

International Accounting Standards Board
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Japanese Bankers Association

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

The Japanese Bankers Association (the “JBA”)¹ is pleased to provide comments on the Exposure Draft Business Combinations—Disclosures, Goodwill and Impairment—Proposed amendments to IFRS 3, and IAS 36 Impairment of Assets (the “ED”) issued by the International Accounting Standards Board (the “IASB”).

The JBA appreciates the work of the IASB and would like to express our views based on comments received from member banks on several of the questions raised in the ED.

Answers to specific questions

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

¹ The Japanese Bankers Association is an organisation that represents the banking industry in Japan. Its members are banks and bank holding companies operating in Japan.

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?

We do not agree with the proposal to require disclosing information about the performance of a strategic business combination.

In many business combinations, the information available to the acquirer from the acquiree by the time that the acquisition occurs is limited. In addition, it is often the case that performance targets will need to be revised as a result of facts discovered after the acquisition. It is also expected that performance targets will need to be updated many times to address rapid changes in regulatory trends, the economic environment, and other factors. These revisions of performance targets include those attributable to the business combination itself, but it is expected that the proportion of those attributable to the acquirer's operations will increase with the passage of time after the business combination. This would not only be inconsistent with the objective of the proposed amendment, "to require entities to provide users with better information about the performance of a business combination at a reasonable cost" (paragraph BC20), but could also cause confusion and misunderstanding among investors.

Therefore, even if the IASB requires disclosing information about the performance of a strategic business combination, we believe that, given these practices by entities, careful consideration should be given to when and for what purpose the objectives should be disclosed, taking into account the costs and benefits.

It should also be considered that, in some cases, information about the performance of a business combination

can be disclosed more flexibly to meet the needs of analysts and investors if it is disclosed in another document as part of the explanation of the entity's business strategy, together with information on forecasts, rather than disclosing in financial statements which are required to be audited.

If the IASB requires entities to disclose information about the performance of a strategic business combination in their financial statements, it would be desirable to provide illustrative examples of common disclosure items (e.g., profit.) for entities from an auditability perspective, while basing on the management approach.

Question 2— Disclosures: Strategic business combinations (proposed paragraph B67C of IFRS 3)
<p>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.</p> <p>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).</p> <p>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).</p> <p>(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?</p> <p>(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?</p>

We do not agree with the proposal to use a threshold approach.

We request to give careful consideration on this issue as setting specific thresholds is inconsistent with the basic idea of the principle-based approach underlying the IFRS. In particular, the effect of setting specific thresholds in the body of the standard would be significant and could lead to formalistic judgments regarding the disclosure of information about the performance of a business combination. Therefore, we request the IASB to consider, for example, an approach to describe numerical values as a guideline in the illustrative

examples, so as to enable flexible implementation.

The IASB proposes to determine whether it is a “strategic business combination” based on the acquirer’s consolidated operating profit or loss in the most recent annual reporting period before the acquisition date (paragraph B67C (a)), but we believe that the use of a single year's performance needs to be reconsidered. For example, industries that hold a large number of financial instruments, such as the financial industry, are subject to high volatility in profit levels. In addition, profit levels may decline temporarily in cases such as when a large amount of fixed assets were impaired in the annual reporting period prior to the acquisition date. In these cases, even business combinations that are not material to the acquirer’s overall business strategy may be subject to disclosure as “strategic business combinations”. For this reason, even if specific thresholds are used as a guideline, the IASB should consider using an average over several years (e.g., three or five years) before the acquisition date.

We believe that the proposal for qualitative thresholds of “the acquirer entering a new major line of business or geographical area of operations” (paragraph B67C(c)) should also be reconsidered. In particular, the requirement of “entering a new geographical area of operations” could result in the disclosure of not only non-strategic business combinations, but also immaterial business combinations for the acquirer. Therefore, it would be appropriate to delete the “geographical area of operations” requirement. In addition, we are concerned that the inconsistency in the disclosure will arise in the following situation: while a business combination that meets the requirement of “the acquirer entering a new major line of business or geographical area of operations” requires the disclosure of information about business performance as long as the acquisition is reviewed by the acquirer’s key management personnel, an entity that enters a new major line of business or geographical area without a business combination would not be required to disclose such information (voluntary disclosure).

Question 3— Disclosures: Exemption from disclosing information (proposed paragraphs B67D–B67G of IFRS 3)

<p>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 paragraphs BC74–BC107).</p>

<p>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.</p>

- (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.

We agree to allow the exemption from the disclosure under certain conditions. However, we request that the conditions for the application of the exemption be relaxed and that the scope of the exemption be expanded.

< Regarding the conditions for application of the exemption >

We believe that the IASB should explicitly stipulate that disclosure is exempted even in cases where damage or disadvantage to the acquiree can be expected. The disclosure of the acquisition-date key objectives for the strategic business combination and the extent to which the targets have been achieved, as proposed in paragraph B67A of the ED involves evaluating and disclosing the financial information and business performance of the acquiree. Therefore, in particular, if the acquiree is a public company, there is a risk of causing confusion among investors and stakeholders and affecting the activities of the acquiree in the capital markets from the perspective of consistency between the disclosure of the acquiree's own financial results and those of the acquirer.

In addition, paragraph BC79 states that an entity can apply the exemption to commercially sensitive information, such as information relating to synergies and objectives of the business combination, only when "a disclosure can be expected to prejudice seriously the achievement of the key objectives". However, since it is excessive and inappropriate to require an entity "can be expected to prejudice seriously", we recommend that the IASB consider changing the wording to "~~can be expected to~~ prejudice seriously the achievement of any of the acquirer's acquisition-date key objectives" or "~~can be expected to~~ prejudice ~~seriously~~ the achievement of any of the acquirer's acquisition-date key objectives".

Highly confidential information such as synergies and objectives in a business combination is affected by factors beyond the control of the entity, and the extent and scope of such effects can vary. For example, it is difficult to predict how disclosure of information, such as information regarding redundancy elimination, will affect employee motivation and engagement, and whether it will cause effects to the extent that the key objectives are significantly impaired. It may also be difficult to predict cost targets, for example, because they can change depending on the actions of competitors.

If a level such as "significant" has to be set, it is necessary to fully consider adding examples of what kind of cases would be applicable.

From an audit perspective, requiring auditors to audit the reasonableness of such forecasts would impose an excessive burden on auditors. The level of “significant” could cause a wide range of variations in judgment, which could create an expectation gap for investors. In addition, entities would be required to disclose information in order to respond to these situations, which could make it very difficult to apply the exemption in practice.

Information about synergies and objectives is sensitive, and therefore the disclosure could result in not only the failure to achieve the key objectives of the business combination, but could even endanger the survival of the entity. Such a situation would be extremely detrimental to the interests of investors as well as the entity.

< Regarding the information to which the exemption applies >

Paragraphs BC87(a) and BC87(b) of the ED provide an exemption from the disclosures about the acquisition-date objectives for a business combination and the qualitative statement of whether actual performance is meeting or has met the objectives after acquisition. On the other hand, the IASB proposes not to exempt an entity from disclosing information about “the actual performance being reviewed to determine whether acquisition-date key objectives and the related targets are being met” (“Performance results”) in paragraph BC88 (b) of the ED. However, given that the disclosure of objectives and the qualitative statements regarding the assessment of the entity’s achievement is exempted, we believe that disclosing only Performance results may mislead investors.

In the case of mergers and other integrations, in practice, performance is often managed on a post-merger basis without distinguishing between the acquirer and the acquiree. We believe that this is only a review of the performance of the integrated entity and does not necessarily indicate the achievement of the purpose for acquiring the entity. The ED proposes to disclose post-merger performance results without allowing the application of the exemption in such cases. However, we are concerned that this is not only inconsistent with the objective of the ED, which is “to require entities to provide users with more useful information about the performance of a business combination at a reasonable cost”, but also may cause significant misunderstanding among investors.

Therefore, we recommend that the IASB consider allowing entities to apply the exemption from the disclosure of performance results, or at least not requiring such disclosure in the case of a merger.

Question 5—Disclosures: Other proposals
<p>The IASB is proposing other amendments to the disclosure requirements in IFRS 3. These proposals relate to:</p> <p>[...]</p> <p>Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)</p>

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.

[...]

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

We disagree with the requirements to disclose quantitative information about expected synergies in the year of acquisition.

In many business combinations, goodwill includes elements other than synergies, and in practice, the amount of synergy is not necessarily quantified and used in entity's key management personnel's decisions in all business combinations. For example, if the profitability of the acquiree is high, goodwill can arise without consideration of synergies, and in some cases the majority of goodwill consists of elements other than synergies. In such cases, additional disclosure costs would be incurred to meet the requirements of paragraph B64(ea) (requirements to disclose quantitative information about expected synergies in the year of acquisition) and would also be contrary to the intent of the management approach.

Therefore, the requirement in paragraph B64(ea) should be deleted, or at least the disclosure of synergies should be exempted if the entity does not calculate quantitative information about synergies for internal management purposes and the entity's key management personnel does not review it.

We believe that if the IASB requires the disclosure of quantitative information on synergies, it is necessary to clarify the definition and duration of synergies that need to be clarified.

Failure to define synergies may lead to confusion in the disclosure decisions of entities and in external audits, which may have a negative impact on investors' decisions. Therefore, consideration should be given to defining synergies to help stakeholders have a shared understanding.

Furthermore, due to the nature of the duration of synergies, such as the useful life of goodwill, it is difficult to provide users of financial statements with a reasonable estimate that excludes arbitrariness, and disclosing such information could be misleading to them*.

*The IASB's research has not concluded on which view is more appropriate: the view that benefits expected from synergies can be maintained over an indefinite period (paragraph BC238); or the view that benefits expected from synergies have finite and the concept of indefinite duration is internally generated (paragraph BC236).

As noted in the answer to Question 1, in many cases, the information available to the acquirer by the time of acquisition is limited, and it is reasonably assumed that the benefits expected from synergies may be revised after the business combination. In addition, the amount of goodwill will be determined after the acquisition based on the purchase price allocation (PPA). In light of these considerations, we believe that disclosing quantitative information about expected synergies at the time of the business combination would be misleading to investors.

In addition, as noted in the answer to Question 3, taking into account that synergies include sensitive information, such as redundancies, careful consideration should be given, such as relaxing the requirements for the application of the exemption.

(End)