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| Date | : | Amsterdam, 3 April 2003 |
| Re | : | Exposure Draft ED 3 Business Combinations, Proposed Amendments to IAS 36 Impairment of Assets, Proposed Amendments to IAS 38 Intangible Assets |

Dear Sirs,

The Netherlands Council for Annual Reporting (CAR) appreciates the opportunity to respond to the *"Exposure Draft ED 3 Business Combinations, Proposed Amendments to IAS 36 Impairment of Assets, Proposed Amendments to IAS 38 Intangible Assets"* (further referred to as ED 3).

In the attachment we answer the specific questions raised in ED 3 together with additional comments we have.

Yours sincerely,

Prof. dr. Martin Hoogendoorn RA
(Chairman CAR)

# Response

# Council for Annual Reporting (CAR)

# on

ED 3 *Business Combinations*,

Proposed Amendments to IAS 36 *Impairment of Assets*

Proposed Amendments to IAS 38 *Intangible Assets*

## Contents

## Summary of main comments on ED 3 *Business Combinations*, and Proposed Amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*

### General

The CAR has views that are different from that of the IASB, especially regarding accounting for goodwill and intangible assets with an indefinite useful life and the related impairment test.

In this section we summarize our specific views. In the next section we respond to the specific questions raised. There is an overlap in text between the two sections.

As a general comment, we point out that the IASB proposals relate to the consolidated financial statements. The guidance does not relate to a company's single financial statements. We recommend including guidance on how the related business combinations issues should be accounted for in the company' single financial statements. This is especially important in situations of reverse acquisitions.

### Abolition of Pooling Accounting

We agree with the Board's proposal on the abolition of pooling accounting, but are concerned by the lack of guidance on accounting for business combinations where an acquirer cannot be identified. We believe this guidance should be included in phase I. Business combinations in which an acquirer cannot be identified do take place in practice. It is in our view unacceptable to have no guidance available until the draft of phase II is issued. Furthermore, all issues relating to the application of purchase method should be included in phase I to be able to comment on the implications of purchase accounting as a whole. If not possible, we should be granted a possibility to comment on the total business combinations project (phase I and phase II) after the draft of phase II is issued.

Furthermore, as there is no guidance to account for the situations where a new entity is formed to effect a business combination, we recommend including this guidance in ED 3. It will be necessary to determine which party should be identified as the acquirer. This will be a starting point for applying purchase accounting in the consolidated financial statements of the newly formed entity.

### Accounting for Goodwill (and Impairment Test)

On accounting for goodwill we do not agree with the IASB. We are of the opinion that the factors constituting goodwill paid at acquisition generally diminish in value over time. We believe this is also true where there is no loss in the overall value of the acquired business, based on the fact that external goodwill will be replaced by internally generated goodwill in due time. We therefore believe that goodwill should be amortised systematically over its useful life. Furthermore, we believe that the proposed impairment test will prove insufficiently robust to measure any decline in the value of goodwill with a reasonable degree of reliability and objectivity.

Our objective is not to seek international convergence at any price, but primarily to improve the quality of accounting. In our opinion the objective of qualitative good accounting can only be achieved by recognising goodwill as an asset and amortising the goodwill over the useful life. Therefore, we believe that IAS 22 should be retained in this respect. We also favour to retain the impairment test and the rebuttable presumption of IAS 22, as well as the possibility to reverse goodwill impairments in certain cases. Reversals of goodwill impairment should be allowed in cases where management could not control the reasons underlying the impairment and management cannot control the reasons underlying the reversal of the impairment. In these cases, there is no risk of recognising internally generated goodwill.

We believe the current proposal is mainly a result of a desire to converge to US GAAP. In that respect, we do not understand why the level of impairment testing differs between ED 3 (cash generating units) an US GAAP (reporting entities). Such differences will be impracticable, burdensome and difficult to communicate to stakeholders.

**Intangible Assets with an Indefinite Useful Life**

As a consequence of our comments on goodwill accounting, we believe the same holds in accounting for intangible assets with an indefinite useful life. It is our view that the current requirements of IAS 36 and IAS 38 should be retained.

## Responses to IASB's Questions on ED 3 *Business Combinations*

**Question 1 – Scope**

The Exposure Draft proposes:

- 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?*

- 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**

Yes, we agree with the Board's proposal that these scope exclusions are appropriate for phase I of the project, but we believe that phase II of the Business Combinations project should deal with these issues which is in line with our understanding of Board's intention.
We regard the definition of business combinations involving entities under common control and additional guidance on identifying such transactions helpful. We believe that the proposed revision to the definition of joint control in IAS *28 Accounting for Investments in Associates* and IAS 31 *Financial Reporting of Interests in Joint Ventures* is an oversimplification. Although joint control requires unanimous consent on strategic decisions, it is compatible with the use of majority voting for lesser issues.

**Question 2 – Method of accounting for business combinations**

The Exposure Draft proposes to eliminate the use of the pooling of interests method and require 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?*

**Response**

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| Yes, we agree with the Board's proposal and believe that purchase accounting is the appropriate method for business combinations which are real acquisitions. Purchase accounting should replace pooling of interests accounting because in our view the reality is that it is only rarely that an acquirer cannot be identified in business combinations.<br>However, at the moment no guidance is available on accounting for business combinations in which an acquirer cannot be identified. This guidance should be included in phase I. Business combinations in which an acquirer cannot be identified do take place. It is in our view unacceptable to have no guidance available until the draft of phase II issued.<br>Furthermore, all issues related to purchase accounting should be included in phase I to be able to comment on the implications of purchase accounting as a whole. If not possible, we should be granted a possibility to comment on the total business combinations project (phase I and phase II) after the draft of phase II is issued. |

**Question 3 – Reverse acquisitions**

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:

- 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 policies of the other entity (or entities) so as to obtain benefits from its (or their) activities. As a result, a reverse acquisition 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?*

- 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, what specific guidance should be added?*

**Response**

Yes, we agree with the proposed description of the circumstances in which a business combination should be accounted for as a reverse acquisition. We believe that even though the majority of the instigating group of shareholders may be from the acquired entity the acquirer should be the entity whose shareholders have obtained the power to govern the financial and operating policies of the other entity.

We regard the proposed additional guidance together with the illustrative examples as appropriate. Nevertheless, we think it would be helpful if the Board added guidance in the standard making it clear that the comparative figures presented should be those of the legal subsidiary and not those of the legal parent.

Furthermore, as a general comment, we point out that the Board's proposals relate to consolidated financial statements. The guidance does not relate to a company's single financial statements. We recommend including guidance on how the related business combinations issues should be accounted for in the single company financial statements. This is especially important in situations of reverse acquisitions.

**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, we agree with the general principle that in business combinations an acquirer has to be identified based on the evidence available. The newly formed entity individually has little economic substance and can therefore not be considered as the acquirer. The legal form of the transaction should not change the general principle and consequently, we support the Board's proposal that one of the combining entities that existed before the combination should be determined to be the acquirer on the evidence available.

However, as there is no guidance to account for the situations in which a new entity is formed to effect a business combination, we recommend including such guidance in ED 3. It will be necessary to determine which party can be recognised as the acquirer. This will be a starting point for applying purchase accounting in the consolidated financial statements of the newly formed entity.

**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?*

**Response**

Yes, we agree with the Board's proposal not to apply recognition criteria different from IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for a restructuring provision in the case of a business combination.

**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?*

**Response**

No, we do not believe that the Board's proposal is appropriate. We believe that contingent liabilities should be recognised separately only if they satisfy the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*
Our main concerns with the proposal are:

- non compliance with the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*;
- unreliable measurement; and
- potential recognition of contingent liabilities with high amounts but low probability of becoming an actual liability.

We do think it is illogical to recognise contingent liabilities in an acquisition, if it is not possible to recognise them under the current requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The nature of a contingent liability does not change as a result of an acquisition and we believe the IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* criteria should still be applied. Although the purchase price of the acquired entity may include an allowance for contingent liabilities (and for contingent assets), we are not convinced that their fair values can be measured reliably.
Many contingent liabilities arise from legal claims (for example for tobacco or fast food industries) and can result in very large figures according to Appendix B15 (l), which requires the amount of the contingent liability to "reflect all expectations about possible cash flows and not the single most likely or the expected maximum or minimum cash flow". The resulting number does not reflect the potential future cash outflow because it is based on an average expectation covering a wide spectrum of possible outcomes. It is very difficult in reality, sometimes impossible, to quantify the possible outcome of contingent matters such as legal proceedings.
Once contingent liabilities are recognised separately, the acquirer must measure them at their fair values with changes in fair value recognised in profit or loss (paragraph 46). Such contingent liabilities are explicitly excluded from the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. We disagree with the proposal, because it results in inconsistent treatment between contingent liabilities acquired in a business combination and other contingent liabilities of the same or a different entity.
Overall, we are of the opinion that ED 3 is conceptually inconsistent in incorporating all parts in allocating the cost of a business combination. For example: Provisions for terminating or reducing the activities of the acquiree are excluded from the cost of a business combination based on not being consistent with IAS 37 (refer to Question 5). At the same time, contingent liabilities are included in the cost of a business combination, being not consistent with IAS 37.

Additionally, we understand from BC74 that the Board agreed that the role of probability in the Framework should be considered more generally as part of a later Concepts project. While we welcome this initiative, we believe that meanwhile the recognition criteria for assets and liabilities should not be altered in the case of a business combination.

**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?*

**Response**

In principle, we agree with the Board's proposal requiring the acquiree's identifiable assets and liabilities to be recognised as part of the cost allocation to be measured initially by the acquirer at their fair values at the acquisition date. We agree that any minority interest in the acquiree will be stated at the minority's proportion of the net fair values of those items.

However, while we acknowledge that the purchase price in general is affected by contingent liabilities and in-process research and development, we believe that assets and liabilities that do not meet the recognition criteria of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 38 *Intangible Assets* should not be recognised as assets and liabilities in a business combination.

We refer to our answer to Question 6 that for reasons of comparability and understandability the recognition criteria of the Framework should be applied consistently when accounting for business combinations.

**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?*

**<u>Response</u>**

No, we do <u>not agree</u> with the Board's proposal. We are of the opinion that the factors that constitute the goodwill paid at acquisition generally diminish in value over time. We believe this is also true where there is no loss in the overall value of the acquired business, based on the fact that external goodwill will be replaced by internally generated goodwill in due time. We therefore believe that goodwill should be amortised systematically over its useful life.

The impairment test as proposed has <u>conceptual and practical weaknesses</u>, for example:

- in applying the impairment test acquired goodwill and internally generated goodwill will be intermingled;
- no reversal of the carrying amount of goodwill will take place when the factors that caused the impairment reverse; and
- annual impairment testing is an onerous and very judgemental process.

We believe that the proposed impairment test will prove insufficiently robust to measure any decline in the value of goodwill with a reasonable degree of reliability and objectivity.

Our objective is not to seek international convergence <u>at any price</u>, but primarily to improve the quality of accounting. In our opinion the objective of qualitative good accounting can only be achieved by recognising goodwill as an asset and amortising the goodwill over the useful life. Therefore, we believe that IAS 22 should be retained in this respect.

**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:

- 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
- 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 do not believe that the proposed treatment is appropriate and therefore disagree with the Board's proposal. Although we agree that "negative goodwill" does not meet the definition of a liability, we believe that its treatment should be consistent with the treatment of positive goodwill. In a business combination an entity should be required to recognise assets and liabilities according to current standards and recognition criteria. The remaining difference between the purchase price and the separately recognised identifiable assets and liabilities can either be a positive or negative premium, called goodwill. The remainder is economically justified by future profits or future losses that are identified in the acquirer's plan for the acquisition and can be measured reliably, but which do not represent identifiable liabilities at the date of acquisition (for example restructuring provisions and contingent liabilities). That portion of negative goodwill should be recognised as income in the profit and loss account when the future losses and expenses are recognised.
The reference to expected future losses in the case of negative goodwill is clearly expressed in the current IAS 22 *Business Combinations* in paragraph 61. Accordingly, negative goodwill should only be recognised immediately as income to the extent that it does not relate to identified expected future losses and expenses that can be measured reliably at the date of acquisition. Therefore, we prefer to retain the present requirements for negative goodwill (IAS 22 *Business Combinations* paragraphs 59 to 63) particularly the treatment in paragraphs 61 and 62.

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

The Exposure Draft proposes that:

- 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?*

- 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?*

**Response**

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| Yes, we believe that adjustments to estimates of the total cost of the combination should normally be made within 12 months of the acquisition date. Thereafter adjustments should only be made to correct an error (as proposed). |

**Other comments**

*Disclosure requirements of paragraphs 73 to 76*

Paragraphs 65 to 76 of ED 3 require certain disclosures for past business combinations and business combinations effected during the reporting period or after the balance sheet date but before the issue date of the financial statements.
Although paragraphs 65, 71 and 73 are not explicit as to whether comparative figures are required or not, we believe that paragraph 65 (covering current and future business combinations) as well as paragraph 71 (asking for cumulative information) do not require comparative figures for the information requested. However, paragraph 73 and the following paragraphs are not clear in that respect.
We ask the IASB to clarify whether paragraphs 73 to 76 require comparative information or not.

## Responses to IASB's Questions on Proposed Amendments to IAS 36 *Impairment of Assets*

### 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 do not agree with the Board's proposal that:

- indefinite useful life intangibles shall be tested for impairment annually at the end of each annual reporting period; and whenever there is an indication of possible impairment;
- acquired goodwill shall be tested for impairment annually at any time during an annual reporting period, provided the test is performed at the same time every year, and whenever there is an indication of possible impairment.

We believe that permitting annual impairment tests at different dates for indefinite useful life intangibles (at the end of each annual reporting period) and for acquired goodwill (at any time during an annual reporting period) is impractical. Testing other intangible assets for impairment is conceptually related to testing goodwill for impairment. Therefore, all annual impairment tests should be performed at the same date at any time during an annual reporting period provided the test is performed at the same time every year. For reasons of comparability and relevance of interim and annual financial reports testing in the fourth quarter should be recommended.

### 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**

No, we do not agree with the Board's proposal. We refer to Question 8 related to ED 3.

**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?*

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**

Yes, we agree with the Board's proposal.

**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**

In principle, we agree with the Board's proposals. The cash-generating unit is 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. We believe the current proposal is mainly a result of a desire to converge to US GAAP. In that respect, we do not understand why the level of impairment testing differs between ED 3 (cash generating units) and US GAAP (reporting entities). Such differences will be impracticable, burdensome and difficult to communicate to stakeholders.
Furthermore, we consider the measurement of the goodwill in (b) and (c) based on relative values to be a practical solution.

**Question 5 – Determining whether goodwill is impaired**

The Exposure Draft proposes:

- 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?*

- 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?*

- 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?*

**Response**

No, we do not agree with the Board's first and third proposal. In order not to result in a lack of reliability and objectivity to measure any decline in the value of goodwill, the impairment test needs to be a robust test. Therefore, the testing criteria need to be very strong. Because pre-existing internally generated goodwill of the acquirer cannot be separated from the measurement of acquired goodwill, we are of the opinion that goodwill should be amortised and that the impairment test of the current IAS 36 should be retained. We refer to Question 8 related to ED 3.

We agree with the Board's second proposal and support the use of a screening mechanism whereby if the carrying amount of a cash-generating unit does not exceed its recoverable amount, no further assessment of impairment needs to be made. However, we recognise that this can mask a situation where the goodwill has been impaired, but the impairment is more than offset by gains in other assets or intangibles which may or may not be recognised on the balance sheet (e.g. internally generated goodwill). At the borderline anomalous results may appear such that no impairment of goodwill is recognised if the screening test is passed but a significant write down must be made if the full impairment test is performed. Nevertheless, the complexity is reduced if a screening test is applied and we regard that as a practical solution.

**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?*

**Response**

In principle, we agree with the Board's proposal that reversal of goodwill impairment should not be treated as any other reversal of impairment. However, we favour to retain the possibility to reverse goodwill impairments in certain cases. Reversals of goodwill impairment should be allowed in cases where management could not control the reasons underlying the impairment and management cannot control the reasons underlying the reversal of the impairment. In these cases, there is no risk of recognising internally generated goodwill.
For example, the impairment and the reversal of the impairment as a result of major foreign currency movements when the goodwill and the cash flows are noted in different currencies. Furthermore, refer to the examples in the current IAS 22.

**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?*

**Response**

a) No, we believe that disclosed information should be useful for users of financial statements in drawing conclusions on the financial position and financial performance of entities. Therefore, we believe the list of required items given in paragraph 134 should be reduced. Some of the required information seems to us being excessive and having no value in meeting the criterion of understandability of financial statements. For example, we believe it is likely that a segment may include different cash-generating units where for some the recoverable amount is net selling price and for others where it is value in use. The information required by paragraph 134 (e) and (f) then may become unwieldy and of little benefit to the reader.

b) Yes, we agree with the principle as proposed in paragraph 137 but once again have concerns about the very extensive disclosure requirements in paragraph 134 (e) and (f).

**Responses to IASB's Questions on 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?*

**Response**

Yes, we agree that the separability and contractual or other legal rights criteria are appropriate for determining whether an asset meets the identifiability criterion in the definition of an intangible asset as prescribed in paragraph 11.

**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 29-32 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. Paragraph 89 of the Framework requires an asset to meet the criteria of the probability test in order to be recognised. The general principle that an asset is recognised when (i) future economic benefits will probably flow to the entity and (ii) the cost or value can be measured reliably, should be consistently applied in all situations including business combinations. The current proposal results in an inconsistent treatment of internally generated and externally acquired intangible assets, because the probability criterion for recognition of an asset as defined in the Framework is now presumed to be fulfilled in the case of a business combination or separate acquisition. We regard the Board's proposal as **a major change** which **should not be introduced** in the context of the newly proposed consequential amendments to IAS 38 *Intangible Assets* but instead be considered more generally as part of a separate Concepts project.

Furthermore, we believe that the proposed amendments are not clear enough in respect of how to account for in-process research and development projects (paragraph 36(c) of ED 3). The Basis for Conclusions clarifies in BC67 that any item must first meet the definition of an asset to be recognised on the balance sheet. We disagree that an acquired in-process research and development project meets the criterion of "control over a resource" and we fail to see why such acquired in-process research and development would qualify as an asset while internally generated in-process research and development would not. Therefore we ask the Board to investigate these issues in a separate "Concepts" project.

**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?*

**Response**

No, we do not agree with the Board's proposal. In line with our answers to Question 8 related to ED 3 and Questions 2 and 5 related to impairment of assets, we believe that the rebuttable presumption and the impairment test of the current IAS 36 should be retained.

**Question 4 – Useful life of 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 92 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 that 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, we support the useful life requirements in paragraphs 91 and 92. It may be the case that after a limited time of a patent that cannot be renewed, there is still an intangible asset – e.g. unpatented know how – which already existed at the time of the business combination. However, we find it too difficult to apply an "economic renewal concept" and furthermore it may lead to discretionary interpretations.

**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?*

**Response**

No, we do not agree with the Board's proposal. In line with our answers to Question 8 related to ED 3 and Questions 2 and 5 related to impairment of assets, we believe that intangible assets should be amortised.

**Other comments**

*Directly attributable expenditures*

The deletion of item (d) in paragraph 58 (old paragraph 54), regarding overheads that can be allocated, seems to be a consequential amendment of the improvements proposed to IAS 16 *Property, Plant and Equipment* as published by the Board in its Exposure Draft of May 2002.

The Board confirmed in its November 2002 deliberations that administration and general overhead costs are excluded from the cost of an item of property, plant and equipment. However, we believe that the overheads referred to in the old paragraph 54 (d) should be regarded as directly attributable costs to generate the asset, for example in the case of Research and Development, and should be reinstated.