REDOVISNINGSRÅDET

**CL 36**

4 April 2003

International Accounting Standards Board
30 Cannon Street
London ED4M 6XH
United Kingdom

**Re: ED 3 *Business Combinations,***
**Proposed Amendments to IAS 36 *Impairment of Assets* and**
**IAS 38 *Intangible Assets***

# General Comments

According to the IASC Foundation Constitution one of the objectives of the Foundation is:

”To develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions”.

The attributes specified in the above quotation, in particular, high quality, understandable and enforceable, require consistency in the process of developing standards. Consistency is also dealt with in the IASB Framework in the context of the description of one of the qualitative characteristics – comparability – where the following is stated: ”Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprises”.

This important characteristic of high quality global accounting standards may not be fully reflected in a number of areas in ED 3, Business Combinations, which is briefly commented upon below:

*1. Recognition of the acquiree's contingent liabilities*

According to ED 3, paragraph 35, the acquirer shall recognise, at acquisition date, the acquiree's identifiable assets, liabilities and contingent liabilities, satisfying certain recognition criteria, at their fair values. This is further developed in BC80-BC85. The proposed treatment of contingent liabilities in a business combination is inconsistent with the treatment of contingent liabilities in entity-specific financial statements under IAS 37 and results in an anomaly in the recognition of contingent liabilities.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

2. *Measurement of contingent liabilities*

According to BC84, contingent liabilities, recognised as part of allocating the cost of a business combination, should be measured after initial recognition at fair value until settled. This is the result of moving the recognition of contingent liabilities in a business combination outside the scope of IAS 37. It is not quite clear why this measurement anomaly between contingent liabilities, arising from a business combination, and other contingent liabilities should exist. The treatment seems to deviate, not only from IAS 37, but also from the treatment of other liabilities that are outside the scope of IAS 37, e.g. deferred tax liabilities.

3. *The treatment of contingent liabilities versus contingent assets*

According to ED 3, paragraph 35, contingent liabilities, but not contingent assets, satisfying certain recognition criteria, shall be recognised in a business combination.

According to BC85, the Board is considering, as part of the second phase of its business combination project, whether the contingent assets of the acquiree should also be recognised separately, as part of allocating the cost of a business combination.

However, there is an inconsistency in ED 3 itself, as regards the recognition of contingent assets and liabilities.

4. *Effects of circumstances that may have depressed the purchase price for the acquirer*

According to BC85, negative goodwill, as determined under IAS 22, could arise as a result of, amongst other things, the failure to recognise the contingent liabilities of the acquiree, for which the acquirer has been paid in the form of a reduced purchase price. The proposal to recognise contingent liabilities in a business combination is, therefore, related to the existence of the acquiree's contingent liabilities and their perceived effect on the purchase price.

According to BC112, expectations of future losses and expenses may have the effect of depressing the price that an acquirer is prepared to pay for the acquiree. Although such expectations of future losses and expenses should be taken into account when assessing the fair values of the acquired net assets, they should, however, not be reflected in the consolidated financial statements when recognising provisions for restructurings.

Therefore, there is an inconsistent approach regarding circumstances of a similar nature, that might affect the purchase price in a business combination.

5. *The treatment of in-process research and development projects*

According to ED 3, paragraph 36(c), in-process research and development projects, meeting the definition of intangible assets, should be recognised separately in a business combination.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

It is acknowledged in BC79 that this treatment differs from the treatment of similar, internally initiated projects. As pointed out by the Board, this highlights the need to reconsider the view taken in IAS 38 that an intangible asset can never exist in respect of an in-process research project and that it can exist, in respect of an in-process development project, only when certain criteria have been satisfied. For the time being, however, the proposed treatment of in-process research and development projects in ED 3 creates an inconsistency.

It would be more in line with IAS 38 to recognise only development projects as assets, but not research projects.

6. *The treatment of goodwill and negative goodwill*

According to ED 3, paragraph 50, goodwill acquired in a business combination should be recognised as an asset. The total cost of the business combination would, therefore, be reflected in the consolidated financial statements, as the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities, contingent liabilities and goodwill.

According to ED 3, paragraph 55, any excess of the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the acquisition, should, under certain circumstances, be recognised in profit or loss immediately. As a result, the cost of the business combination would be reflected in the consolidated financial statements at a value exceeding the acquisition cost.

Therefore, there is an inconsistency: goodwill and the excess over the fair value of the acquiree's net assets are treated differently in the financial statements (cost and higher than cost, respectively).

7. *Impairment versus amortisation*

According to ED 3, paragraphs 53 and 54, goodwill acquired in a business combination shall not be amortised, but tested for impairment annually or more frequently, if needed. This is further developed in BC103-BC108. This is not consistent with the approach taken towards other intangible and tangible assets that do not have indefinite useful lives.

The BC does not include any convincing arguments as to the reason that one approach – impairment test – should be used in one case and another approach – amortisation – in other, similar cases. This would appear to be an inconsistency.

8. *Proposed changes affecting the Framework*

The most fundamental issue is the inconsistency between the recognition criteria applying to (1) liabilities and contingent liabilities in IAS 37 and the Framework and (2) the fair value measurement of the cost of a business combination. As is further discussed in BC82, this has led the Board to conclude that the role of probability in the Framework should be considered more generally as part of a later Concepts project. However, for the time being, the Framework remains unchanged. It seems odd to propose an amendment to one particular standard, but leave the Framework, and all other standards based on the recognition criteria of the Framework, unchanged. In our opinion, the Framework should be considered first and possibly, as a result of relevant considerations, be amended. Thereafter, the standards, not only one standard but all relevant standards, might be amended to be in line with the language in the amended Framework.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

We understand that some of the inconsistencies commented upon above are intended to be addressed in forthcoming projects. We also understand that some inconsistencies may have resulted from the ambition to achieve convergence with US GAAP. Nevertheless, as indicated above, we are concerned about the route taken by the Board in ED 3 and in the proposed amendments to IAS 36 and IAS 38. The way forward, as proposed by the Board, will create, at least for a period of time, a number of inconsistencies in a set of global accounting standards which should be principle-based and characterised, amongst other things, by internal consistency.

## Response to Specific Questions

### ED 3, Question 1 – Scope

*The Exposure Draft proposes:*

(a) *to exclude from the scope of the IFRS business combinations in which separate entities or operations of entities are brought together to form a joint venture, and business combinations involving entities under common control (see proposed paragraphs 2 and 3 and paragraphs BC9-BC11 of the Basis for Conclusions).*

*Are these scope exclusions appropriate? If not, why not?*

(b) *to include in the IFRS a definition of business combinations involving entities under common control, and additional guidance on identifying such transactions (see proposed paragraphs 9-12 and Appendix A, and paragraphs BC12-BC15 of the Basis for Conclusions).*

*Are the definition and additional guidance helpful in identifying transactions within the scope exclusion? If not, what additional guidance would you suggest, and why?*

### Response

a) Yes.

b) Yes.

### ED 3, Question 2 – Method of accounting for business combinations

*The Exposure Draft proposes to eliminate the use of the pooling of interests method and requires all business combinations within its scope to be accounted for by applying the purchase method (see proposed paragraphs 13-15 and paragraphs BC18-BC35 of the Basis for Conclusions).*

*Is this appropriate? If not, why not? If you believe the pooling of interests method should be applied to a particular class of transactions, what criteria should be used to distinguish those transactions from other business combinations, and why?*



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

**Response**

Yes.

However, we question if the pooling of interests method should be eliminated already in phase 1 of the project. There might exist rare circumstances in which an acquirer cannot be identified and in which the fresh start method might be appropriate. We feel, therefore, that it might be premature to single out one approach for all business combinations prior to a comprehensive examination of the potential of the fresh start method being completed.

## ED 3, Question 3 – Reverse acquistions

*Under IAS 22 Business Combinations, a business combination is accounted for as a reverse acquisition when an entity (the legal parent) obtains ownership of the equity of another entity (the legal subsidiary) but, as part of the exchange transaction, issues enough voting equity as consideration for control of the combined entity to pass to the owners of the legal subsidiary. In such circumstances, the legal subsidiary is deemed to be the acquirer. The Exposure Draft:*

*(a) proposes to modify the circumstances in which a business combination could be regarded as a reverse acquisition by clarifying that for all business combinations effected through an exchange of equity interests, the acquirer is the combining entity that has the power to govern the financial and operating polices of the other entity (or entities ( so as to obtain benefits from its (or their) activities. As a result, a reverse acquision occurs when the legal subsidiary has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities (see proposed paragraph 21 and paragraphs BC37-BC41 of the Basis for Conclusions).*

*Is this an appropriate description of the circumstances in which a business combination should be accounted for as a reverse acquisition? If not, under what circumstances, if any, should a business combination be accounted for as a reverse acquisition?*

*(b) proposes additional guidance on the accounting for reverse acquisitions (see proposed paragraphs B1-B14 of Appendix B).*

*Is this additional guidance appropriate? If not, why not? Should any additional guidance be included? If so so, what specific guidance should be included?*

## Response

(a) No.

We believe that the description of the circumstances in which a business combination should be accounted for as a reverse acquisition should include more precise, but not more detailed, guidance. We observe that ED 3, paragraph 21 states only that ”all pertinent facts and circumstances shall be considered to determine which of the combining entities has the power to govern the financial and operating policies of the entity” and that a large part of the paragraph consists of only an example. Against this background, we believe that the standard should indicate



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

(i) facts and circumstances related to the owners of the entities (e.g. the interaction between voting power, composition of the board (immediately after the business combination and afterwards) and the board's decision-making process) and also

(ii) other facts and circumstances

that may constitute a legal subsidiary's control over its parent, and how to assess the relative importance of such facts and circumstances.

(b) Yes.

We believe that the guidance for the reverse acquisition, as such, is appropriate.

However, we believe that the new standard (or possibly the revised IAS 27) should also include guidance for the case in which the legal parent, accounted for in a reverse acquisition, ceases to fall within the definition of a subsidiary (from an accounting point of view), as we question that IAS 27, paragraphs 24 and 25, could be applied to a group of companies in which the business combination has been accounted for as a reverse acquisition.

## ED 3, Question 4 – Identifying the acquirer when a new entity is formed to effect a business combination

*The Exposure Draft proposes that when a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination should be adjudged the acquirer on the evidence available (see proposed paragraph 22 and paragraphs BC42-BC46 of the Basis for Conclusions).*

*Is this appropriate? If not, why not?*

## Response

Yes.

However, we believe that the standard should provide further clarification as to how to account for the business combination in this case, for example on the basis of an Illustrative Example.

## ED 3, Question 5 – Provisions for terminating or reducing the activities of the acquiree

*Under IAS 22, an acquirer must recognise as part of allocating the cost of a business combination a provision for terminating or reducing the activities of the acquiree (a 'restructuring provision') that was not a liability of the acquiree at the acquisition date, provided the acquirer has satisfied specified criteria. The Exposure Draft proposes that an acquirer should recognise a restructuring provision as part of allocating the cost of a business combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets (see proposed paragraph 40 and paragraphs BC55-BC66 of the Basis for Conclusions).*



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

*Is this appropriate? If not, what criteria should an acquirer be required to satisfy to recognise a restructuring provision that was not a liability of the acquiree as part of allocating the cost of a combination, and why?*

## Response

Yes.

However, see the last section in our response to ED 3, Question 6, in which we comment upon the inconsistency in the accounting treatment, according to ED 3, of contingent liabilities, contingent assets and provisions for terminating or reducing the activities of the acquiree.

## ED 3, Question 6 – Contingent liabilities

*The Exposure Draft proposes an acquirer should recognise separately the acquiree's contingent liabilities at the acquisition date as part of allocating the cost of a business combination, provided the fair values can be measured reliably (see proposed paragraphs 36 and 45 and paragraphs BC80-BC85 of the Basis for Conclusions).*

*Is this appropriate? If not, why not?*

## Response

No.

We believe that contingent liabilities should be recognised separately only when they satisfy the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

We note that the criteria in ED 3 for the recognition of contingent liabilities in business combinations represent a departure from the Framework, as well as from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.* According to our opinion, changes in recognition criteria should not be introduced ad hoc, as in this case, but should be made in a logical and systematic manner. This implies that the procedure should start with a comprehensive study of the issue in question, which may result in changes in the Framework. Then, and only then, should the individual standards be amended. These amendments should be implemented simultaneously in all applicable standards in order to avoid inconsistencies.

We, thus, believe that the suggestion in ED 3 to recognise contingent liabilities in connection with business combinations should be withdrawn for the time being, awaiting the result of a general consideration of the role of probability in a later Concepts project.

We agree that the purchase price of the acquired entity may include an allowance for contingent liabilities but we are not convinced that the fair values of the contingent liabilities can be measured reliably, other than in a few cases.

We observe that subsequent changes in the fair values of contingent liabilities assumed in a business combination will be recognised in profit and loss, while the same type of changes regarding other contingent liabilities will not. This inconsistency will, no doubt, impair the information provided in the financial statements.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

We observe the inconsistency in the accounting treatment, according to ED 3, of contingent liabilities, contingent assets and provisions for terminating or reducing the activities of the acquiree, which all influence the cost of the business combination. While the rules in ED 3 concerning the two latter items are in agreement with the Framework, the rules concerning contingent liabilities are not. We can not find any convincing arguments for this inconsistency.

### ED 3, Question 7 – Measuring the identifiable assets acquired and liabilities and contingent liabilities assumed

*IAS 22 includes a benchmark and an allowed alternative treatment for the initial measurement of the identifiable net assets acquired in a business combination, and therefore for the initial measurement of any minority interests. The Exposure Draft proposes requiring the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocationg the cost to be measured initally by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree will be stated at the minority's proportion of the net fair values of those items. This proposal is consistent with the allowed alternative treatment in IAS 22 (see proposed paragraphs 35 and 39 and paragraphs BC88-BC95 of the Basis for Conclusions).*

*Is this appropriate? If not, how should the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of a business combination be measured when there is a minority interest in the acquiree, and why?*

### Response

Yes.

However, as stated in our response to ED 3, Question 6, we do not agree with the proposed recognition of contingent liabilities in a business combination.

Furthermore, as stated above, we do not see any convincing arguments for treating contingent assets differently from contingent liabilities.

### ED 3, Question 8 – Goodwill

*The Exposure Draft proposes that goodwill acquired in a business combination should be recognised as an asset and should not be amortised. Instead, it should be accounted for after initial recognition at cost less any accumulated impairment losses (see proposed paragraphs 50-54 and paragraphs BC96-BC108 of the Basis for Conclusions).*

*Do you agree that goodwill acquired in a business combination should be recognised as an asset? If not, how should it be accounted for initally, and why? Should goodwill be accounted for after intital recognition at cost less any accumulated impairment losses? If not, how should it be accounted for after initial recognition, and why?*



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

## Response

We agree that goodwill acquired in a business combination should be recognised as an asset.

We do not agree that goodwill should be accounted for after initial recognition at cost less accumulated impairment losses, without amortisation, as proposed in ED 3.

We recommend the Board to retain the principles in the current IAS 22 *Business Combinations* as the only alternative for the accounting for goodwill after intitial recognition. However, we believe that IAS 22 should be improved, as indicated below.

Our rejection of the proposal in ED 3 is based on deficiencies in the proposed impairment test:

- The test, as drafted, is not appropriate as it makes no distinction between goodwill acquired in a business combination and internally generated goodwill. As a consequence, the test does not measure what it should measure, namely, acquired goodwill, but, instead, measures the cash-generating unit's *total* goodwill. This deficiency could easily lead to the recognition of internally generated goodwill, which is in conflict with IAS 38. In fact, this will probably normally be the case.

- The test has not been sufficiently tested and proven in practice.

- The reliability of the estimates on which the cash flow projections in the test are based, can vary considerably between different industries and entities.

- The test is complex, expensive and time-consuming.

- The application of the test requires that the entities must provide information that may be sensitive from a business point of view.

We, therefore, believe that the test cannot be used as the only measurement tool without serious consequences as regards the quality of the financial information provided concerning goodwill.

On the other hand, we believe that the impairment test is a valuable complement to amortisation. This application of the impairment test puts fewer requirements on the test. In this case, the sensitive information mentioned above may not be required.

We believe that the alternative ”amortisation combined with impairment tests” has merits that are not fully expressed in the Basis for Conclusions (except in the ”alternative views” of the two dissidents). Amortisation of goodwill is a well-established and well-understood practice. It is transparent and targeted only on acquired goodwill and, therefore, prevents acquired goodwill from being retained in the balance sheet for an undetermined number of years, which may happen with the alternative ”impairment tests only”, by which internally generated goodwill acts as a ”cushion” against write-downs of goodwill which would have otherwise been made.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

The main criticism, in the Basis for Conclusions (BC107), of amortisation is that the useful life of acquired goodwill, and the pattern in which it diminishes, generally are not possible to predict. We note, however, that IAS 22 contains, in fact, some guidelines for the estimation of the useful life of goodwill. We believe that these guidelines could be improved, e.g. by examples illustrating the determination of useful lives in different situations.

Even before the introduction of such improvements, and still to a greater degree after their introduction, we believe that the alternative ”amortisation combined with impairment tests” would not be less precise than the alternative ”impairment tests only”, given the deficiencies in the tests as commented upon above.

**ED 3, Question 9 – Excess over the cost of a business combination of the acquirer’s interest in the net fair value of the acquiree’s identifiable assets, liabilities and contingent liabilities**

*In some business combinations, the acquirer’s interest in the net fair value of the acquiree’s identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of the combination exceeds that cost. The Exposure Draft proposes that when such an excess exists, the acquirer should:*

*(a) reassess the identification and measurement of the acquiree’s identifiable assets, liabilities oand contingent liabilities and the measurement of the cost of the combination; and*

*(b) recognise immediately in profit or loss any excess remaining after that reassessment.*

*(See proposed paragraphs 55 and 56 and paragraphs BC109-BC120 of the Basis for Conclusions).*

*Is this treatment appropriate? If not, how should any such excess be accounted for, and why?*

### Response

No.

We believe that all aspects relating to the accounting treatment of ”the excess” have yet to be fully investigated, as stated, for example, in BC116. Therefore, we are of the opinion that the requirements in IAS 22 should be retained in phase I of the Business Combinations project, awaiting the completion of a comprehensive study of the total issue in phase II.

We question the possibility to allow deviations from the normal principle that a business transaction is an exchange of equal values. The reason for our position is that we believe that it would be extremely difficult to define situations (e.g. in the form of a definition of bargain purchase) in which such a deviation would be justified. In any case a deviation should be supported by appropriate evidence. We note that no attempt to present such evidence has been made in ED 3.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

Therefore, we question the following consequences of the position taken i n ED 3:

- Business combinations resulting in goodwill are treated differently from business combinations resulting in an ”excess”. In the first case, the acquired net assets, including goodwill, are measured at cost and no gain or loss is recognised. In the second case, the acquired net assets are measured at what is deemed to be fair value and a gain is recognised immediately.

- An excess, remaining after the reassessment of the measurement of the acquiree’s identifiable assets, liabilities and contingent liabilities, might arise for several reasons, as indicated in BC111. We note that some of these, probably the most frequent ones, are due to measurement imperfections. We find it inappropriate that amounts resulting from such imperfections should be recognised immediately as gains in profit or loss.

We further question that the treatment of “the excess” in ED 3, is in agreement with the working principle for the application of the purchase method to be applied in phase II, as stated in “Project Updates 2003/03/01”:

> *“Basis underlying the decision to measure a business combination from either side of the transaction*
>
> The accounting for a business combination is based on the assumption that the transaction is an arm’s-length transaction in which independent and willing parties exchange equal values, and, accordingly, absent evidence to the contrary, the consideration paid by the acquirer is representative of the fair value of the acquirer’s interest in the business over which it obtains control (the acquireee).
>
> *The working principle*
>
> In a business combination the total amount to be recognized by the acquirer should be the fair value of the acquiree. Assuming an exchange of equal values, that amount may be measured through direct measurement of the fair value of the acquiree or based on the fair value of the consideration paid, whichever is more clearly evident of the fair value of the acquiree.”

We cannot see how the above principle is reflected in ED 3. Particularly, we do not find any language, in ED 3, indicating that the “evidence to the contrary” sentence has been properly addressed. We, therefore, see a risk that the proposed treatment of “the excess” in ED 3 will have to be revisited and amended in phase II.

Generally speaking, we cannot see that the changes proposed in ED 3 will lead to improved financial information, but, rather, anticipate that the opposite may be the case.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

## ED 3, Question 10 – Completing the inital accounting for a business combination and subsequent adjustments to that accounting

*The Exposure Draft proposes that:*

*(a) if the inital accounting for a business combination can be determined only provisionally by the end of the reporting period in which the combination occurs because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer should account for the combination using those provisional values. Any adjustment to those values as a result of completing the inital accounting is to be recognised within twelve months of the acquisition date (se proposed paragraphs 60 and 61 and paragraphs BC123-BC126 of the Basis for Conclusions).*

*Is twelve months from the acquisition date sufficient time for completing the accounting for a business combination? If not, what period would be sufficient, and why?*

*(b) with some exceptions carried forward as an interim measure from IAS 22, adjustments to the initial accounting for a business combination after accounting is complete should be recognised only to correct an error (see proposed paragraphs 62 and 63 and paragraphs BC127-BC132 of the Basis for Conclusions).*

*Is this appropriate? If not, under what other circumstances should the initial accounting be amended after it is complete, and why?*

### Response

a) Yes.

b) Yes.

We assume that paragraphs 62 and 63 do not prohibit changes in the initial accounting for business combinations as a consequence of amendments to IFRSs stipulating retrospective application, reflecting changes in accounting policies. This should be clarified in the new IFRS, replacing IAS 22.

## IAS 36, Question 1 – Frequency of impairment tests

*Are the proposals relating to the frequency of impairment testing intangible assets with indefinite useful lives and acquired goodwill appropriate (see proposed paragraphs 8 and 8A and paragraphs C6, C7 and C41 of the Basis for Conclusions)? If not, how often should such assets be tested for impairment, and why?*

### Response

No.

We believe that the testing for impairment of goodwill and other intangible assets with indefinite lives should be performed on the same date, as the testing of other intangible assets is conceptually related to the testing of goodwill.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

### IAS 36, Question 2 – Intangible assets with indefinite useful lives

*The Exposure Draft proposes that the recoverable amount of an intangible asset with an indefinite useful life should be measured, and impairment losses (and reversals of impairment losses) for such assets accounted for, in accordance with the requirements in IAS 36 for assets other than goodwill (see paragraphs C10-C11 of the Basis for Conclusions).*

*Is this appropriate? If not, how should the recoverable amount be measured, and impairment losses (and reversals of impairment losses) be accounted for?*

### Response

Yes.

### IAS 36, Question 3 – Measuring value in use

*The Exposure Draft proposes additional guidance on measuring the value in use of an asset. Is this additional guidance appropriate? In particular:*

*(a) should an asset's value in use reflect the elements listed in proposed paragraphs 25A? If not, which elements should be excluded or should any additional elements be included? Also, should an entity be permitted to reflect those elements either as adjustments to the future cash flows or adjustments to the discount rate (see proposed paragraph 26A and paragraphs C66 and C67 of the Basis for Conclusions)? If not, which approach should be required?*

*(b) should the assumptions on which cash flow projections are based take into account past actual cash flows and management's past ability to forecast cash flows accurately (see proposed paragraph 27(a)(ii) and paragraphs C66 and C67 of the Basis for Conclusions)? If not, why not?*

*(c) is the additional guidance in proposed Appendix B to (draft) IAS 36 on using present value techniques in measuring an asset's value in use appropriate? If not, why not? Is it sufficient? If not, what should be added?*

### Response

a) Yes, we believe that an asset's value in use should reflect the elements stated in paragraph 25A. We believe that an entity should be permitted to use any of two adjustment techniques indicated in paragraph 26A.

b) Yes.

c) Yes.

We would like to stress, as indicated in our response to ED 3, Question 8, that we do not agree that goodwill should be accounted for at cost less accumulated impairment losses, without amortisation.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

## IAS 36, Question 4 – Allocating goodwill to cash-generating units

*The Exposure Draft proposes that for the purpose of impairment testing, acquired goodwill should be allocated to one or more cash-generating units.*

*(a) Should the allocation of goodwill to one or more cash-generating units result in the goodwill being tested for impairment at a level that is consistent with the lowest level at which management monitors the return on the investment in that goodwill, provided such monitoring is conducted at or below the segment level based on an entity's primary reporting format (see proposed paragraphs 73-77 and paragraphs C18-C20 of the Basis for Conclusions)? If not, at what level should the goodwill be tested for impairment, and why?*

*(b) If an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, should the goodwill associated with that operation be included in the carrying amount of the operation when determining the gain or loss on disposal (see proposed paragraph 81 and paragraphs C21-C23 of the Basis for Conclusions)? If not, why not? If so, should the amount of the goodwill be measured on the basis of the relative values of the operation disposed of and the portion of the unit retained or on some other basis?*

*(c) If an entity reorganises its reporting structure in a manner that changes the composition of one or more cash-generating units to which goodwill has been allocated, should the goodwill be reallocated to the units affected using a relative value approach (see proposed paragraph 82 and paragraphs C24 and C25 of the Basis for Conclusions)? If not, what approach should be used?*

### Response

a) Yes.

b) Yes.

c) Yes.

## IAS 36, Question 5 – Determining whether goodwill is impaired

*The Exposure Draft proposes:*

*(a) that the recoverable amount of a cash-generating unit to which goodwill has been allocated should be measured as the higher of the unit's value in use and net selling prise (see proposed paragraphs 5 (definition of recoverable amount) and 85 and paragraph C17 of the Basis for Conclusions).*

*Is this appropriate? If not, how should the recoverable amount of the unit be measured?*

*(b) the use of a screening mechanism for identifying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as potentially impaired only when the carrying amount of the unit exceeds its recoverable amount (see proposed paragraph 85 and paragraphs C42-C51 of the Basis for Conclusions).*



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

*Is this an appropriate method for identifying potential goodwill impairments. If not, what other method should be used?*

(c) *that if an entity identifies goodwill allocated to cash-generating unit as potentially impaired, the amount of any impairment loss for that goodwill should be measured as the excess of the goodwill's carrying amount over its implied value measured in accordance with proposed paragraph 86 (see proposed paragraphs 85 and 86 and paragraphs C28-C40 of the Basis for Conclusions).*

*Is this an appropriate method for measuring impairment losses for goodwill? If not, what method should be used, and why?*

**Response**

a) Yes.

b) Yes.

c) Yes.

We would like to stress, as indicated in our response to ED 3, Question 8, that we do not agree that goodwill should be accounted for at cost less accumulated impairment losses, without amortisation.

## IAS 36, Question 6 – Reversals of impairment losses for goodwill

*The Exposure Draft proposes that reversals of impairment losses recognised for goodwill should be prohibited (see proposed paragraph 123 and paragraphs C62-C65 of the Basis for Conclusions).*

*Is this appropriate? If not, what are the circumstances in which reversals of impairment losses should be recognised?*

## Response

Our response to the Board's question, as regards whether reversals of impairment losses recognised for goodwill should be prohibited, is dependent upon the Board's position regarding our suggestion in our response to ED 3, Question 8 to retain amortisation of goodwill.

If our suggestion is accepted, our response to the Board's question is 'no'. We, then, believe that the rules in IAS 22, paragraph 109 should be carried forward to the new IFRS. In combination with amortisation, the conditions in IAS 22, paragraph 109 provide, according to our opinion, sufficient protection against the recognition of internally generated goodwill.

If the Board does not accept our suggestion to retain amortisation of goodwill, our answer to the Board's question is 'yes'. We believe that strict rules are needed in this case, in order to prevent the recognition of internally generated goodwill, due to the characteristics of the impairment test.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

**IAS 36, Question 7 – Estimates to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives**

*The Exposure Draft proposes requiring a variety of information to be disclosed for each segment, based on an entity's primary reporting format, that includes with its carrying amount goodwill or intangible assets with indefinite useful lives (see proposed paragraph 134 and paragraphs C69-C82 of the Basis for Conclusions).*

*(a) Should an entity be required to disclose each of the items in proposed paragraph 134? If not, which items should be removed from the disclosure requirements, and why?*

*(b) Should the information to be disclosed under proposed paragraph 134 be disclosed separately for a cash-generating unit within a segment when one or more of the criteria in proposed paragraph 137 are satisfied? If not, why not?*

## Response

a) No.

We have concluded that the disclosures required in (draft) IAS 36 to some degree seem to have a different purpose than the disclosures in other IASs / IFRSs. While the purpose of the disclosures requested in other IASs / IFRSs seems to be to facilitate, for the users, their understanding and interpretation of the information in the financial statements, e.g. by providing supplementary information, the purpose of some of the disclosures requested in (draft) IAS 36 seems to be to assist users in evaluating the reliability of the estimates used by management to support the carrying amounts of goodwill and indefinite life intangibles. We cannot see that the disclosure requirements in any other IAS / IFRS have a similar flavour.

Thus, we believe that (draft) IAS 36 introduces a new purpose, which may be a consequence of the imperfections of the impairment test, and which leads to requirements that are very extensive and include requests for information that is sensitive from a business point of view.

We are of the opinion that the disclosure requirement should have its focus on fairly high-level information, of the type illustrated in Appendix A to IAS 36, Example 9, under the headings ”Europe” and ”North America” on page 119 and should exclude some of the detailed information illustrated on page 120, e.g. budgeted market shares and budgeted gross margins. In order to achieve a better focus, we believe that sections (e) (iv), (e) (v) and the whole of section (f) in paragraph 134 should be deleted.

b) Yes.

However, as stated above, we are concerned about the extensive disclosure requirements in paragraph 134.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

## IAS 38, Question 1 – Identifiability

*The Exposure Draft proposes that an asset should be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable or arises from contractual or other legal rights (see proposed paragraph 10 and 11 and paragraphs B6-B10 of the Basis for Conclusions).*

*Are the separability and contractual/other rights criteria appropriate for determining whether an asset meets the identifiability ciriterion in the definition of an intangible asset? If not, what criteria are appropriate, and why?*

### Response

Yes.

## IAS 38, Question 2 – Criteria for recognising intangible assets acquired in a business combination separately from goodwill

*This Exposure Draft proposes clarifying that for an intangible asset acquired in a business combination, the probability recognition criterion will always be satisfied and, with the exception of an assembled workforce, sufficient information should always exist to measure its fair value reliably (see proposed paragraphs 39-32 and paragraphs B11-B15 of the Basis for Conclusions). Therefore, as proposed in ED 3, an Exposure Draft of a proposed International Financial Reporting Standard Business Combinations, an acquirer should recognise, at the acquisition date and separately from goodwill, all of the acquiree's intangible assets, excluding an assembled workforce, that meet the definition of an intangible asset (see proposed paragraphs 36, 43 and 44 of ED 3).*

*Do you agree that, with the exception of an assembled workforce, sufficient information can reasonably be expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination? If not, why not? The Board would appreciate respondents outlining the specific circumstances in which the fair value of an intangible asset acquired in a business combination could not be measured reliably.*

### Response

No.

We disagree with the Board's proposal as the proposed recognition criteria are in conflict with the probability criterion of an asset as defined in the Framework. We believe that the recognition criteria in the individual IASs, which are consistent with the Framework, should also be applied in a business combination.

We regard the Board's proposal as a major alteration to the recognition criteria. Such alterations should not be introduced in the form of amendments to individual standards but, instead, should be generally considered, as part of a separate Concepts project. In such a project, the Framework should first be reviewed and, as a result of considerations arising in the review, then be amended, as deemed appropriate. Only, thereafter, should the indiviual standards, not only one but all of the standards, be amended to be in line with the new Framework.



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

See also comments below under the heading ”Draft Illustrative Examples ED 3, Business Combinations”.

### IAS 38, Question 3 – Indefinite useful life

*The Exposure Draft proposes to remove from IAS 38 the rebuttable presumption that an intangible asset's useful life cannot exceed twenty years, and to require its useful life to be regarded as indefinite when, based on an analysis of all of the relevant factors, there is no foreseeable limit on the period of time over which the asset is expectod to generate net cash inflows for the entity (see proposed paragraphs 85-88 and paragraphs B29-B32 of the Basis for Conclusions).*

*Is this appropriate? If not, under what circumstances, if any, should an intangible asset be regarded as having an indefinite useful life?*

### Response

Yes.

### IAS 38, Question 4 – Useful life of an intangible asset arising from contractual or other legal rights

*The Exposure Draft proposes that if an intangible asset arises from contractual or other legal rights that are conveyed for a limited term that can be renewed, the useful life shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost (see proposed paragraphs 91 and 02 and paragraphs B33-B35 of the Basis for Conclusions).*

*Is this an appropriate basis for determining the useful life of an intangible asset arising from contractual or other legal rights thar are conveyed for a limited term that can be renewed? If not, under what circumstances should the useful life include the renewal period(s)?*

### Response

Yes.

However, and in addition, we note that (draft) IAS 38 does not provide guidance for the accounting for contractual or other legal rights where, in fact, significant costs do arise in the renewal of such rights. We would appreciate if such guidance could be included in the standard.

### IAS 38, Question 5 – Non-amortisation of intangible assets with indefinite useful lives

*The Exposure Draft proposes that an intangible asset with an indefinite useful life should not be amortised (see proposed paragraphs 103 and 104 and paragraphs B36-B38 of the Basis for Conclusions).*

*Is this appropriate? If not, how should such assets be accounted for after their initial recognition?*



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se

**Response**

Yes.

**Draft Illustrative Examples ED 3, Business Combinations**

We would like to make the following comments.

*B 4 Non-contractual customer relationships*

We note that the examples in the booklet Illustrative Examples are not intended to be an exhaustive list of intangible assets that would be recognised separately from goodwill. We, thus, believe that the booklet should only include assets, of various kinds, that typically qualify for separate recognition. Against this background, we question the inclusion of non-contractual customer relationships. Separate recognition requires that the assets should be capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged. We believe that non-contractual customer relationships will meet this condition only in very rare circumstances and that, therefore, they do not justify being included in the booklet.

*D 9 Employment contracts that are beneficial contracts from the perspective of the employer because the pricing of those contracts is below current market value*

We believe that the character of the employment contracts referred to in (draft) Illustrative Examples should be described more clearly, in order, amongst other things, to avoid confusions with ordinary employment agreements.

*E 4 Databases*

Databases could have very different contents and may, or may not, be separable. We, therefore, believe that the Illustrative Examples should include a more precise description of the characteristics of databases meeting the separability criterion.

Yours sincerely,
The Swedish Financial Accounting Standards Council

Dennis Svensson
Managing Director



Box 6417 • S-113 82 STOCKHOLM • TFN +46 (0)8-506 112 75 • FAX +46 (0)8-32 12 50
E-mail: mail@redovisningsradet.se