CL 05

Paris, 7th March 2003

Dear Sir,

The AFEP-AGREF appreciates the opportunity to offer its views on the Exposure Draft "ED 3 Business Combinations and on the Exposure Draft of proposed amendments to IAS 36, *Impairment of Assets* and IAS 38, *Intangible Assets*, and to set out the position expressed by its members.

The AFEP-AGREF welcomes the decisions by the IASB to seek convergence between FAS 141, *Business Combinations* and FAS 142, *Goodwill and Other Intangible Assets* and the IASB related standards.

In particular the AFEP-AGREF agrees with the Board that more useful information is provided under an impairment approach than from amortisation of goodwill and intangible assets with an indefinite useful life.

Therefore, the AFEP- AGREF believes it is essential that the Board revises the current amortisation requirements and adopts the impairment approach before the future standard on First-time Application becomes effective.

However, there are some issues we would like to bring to your attention.

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Use of the market price at the date of exchange as the sole valuation technique would be contrary to laws and regulations and to the substance and terms of the transactions

The AFEP-AGREF disagrees with the proposal in the Exposure Draft that the published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and of the total fair value given by the acquirer in exchange for control of the acquiree; also it disagrees with the proposal that other valuations shall be considered only in the rare circumstance when it can be demonstrated that the published price is affected by the thinness of the market.

For quoted equity based transactions, those proposals would result in business combinations being measured only based on the market price of the equity instrument(s) at the date of exchange, which would not reflect the value of the acquiree or the values of the combining entities, as well as the substance and terms of the transaction (e.g. the offer price or the parity of exchange agreed by the shareholders).

It is therefore not relevant to require use of the market price at the date of exchange as the sole valuation technique. Furthermore any such requirement would be in many cases contrary to laws and regulations, at the European and national levels.

Recognise the possibility to use several valuation techniques when determining the value of securities (quoted or not quoted) / Take into consideration the control premium, where appropriate

Except for business combinations that are not business combinations involving entities (or operations of entities) under common control or business combinations in which separate entities or operations of entities are brought together to form a joint venture, which are scoped out of the Exposure Draft, the AFEP-AGREF believes it necessary to use several valuation techniques, regardless of whether the equity instruments are quoted or not.

Where appropriate, the control premium paid by the acquiring entity should be taken into consideration, both initially and in subsequent measurements.

When measuring the value of marketable securities issued by the acquirer, independent valuations should be capable of being used as an aid in determining their value.
Undue fluctuations of market prices in general or the market prices of the equity instruments concerned should be recognized as an exception to the use of market price.

Use an average market value, when considering market prices

When using market prices of quoted equity instruments, the valuation should be based on an average market value over a period ending at the market session preceding the announcement of the proposed combination (or, in a takeover bid, another date justified by the offeror and accepted by the supervisory authority), rather than just a published price at the date of exchange.

In assessing the acquisition date, consider also laws and regulations, as well as the terms, conditions and contingencies of the transactions

The proposed revision to IAS 36 provides that "The *agreement date* for a business combination is the date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the *earliest date* that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree."
Also the Exposure Draft 3, *Business combinations*, indicates that " (…) it is not necessary for a transaction to be closed or finalised at law before the acquirer effectively obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has effectively obtained control."

The AFEP-AGREF believe that the future standard should clearly stipulate that :
(a) laws and regulations applicable to the transactions, as well as the terms, conditions and contingencies of those transactions, shall be considered in assessing when the acquirer has effectively obtained control ;
(b) there are situations where it is necessary for a transaction to be closed or finalised at law before the acquirer effectively obtains control.

In particular, we have concerns regarding the proposed definition and guidance, in the following cases:

- *Merger between publicly listed entities*: application of the announcement date to a merger would not reflect the substance and terms of the transaction, as, for example, under French law, it has no effect on the effective date of a merger, which may be either the date of the shareholders' approval or the date that is contractually agreed between the parties (under conditions provided for by the Code of commerce).

- *Hostile takeover: the acquisition date would be, at the earliest, the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree.*

It is worth noting that, even if a sufficient number of the acquiree's owners have accepted the acquirer's offer, internal and external contingencies may exist and prevent, <u>if not prohibit</u>, the transfer of control, until the occurrence of such events as shareholder or regulatory approval.
Therefore, it should be clarified that there are situations in which the transfer of a sufficient number of shares is not sufficient to make a hostile takeover binding.
For example, the absence of a regulatory approval can result in the acquirer not being able to exercise the rights attached to the shares transferred by the acquiree's owners.

Measure the subsequent value of goodwill at the level at which management monitors the return on acquisition, rather than at the level of individual assets or groups of assets

The AFEP-AGREF believe that the impairment test for goodwill should not be performed at the lowest level at which management monitors the return on investment in assets that include goodwill. The practice in international groups is rather to monitor the return on acquisition at a much higher level, e.g. entity, business or geographical segment, which is consistent with the level at which management initially assesses the appropriateness of an acquisition.

The allocation of goodwill to the smallest cash-generating units often would not reflect the substance of the transactions, would be subjective and costly, notably in that it would imply the development of additional reporting systems.

By contrast, the allocation of goodwill to a higher level would facilitate the determination of the implied value of goodwill and the implementation of the principle that the entity shall use the values of the assets and liabilities it would recognise if it acquired the unit in a business combination on the date of the impairment test.

We agree that the notion of unit used for the purpose of impairment testing goodwill shall not be larger than a segment based on an entity's reporting format. However we believe that it is necessary to adopt for that purpose pragmatic principles, similar to those provided for in FAS 142, *Goodwill and Other Intangible Assets*, in particular:

- Qualify a component of a segment as a cash-generating unit if discrete financial information is available and segment management regularly reviews the operating result of that unit ;
- Aggregate two or more components of a segment if those components have similar economic characteristics.

As mentioned in FAS 142, the amount of goodwill assigned to a reporting unit would be determined in a manner similar to how the amount of goodwill recognized in a business combination is determined.

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The AFEP-AGREF appreciates the opportunity to comment and would be pleased to discuss these comments further.

Yours sincerely

Patrick Rochet

ED 3 BUSINESS COMBINATIONS

Due to the importance of the section relating to the measurement of a business combination, our response to question 7 precedes our responses to other questions.

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 allocating the cost to be measured initially 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 ?

7.1. <u>IASB proposal regarding the cost of a business combination</u>

Pursuant to paragraph 26 of the Exposure Draft, relating to quoted equity based transactions, the published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and of the total fair value given by the acquirer in exchange for control of the acquiree ; other valuations shall be considered only in the rare circumstance when it can be demonstrated that the published price is an unreliable indicator, i.e. only when it has been affected by the thinness of the market.

In particular, in measuring the value of marketable securities issued by the acquirer, independent valuations may no more be used as an aid in determining the fair value of securities issued. Also undue fluctuations are no more recognized as an exception to the use of market price (exception provided for in paragraph 24 of current IAS 22).

Also it is unclear in the current wording of section "Cost of a business combination" to which equity instruments paragraph 26 would apply :
- *Valuation of the securities issued by the acquirer ;*
- *Valuation of the acquiree's shares ;*
- *Equity instruments previously held by the acquiree.*

In case of exchange of shares, one additional open issue is how use of published prices at the date of exchange for both acquirer's and acquiree's shares would operate when the parity of exchange is based on several valuation techniques.

7.2. Background of our concerns regarding the proposed requirement to use market price at the date of exchange as the sole valuation technique

Our concerns are based on the following points :

(a) *In substance, market price does not necessarily reflect an enterprise's value. It is all the more so as, when assessing market value, published price is considered only at the date of exchange.*

(b) *In fact, practitioners, including investors, use other valuation techniques, which, among other factors, take into account the value of assets and liabilities, the results and the business perspectives, in particular long term perspectives.*
The techniques commonly used include specific valuations or references to recent transactions, market comparisons, discounted cash flow analysis, return ratios, break-up value and other valuation techniques used by market participants (e.g. multiples of earnings or revenue).
They also include the average market value over a particular period (which in France, for takeover bids, must end at the market session preceding the announcement of the bid's filing for prior approval) ;

(c) *Some of these techniques are recognized in current accounting and financial reporting standards.*
This is true under IAS/IFRS, even though their use under the Exposure Draft would be permitted only for non quoted equity instruments or when the market price of a quoted equity instrument is affected by the thinness of the market (IAS 39, for example, refers to techniques such as references to recent transactions, discounted cash flow analysis, techniques commonly used by market participants).

FAS 142, Goodwill and Other Intangible Assets takes a different approach; as it acknowledges that the quoted market price of an individual equity security need not be the sole measurement basis of the fair value of the reporting unit. It allows use of a valuation technique based on multiples of earnings or revenue or a similar performance measure. Those principles reflect the fact that the quoted market price (and thus the market capitalization of a reporting unit with publicly traded equity securities) may not be representative of the fair value of the reporting unit as a whole (due inter alia to the control premium an acquiring entity may be willing to pay).

(d) *Beyond practices and standards, laws and regulations within the European Union recognize the need for not relying only on market prices at the date of exchange. Consequently, many of them even require use of several valuation techniques, regardless of whether the equity instruments are quoted or not. Also, when assessing market value, they generally require to take into account a series of prices, rather than a single price, which is subject to undue fluctuations.*

7.3. Our concerns regarding the proposed requirement to use market price at the date of exchange as the sole valuation technique

Business combinations generally imply a change in control; specific internal and/or external valuations reflecting the circumstances and perspectives at the date of merger/acquisition or offer; a control by external auditors, supervisory authorities and, in many cases, the shareholders' approval.

For quoted equity based transactions, the IASB proposal would result in business combinations being measured only based on the market price of the equity instrument(s) at the date of exchange, which would not reflect the value of the acquiree or of the combining entities, as well as the substance and terms of the transaction (e.g. the offer price or the parity of exchange agreed by the shareholders).

It is therefore not relevant to require use of the market price at the date of exchange as the sole valuation technique. Furthermore any such requirement would be in many cases contrary to laws and regulations, at the European and national levels.

When the published price at the date of exchange exceeds the real cost of acquisition or economic value (such as the values used to determine the parity of exchange), it could lead to overestimate the amounts of shares acquired and goodwill at the date of combination and increase artificially the potential for impairment in subsequent periods (even if 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 price).

7.4. Our recommendations: When determining the value of securities, recognize the possibility to use several valuation techniques and, when using market prices of quoted equity instruments, take into account an average market value

Our recommendations, based on the above mentioned rationale, reflect the approaches followed in practice and required by laws and regulations, at the European and national levels, for business combinations that are not business combinations involving entities (or operations of entities) under common control or business combinations in which separate entities or operations of entities are brought together to form a joint venture (those entities are scoped out of the Exposure Draft).

When measuring securities issued or purchased in a business combination covered by the Exposure Draft, as well as the cost of a business combination, we believe it necessary to use several valuation techniques, regardless of whether the equity instruments are quoted or not.

Where appropriate, the control premium paid by the acquiring entity should be taken into consideration, both initially and in subsequent measurements.

When measuring the value of marketable securities issued by the acquirer, independent valuations should be capable of being used as an aid in determining their value.

Undue fluctuations of market prices in general or the market prices of the equity instruments concerned should be recognized as an exception to the use of market price.

When using market prices of quoted equity instruments, the valuation should be based on an average market value over a period ending at the market session preceding the announcement of the proposed combination (or, in a takeover bid, another date justified by the offeror and accepted by the supervisory authority), rather than just a published price at the date of exchange.

Finally we believe that it would be helpful to clarify in the future standard which valuation principles apply to which equity instruments.

7.5. Appendix to point 7.2. (d): Excerpts of laws and regulations

- *Proposal for a European directive on takeover bids (2002/0240 (COD))*

  . *Equitable price in the case of a mandatory bid: The proposal defines the price to be paid in the case of a mandatory bid as the highest price paid for the same securities by the offeror over a period of between six and twelve months prior to the bid (price regarded and referred to as an equitable price). Member states may authorize their supervisory authorities to adjust that price in certain circumstances and according to criteria that are clearly determined;*
  * *Those circumstances may include the cases where the highest price was set by agreement between the purchaser and a seller, where market prices in general or certain market prices have been affected by exceptional occurences*
  * *Criteria may include the average market value over a particular period, the break-up value of the company or other valuation criteria generally used in financial analysis.*

  . *Fair price in squeeze-out and sell-out procedures: The proposal enables a shareholder holding a given percentage of securities to require the remaining minority shareholders to sell him their securities at a fair price. Conversely a minority shareholder can require the majority to buy his securities from him at a fair price. Following a voluntary bid, the bid shall be presumed to be fair where it corresponds to the consideration offered in the bid and the offeror has acquired securities representing not less than 90% of the capital concerned by the bid. Following a mandatory bid, the consideration offered in the bid shall be presumed to be fair.*

- *French regulation on takeover bids (Règlement général du Conseil des Marchés Financiers and COB regulation 2002-04 on takeover bids)*

  . *The price or parity proposed must be based on several assessment criteria / valuation techniques, each of which reflects a different approach*

  . *Valuation techniques to be used depend on the circumstances and include (a) the average market value over a period ending at the market session preceding the announcement of the* *bid's filing for prior approval (or another date justified by the offeror and accepted by the supervisory authority); (b) return ratios;(c)market comparisons;(d) specific valuations or references to recent transactions*

. The offeror must justify his choices or his decision not to retain one of the above mentioned valuation techniques;

. For bids implying an exchange of securities, the criteria or techniques used for the offeree and the offeror must be equivalent

- *French Monetary and Financial Code / Provisions relating to squeeze-out and sell-out (Article L 433-4)*

. The valuation must be based on several valuation techniques and take into account the market value of the securities, the assets' value, the results realized, the existence of subsidiaries and the perspectives.

- *French Code of commerce / Provisions relating to mergers (Article L. 236-10)*

. The ad hoc auditors must check that the relative values of the combining entities are relevant and that the parity of exchange is equitable.

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 ?

In its draft response to IASB, EFRAG indicates that there is a strong case for using "fresh start" accounting in a number of borderline cases, while noting that IASB intends to consider this only in Phase II of the Business combinations project and inviting the Board to put forward "suitable, non-arbitrary and unambiguous criteria for its use". The use of "fresh start" accounting would result in the balance sheets of both entities being adjusted to reflect fair values at the date of the business combination.

As it is unclear what is meant by the terms "borderline cases" and why "fresh start" accounting should be preferred, we believe it premature, if not inappropriate, to suggest that there are "borderline cases" and to recommend the use of that method. In our view, it is up to the Board first to determine whether or not there are borderline cases. If it is so, the use of other valuation methods than fair valuations should be considered in the first place.

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).

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 ?

We do not think that this proposal is appropriate and believe that the treatment provided for in IAS 22.31 should be maintained, i.e. the acquirer being required under certain conditions to recognize a provision that was not a liability of the acquiree at the date of the acquisition.

As set out in IAS 22.30, we believe that the acquirer should recognise a provision that was not a liability of the acquiree at the date of acquisition, if the acquirer has developed plans that are an integral part of the acquirer's plan for the acquisition, if those plans relate to the acquiree's business and an obligation comes into existence as a direct consequence of the acquisition.

We wish to emphasize that IAS 22.31 lays down strict conditions designed to ensure that the plan was an integral part of the acquisition, in particular announcement of the main features of the plan and, shortly after, in any case before the annual financial statements are authorized for issue, development of those main features into a detailed formal plan.

The recognition of a provision and the separate disclosure required in IAS 22.92 permit an appropriate follow-up of provisions for terminating or reducing the activities of an acquiree and convergence with US GAAP, which the proposed treatment would not achieve.

Question 6 – Contingent liabilities

The Exposure Draft proposes that 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 their 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 ?

No comment.

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 initially, and why ? Should goodwill be accounted for after initial recognition at cost less any accumulated impairment losses ? If not, how should it be accounted for after initial recognition, and why ?

We agree that goodwill acquired in a business combination should be recognized as an asset and should not be amortized.

We do not agree with the suggestion that IASB should further consider the possible use of amortization as an alternative to the impairment approach.

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 and 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 ?

We agree with the Exposure Draft proposal that when such an excess exists, the acquirer should (a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and (b) recognize immediately in profit or loss any excess remaining after that reassessment.

Question 10 – Completing the initial accounting for a business combination and subsequent adjustments to that accounting .

The Exposure Draft proposes that :

(a) if the initial 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 initial accounting is to be recognised within twelve months of the acquisition date (see 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 that 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 ?

Question 10 (a) : *No comment*

Question 10 (b): *See comments below*

After initial accounting for a business combination is complete, adjustments to the cost of the combination shall be recognised only to correct an error. Among the limited exceptions is the recognition of deferred tax assets when the potential benefit satisfies the criteria for separate recognition (probability and reliable measurement) after that initial accounting. In that case, the acquirer shall reduce the carrying amount of goodwill to the amount that would have been recognised if the deferred tax asset had been recognised as an identifiable asset from the acquisition date, and recognise the reduction as an expense.

In our view, the proposal is inappropriate in respect of deferred tax assets, as it may lead to goodwill adjustments long after the acquisition date, based on circumstances that are not directly related to the acquisition. For example, the return to profitability may result from new operating conditions.
Therefore we believe that the adjustments due to the recognition of deferred tax assets should give rise to goodwill adjustments only within the time period defined for adjustments to provisional values (i.e. twelve months of the acquisition date).

Disclosure (No related question)

We believe that the proposed following disclosures are unnecessarily burdensome and therefore should be removed:

- *The amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities, and the carrying amount of each of those classes, determined in accordance with IFRSs, immediately before the combination (66 (f))*
- *A description of the factors that contributed to a cost that results in the recognition of goodwill, or a description of the nature of any "negative goodwill" (66 (h))*

With regard to paragraph 66 (f), we wish to emphasize that, when assessing the value of the acquiree's assets, liabilities and contingent liabilities, the acquirer does not necessarily determine the carrying amounts in accordance with IFRSs immediately before the acquisition.

The proposed disclosure in paragraph 66 (h) appears to contradict the principles set out in paragraphs 51 and 52 of the Exposure Draft, which describe goodwill as a <u>residual cost representing a payment</u> made <u>in anticipation of future economic benefits from</u> <u>assets</u> that are <u>not capable of being individually identified</u> and separately recognised.
In addition, the nature of goodwill justifies that the acquirer may allocate it to cash-generating units up to the end of the first annual reporting period beginning after the acquisition date (Proposed paragraph 79 of IAS 36) and, where applicable, that goodwill allocated to cash-generating units shall be tested for impairment before the end of the annual period of the acquisition (Proposed paragraph 93 of IAS 36).

PROPOSED AMENDMENTS TO IAS 36, IMPAIRMENT

Agreement date (No related question)

The Definitions section provides that "The *agreement date* for a business combination is the date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the *earliest date* that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree."
Paragraph 38 of the Exposure Draft 3, *Business combinations*, indicates that "Application of the purchase method starts from the acquisition date, which is the date on which the acquirer effectively obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or operation so as to obtain benefits from its activities, *it is not necessary for a transaction to be closed or finalised at law before the acquirer effectively obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has effectively obtained control.*"

We believe that it is not clear in the proposal how that definition would apply, as, except for the transitional provisions in ED 3 and revised IAS 36, there is no explicit reference to the terms "agreement date".
We understand that the definition could be used to mean the acquisition date, which is the date on which the entity obtains control of the acquiree and starts to apply the purchase method.

If so, we have concerns regarding the proposed definition and guidance, in particular in the case of a merger between publicly listed entities and in the case of a hostile takeover:

- *Merger between publicly listed entities: the acquisition date would be defined as the date on which a substantive agreement is announced to the public ;*
  Application of the announcement date to a merger would not reflect the substance and terms of the transaction, as, for example, under French law, it has no effect on the effective date of a merger, which may be either the date of the shareholders' approval or the date that is contractually agreed between the parties (under conditions provided for by the Code of commerce).

- *Hostile takeover : the acquisition date would be* at the earliest *the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree.*

It is worth noting that, even if a sufficient number of the acquiree's owners have accepted the acquirer's offer, internal and external contingencies may exist and prevent, <u>if not</u>

prohibit, the transfer of control, until the occurrence of such events as shareholder or regulatory approval.
Therefore, it should be clarified that there are situations in which the transfer of a sufficient number of shares is not sufficient to make a hostile takeover binding.
For example, the absence of a regulatory approval can result in the acquirer being allowed to exercise the voting rights attached to shares transferred by the acquiree's owners.
Under French regulation, in most cases, a hostile takeover can be regarded as completed only when the final outcome of the takeover is published by the market regulator.

Generally, we believe that the future standard should clearly stipulate that :
(a) laws and regulations applicable to the transactions, as well as the terms, conditions and contingencies of those transactions, shall be considered in assessing when the acquirer has effectively obtained control ;
(b) there are situations where it is necessary for a transaction to be closed or finalised at law before the acquirer effectively obtains control.

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 ?

An entity shall assess at each balance sheet date whether there is any indication that an asset may be impaired and, in any case :
- estimate *at the end of each annual reporting period* the recoverable amount of an intangible asset with an indefinite useful life ;
- test goodwill acquired in a business combination for impairment *annually, at any time during an annual reporting period,* provided the test is performed *at the same time every year.*

We agree that an entity shall assess at each balance sheet date whether there is any indication that an asset may be impaired.
However, when there is no indication that this asset may be impaired, we believe that the timing of the impairment test for assets with an indefinite life should be brought into line with the timing proposed for goodwill, i.e. annual test at any time during an annual reporting period, with the test performed at the same time every year.

There is no rationale for requiring an asset with an indefinite life to be tested for impairment at a time different from goodwill when there is no indication that this asset may be impaired.
At the time of impairment testing a cash-generating unit to which goodwill has been allocated, it makes sense to perform those tests simultaneously, as impairment losses on other assets or smaller cash-generating units are recognised before testing the larger cash-generating unit (pursuant to §§ 94 and 95).
Furthermore, except for the situation where there is an indication that an asset may be impaired, we believe that tests should be capable of being performed at any time during an annual reporting period, which facilitates timely reporting without affecting its quality.

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 ?

The AFEP-AGREF agrees with the Board that more useful information is provided under an impairment approach than from amortisation of goodwill and intangible assets with an indefinite useful life.

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 paragraph 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 both 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 ?

No comment

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 ?

Question 4 (a)

The Exposure Draft in §§ 73 and 74 proposes that for the purpose of impairment testing goodwill should be allocated to one or more cash-generating units, each of those cash-generating units representing the *lowest level at which management monitors the return on investment in assets that include the goodwill.*

We believe that the impairment test for goodwill should not be performed at the lowest level at which management monitors the return on investment in assets that include goodwill. The practice in international groups is rather to monitor the return on acquisition at a much higher level, e.g. entity, business or geographical segment, which is consistent with the level at which management initially assesses the appropriateness of an acquisition.

The allocation of goodwill to the smallest cash-generating units often would not reflect the substance of the transactions, would be subjective and costly, notably in that it would imply the development of additional reporting systems.

By contrast, the allocation of goodwill to a higher level would facilitate the determination of the implied value of goodwill and the implementation of the principle in § 86 (b) that the entity shall use the net fair value of the identifiable assets, liabilities and contingent liabilities it would recognise if it acquired the unit in a business combination on the date of the impairment test.

We agree that unit used for the purpose of impairment testing goodwill shall not be larger than a segment based on an entity's reporting format. However we believe that it is necessary to adopt for that purpose pragmatic principles, similar to those provided for in FAS 142, Goodwill and Other Intangible Assets, in particular,:
- *Qualify a component of a segment as a cash-generating unit if discrete financial information is available and segment management regularly reviews the operating result of that unit ;*
- *Aggregate two or more components of a segment if those components have similar economic characteristics.*

As mentioned in FAS 142, the amount of goodwill assigned to a reporting unit would be determined in a manner similar to how the amount of goodwill recognized in a business combination is determined.

Questions 4 (b) and (c)

No comments

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 price (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). 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 a 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 ?

(a) Measurement of the recoverable amount of the unit to which goodwill has been allocated

We agree with the Exposure Draft proposal that the recoverable amount of a unit to which goodwill has been allocated should be measured as the higher of the unit's value in use and net selling price.

(b) Use of a screening mechanism for identifying potential goodwill impairments

We agree with the use of a screening mechanism, whereby goodwill allocated to a unit would be identified as potentially impaired only when the carrying amount of the unit exceeds its recoverable amount.

(c) Measurement of the amount of any impairment loss for a goodwill potentially impaired

We agree that the amount of any impairment loss for a goodwill that is potentially impaired should be measured as the excess of the goodwill's carrying amount over its implied value.

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 for goodwill should be recognised ?

No comments

Question 7 – Estimates used 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 within 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 ?

The Exposure Draft proposes requiring a variety of information to be disclosed for each segment that includes in its carrying amount goodwill or intangible assets with indefinite life.

(a) Requirement to disclose each of the item in proposed paragraphs 134 and 137

We consider the amount of disclosures required by the proposal to be excessive, of little value to users of financial statements, and therefore unnecessarily burdensome.
Therefore we urge the IASB to consider significant reductions in the level of detail.

In particular, we believe that an entity should not be required to disclose the items in proposed paragraphs 134 (d), (e) and (f), as well as related cash-generating unit information required in paragraph 137, which paragraphs therefore should be removed. This is based on the following reasons:

- *IAS 36 already requires information for each reportable segment (IAS 36.116 and 117 or §§ 128 and 129 of the Exposure Draft), for individual assets, including goodwill, cash-generating units and classes of assets (IAS 36.117 or § 129 of the Exposure Draft), and, for individual assets and cash-generating units :*
  . *If recoverable amount is net selling price, the basis used to determine net selling price (IAS 36.117 (f) or § 129 (f) of the Exposure Draft) ;*
  . *If recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use (IAS 36.117 (g) or § 129 (g) of the Exposure Draft).*

- *Most of the proposed disclosures in § 134 echo the requirements in §§ 27 (Basis for Estimates of Future Cash Flows in measuring value in use), whose application is controlled by the entity's auditors ;*

- *The numerous sensitivity analyses required in paragraphs 134 (e) (iv) and (v) and 134 (f) (ii) would result in overly detailed information, whose cost would not be outweighed by the informational value to users of financial statements.*

Also paragraph 134 (d) of the Exposure Draft requires for each segment (or for the entity as a whole if it does not report segment information), and for a cash-generating unit that includes in its carrying amount goodwill or an intangible asset with an indefinite useful life (under the conditions set out in paragraph 137), disclosure of the amount by which the aggregate of the recoverable amount(s) of the cash-generating unit(s) exceeds the aggregate of the their carrying amounts.

We believe that paragraph 134 (d) should be removed, as it does not take into consideration the possibility provided for in paragraphs 20A and 96 to use the most recent detailed recoverable amount calculation made in a preceding reporting period, in particular when it resulted in an amount that exceeded the asset's or unit's carrying amount by a substantial margin.

(b) Requirement in paragraph 137 to disclose separately for a cash-generating unit within a segment information to be disclosed under proposed paragraph 134

We consider that the information provided for under proposed paragraph 134 should not be disclosed for a cash-generating unit, for the following reasons.

As mentioned in response to question 4 (a), we believe that the impairment test for goodwill should not be performed at the lowest level at which management monitors the return on investment in assets that include goodwill. Also, for the reasons developed in paragraph (a), we believe that an entity should not be required to disclose the items in proposed paragraphs 134 (e) and (f), as well as related cash-generating unit information required in paragraph 137.

Estimates of cash flows in value in use calculation (No related question)

Paragraph 37 (b) of the Exposure Draft indicates that estimates of future cash flows shall not include estimated cash inflows or outflows that are expected to arise from future capital expenditure that will improve or enhance the asset in excess of its standard of performance assessed immediately before the expenditure is made.

We believe that the principle laid down in paragraph 37 (b) is far too restrictive and does not reflect the way return on investments and recoverable amounts are determined in practice. Like US GAAP, future investments, in particular announced restructurings, should be factored in when calculating value in use, rather than just the restructurings to which an entity is committed.

PROPOSED AMENDMENTS TO IAS 38, INTANGIBLE ASSETS

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 paragraphs 10 and 11 and paragraphs B6-B10 of the Basis for Conclusions).

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

We believe that the separability and contractual / other legal rights criteria set out in paragraphs should be used as the basis for determining whether an asset meets the identifiability criterion.

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 expected 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 ?

We believe that this proposal is appropriate.

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 ?

We believe that this proposal is appropriate.