a series of negotiations, where expected synergy effects are not always factored into the acquisition price. Therefore, we suggest the IASB clarify quantitative information subject to disclosures.

In detail, we recommend making some revisions to the following disclosure requirements for expected synergies:

- According to paragraph B64(ea), an entity is required to describe expected synergies by category. However, in practice, some entities may not have information on the estimated amounts, costs and time for each of the proposed category of synergies. As the Exposure Draft allows entities to disclose estimated synergies aggregated in total when there are concerns about commercial sensitivity and litigation risk, therefore, IASB should allow entities to disclose those quantitative information on synergies aggregated in total, not by category regardless of whether there are concerns about commercial sensitivity and litigation risk.
- According to paragraph B64(ea)(ii), an entity is required to disclose the estimated cost or range of costs to achieve expected synergies. A typical example of such costs will be lay-off costs arising from restructurings conducted after business combination. However, as it is generally extremely difficult to disclose any restructuring-related information before making public announcements in conformity with human resource policies, entities should be allowed to disclose estimated synergies aggregated in total, including such costs.
- Provided that clarifications would be made for the definition and scope of expected synergies, we agree with the IASB's proposal in paragraph B64(ea)(iii) to require entities to disclose the time from which the benefits from the synergies are expected to start and for how long they are expected to last. Although we are basically against

the proposal of disclosing information on estimated synergies by category, we have a comment on the illustrative example in paragraph IE72, which lays out expected synergy disclosures by category. We note that the example in paragraph IE72 only refers to the year 20X4, which represents the time when the benefit of revenue synergies is expected to start. Thus, we recommend including information on how long the benefit is expected to last. If the benefits from the revenue synergies are expected to be indefinite, the fact should be disclosed. Although the Exposure Draft requires entities to disclose the time from which the benefits from the synergies are expected to start and for how long they are expected to last, the illustrative example in paragraph IE72 appears to be inconsistent with the requirement.

- According to paragraph BC160 (a) in the Basis for Conclusions, the IASB decided not to provide a definition of expected synergies, insisting that ‘synergy’ is a term already widely understood by referring to a definition obtained through its research of a number of dictionaries. Although the definition in dictionaries is easy to understand, such definition may widen the scope of synergies. If the IASB intends to prove that the term ‘synergy’ is widely understood, we think it is more appropriate from a standard-setting perspective to indicate that expected synergies represent ‘Component 4,’ part of goodwill referred to in paragraph BC313 of IFRS 3.

Another point is that when management discloses information on expected synergies, auditors can check the consistency of such information, as part of their financial statement audit procedures, with valuation reports and internal approval documents, but cannot determine the reasonableness of the information. ISA 200 *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing* defines financial statements as "structured representation of historical financial information". Therefore we believe that assurance on the amount and time of expected synergies might be out of scope of financial statement audits. That said, if financial statements, including such footnote information, are issued with an audit report attached, it can mislead the users of financial statements, who may, for example, believe that the reasonableness of expected synergies and the possibility of their achievement are also subject to audits. Therefore, in order to avoid creating those expectation gaps, we suggest the IASB require additional disclosures to be made in the notes to the financial statements, describing that the disclosure information on expected synergies is based on the acquisition-date expectation of management and its subjective evaluation. The IASB can also include a description in the Basis for Conclusions, pointing

out that auditors do not provide assurance on the reasonableness of such information. Even if we clarify the subject of audit in such a way, though, we expect audit procedures and involvement of experienced auditors will increase to a certain extent to conform with the proposed disclosure requirements. Accordingly, as we commented in Question 1, we strongly suggest the IASB carefully consult with stakeholders throughout developing the IFRS Standard to achieve the following: reconsider whether such proposed disclosures should be required as part of financial statements from a view point of striking the right balance between benefits and costs, including auditing costs; and find ways to obtain understanding from stakeholders about the increase in audit procedure.

Question 6—Changes to the impairment test (paragraphs 80–81, 83, 85 and 134(a) of IAS 36)

During the PIR of IFRS 3, the IASB heard concerns that the impairment test of cash-generating units containing goodwill results in impairment losses sometimes being recognised too late.

Two of the reasons the IASB identified (see paragraphs BC188–BC189) for these concerns were:

- shielding; and
- management over-optimism.

The IASB is proposing amendments to IAS 36 that could mitigate these reasons (see paragraphs BC192–BC193).

Proposals to reduce shielding

The IASB considered developing a different impairment test that would be significantly more effective at a reasonable cost but concluded that doing so would not be feasible (see paragraphs BC190–BC191).

Instead, the IASB is proposing changes to the impairment test (see paragraphs 80–81, 83 and 85 of IAS 36) to reduce shielding by clarifying how to allocate goodwill to cash-generating units (see paragraphs BC194–BC201).

Proposal to reduce management over-optimism

The IASB's view is that management over-optimism is, in part, better dealt with by enforcers and auditors than by amending IAS 36. Nonetheless, the IASB is proposing to amend IAS 36 to require an entity to disclose in which reportable segment a cash-generating unit or group of cash-generating units containing goodwill is included (see paragraph 134(a) of IAS 36). The IASB expects this information to provide users with better information about the assumptions used in the impairment test and therefore allow users to better assess whether an entity's assumptions are over-optimistic (see paragraph BC202).

(a) Do you agree with the proposals to reduce shielding? Why or why not?

(b) Do you agree with the proposal to reduce management over-optimism? Why or

why not?

Comment:

We support the IASB's considerate approach trying to reduce the shielding effect; however, we are afraid the proposal can only serve as a tentative one, unless further improvement is made to address concerns about impairment losses on goodwill being recognised too late.

We, as auditors, are keenly aware of the importance of dealing with the issue of management over-optimism, and we have put a lot of effort to improve the situation. At the same time, we understand all the deliberations made in the past, including the conclusion about the difficulty of making a fundamental improvement to the impairment testing as well as the IASB's tentative decisions made over the long journey regarding the reintroduction of amortisation of goodwill. Also, we very much appreciate the IASB's proposal in the Exposure Draft.

That said, we are still concerned that the IASB's proposal may not be convincing enough to justify that no more deliberations are needed for a fundamental improvement, including the reintroduction of the amortisation of goodwill. We hope the IASB will reconsider the matter as necessary, including the reintroduction of the amortisation of goodwill, depending on feedback that will be received from market participants and other stakeholders after the implementation of the IASB's proposal.

Also, in the above-mentioned question, the IASB is proposing to 'clarify' how to allocate goodwill to cash-generating units. However, if the IASB truly wants to change the practice to reduce shielding, we recommend the IASB treat the amendments as 'adding or amending guidance', instead of 'clarifying' allocation, because the word 'clarifying' could give an impression that the previous allocation was inappropriate if it was changed due to the amendments.

Question 7—Changes to the impairment test: Value in use (paragraphs 33, 44–51, 55, 130(g), 134(d)(v) and A20 of IAS 36)
The IASB is proposing to amend how an entity calculates an asset's value in use. In particular, the IASB proposes: ・ to remove a constraint on cash flows used to calculate value in use. An entity would no longer be prohibited from including cash flows arising from a future restructuring to which the entity is not yet committed or cash flows arising from improving or enhancing an asset's performance (see paragraphs BC204–BC214).

- to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use. Instead, an entity would be required to use internally consistent assumptions for cash flows and discount rates (see paragraphs BC215–BC222).

(a) Do you agree with the proposal to remove the constraint on including cash flows arising from a future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance? Why or why not?

(b) Do you agree with the proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use? Why or why not?

Comment:
We agree with the IASB's proposal to remove a constraint on cash flows used to calculate value in use. However, further guidance is needed for restructurings that should be included in estimated future cash flows as well as cash flows arising from improving or enhancing an asset's performance.

The Exposure Draft requires estimates of future cash flows of an asset in its current condition should only include future cash flows associated with the current potential of the asset to be restructured, improved or enhanced. However, the proposal is not clear as to when cash flows are or are not associated with the current potential of the asset, which may lead to inconsistent application of the requirement in practice. Accordingly, it is not clear as to when an asset or a CGU includes or does not include the current potential of the asset to be restructured, improved or enhanced. It appears Illustrative Examples 5 and 6 in IAS 36 are simply deleted from the proposed Exposure Draft. Instead, we suggest amending the examples or adding new examples, so we can better understand the practical implication.

We support the IASB's decision to remove the requirement of using pre-tax cash flows and discount rates in calculating value in use because, in practice, after-tax cash flows and discount rates are rather common. We believe the proposal would alleviate the current burden on preparers to work out pre-tax amounts only for disclosure purposes.

Question 8—Proposed amendments to IFRS X *Subsidiaries without Public Accountability: Disclosures*

The IASB proposes to amend the forthcoming IFRS X *Subsidiaries without Public Accountability: Disclosures* (Subsidiaries Standard) to require eligible subsidiaries applying the Subsidiaries Standard to disclose:

- information about the strategic rationale for a business combination (proposed paragraph 36(ca) of the Subsidiaries Standard);

- quantitative information about expected synergies, subject to an exemption in specific circumstances (proposed paragraphs 36(da) and 36A of the Subsidiaries Standard);
- information about the contribution of the acquired business (proposed paragraph 36(j) of the Subsidiaries Standard); and
- information about whether the discount rate used in calculating value in use is pretax or post-tax (paragraph 193 of the Subsidiaries Standard).

See paragraphs BC252–BC256.

Do you agree with the proposals? Why or why not?

Comment:

We agree, provided that our above-mentioned comments to the Questions are addressed properly.

Question 9—Transition (proposed paragraph 64R of IFRS 3, proposed paragraph 140O of IAS 36 and proposed paragraph B2 of the Subsidiaries Standard)
The IASB is proposing to require an entity to apply the amendments to IFRS 3, IAS 36 and the Subsidiaries Standard prospectively from the effective date without restating comparative information. The IASB is proposing no specific relief for first-time adopters. See paragraphs BC257–BC263. Do you agree with the proposals? Why or why not? If you disagree with the proposals, please explain what you would suggest instead and why.

Comment:

We believe the IASB should propose specific relief for first-time adopters from the amendments to IFRS 3 disclosure requirements.

According to paragraph BC258, the IASB decided not to propose relief for first-time adopters because they are expected to plan their transition to IFRS Accounting Standards with enough time; however, not all first-time adopters have enough time for preparation.

Further, according to Appendix C of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which stipulates exemptions for business combinations, the requirement should only be applied to business combinations within the scope of IFRS 3. Per paragraph C1 of IFRS 1, a first-time adopter may elect not to apply IFRS 3 retrospectively to past business combinations, which represent those that occurred before the date of transition to IFRSs. At the same time, IFRS 1 does not provide exemptions from presentation and disclosure requirements in other IFRSs in accordance

with paragraph 20 of IFRS 1. That said, it is uncertain as to whether or not the exemption requirement in IFRS 1 is applicable to disclosures about the performance of business combinations proposed in the Exposure Draft.

Therefore, we suggest the IASB develop specific relief for first-time adopters, including exemptions from disclosing information on strategic business combinations that occurred in periods before the beginning of the first IFRS reporting period.

Yours faithfully,

Eriko Otokozawa
Executive Board Member－Business Accounting Standards and Practice/Corporate Disclosure
The Japanese Institute of Certified Public Accountants