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REF: Invitation to Comment: Exposure Draft - ED-3: BUSINESS COMBINATIONS

We are María Cecilia Subelet and Carlos Javier Subelet and we are Certified Public Accountants, and we live in Santa Rosa, La Pampa, Argentine Republic.

We are pleased to submit our comments on the above Invitation to Comment as prepared by the International Accounting Standards Board.

Our comments are directed at the specific topics identified in the Invitation to comment issued by the IASB.

Our opinion does not represent to any educational or professional institution of our country.

We would want to receive an answer of your institution about the consideration given to our opinion, as well as, if it was possible, a copy of the final standard which results of the exposure drafts.

In the attached file **comments.zip** we made the considerations to the issues and questions of Invitations to Comment, following the outlined structure and adding the observations that we have believed timely

Yours sincerely:

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NOTE: In this response to the Invitation to Comment prepared by us, different fonts have been used to distinguish between IASB questions and our comments:
IASB Questions – Garamond Comments – in Arial Narrow

Invitation to comment on ED 3 Business Combinations

Question 1 – Scope

The Exposure Draft proposes:

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

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

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

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

Answer:

(a) We agree with the IASB. Given the complexity of the business combinations that imply entities under common control, it is necessary that it considers them in a second phase of project on business combinations of the IASB.

(b) Yes, we agree with it.

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?

Answer:

We believe in the first place that if it was used in widespread way a model based on fair values it would be forbidden the use of the uniting of interests method, and the question would be to use the purchase method or the fresh-start method, because the use of this model of fair value increases the predictive value and feedback value of financial information given regarding the future cash flows that must be generated by the assets and liabilities of the combined entity

Since in this first phase of the project of business combinations, the IASB had decided not to carry out a study with depth about the advantages, disadvantages and practical inconveniences of the application of the fresh-start method, it is not had an enough information as to express in a conclusive way the application of the same one as an exception of the purchase method.

This is a reason, for which we believe that it is convenient the allowance of an only method (that of the purchase method) for the accounting for business combinations that are within the scope of the ED 3 of the IASB.

The advantages that arising of the application of the purchase method as the unique for the accounting for business combinations they are the following ones:

1) The comparability increases, when allowing that similar business combinations are accounting for an only method, throwing similar results;

2) It reduces the possibility of the existence of the accounting arbitrage that can show through the following two forms:

    a) the elimination of the implicit subjectivity in the determination of the necessary requirements to apply the method that is exception of that purchase method;

    b) the possibility of the existence of manoeuvres of *"structuring the transactions of combination of business"* is eliminated, to be able to achieve the application of the alternative method that generates better accounting results;

3) We don't believe that it is necessary to admit an exception to the purchase method when the cases to which the alternative method would be applied (for example, fresh-start method) they would be some few ones.

4) the proponents of the existence of two methods for the accounting for business combinations indicate that the comparability is based on representational faithfulness and that the same one is not improved when different things (true mergers and acquisitions) they are treated as if they were similar. It deserves two considerations:

    a) the difference in the structuring of the transaction can be due, ***sometimes***, only to purpose of achieving the application of an accounting method of two or more allowed, situation that is avoided with the application of an unique method;

    b) it can be that in substance the transactions are different. We believe that because the costs-benefits considerations justify the application of the purchase method in a widespread way. If we analyse the ***costs-benefits considerations*** at the global level of the community, we could see that it would be bigger the money, time and effort dedicated by the standards-setters and regulators to settle down the criteria and the interpretation of the same ones that allow the application of the method that is the exception to that of the purchase method. The auditors and the regulators would incur in higher costs to verify if a correct application of the same ones is making. In contrast, we believe that they are smaller the benefits that would take place to the community, the possibility to have more representative information by means of the application from an exception method to the purchase method, for a relatively reduced number of business combinations[1].

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:

(a) proposes to modify the circumstances in which a business combination could be regarded as a reverse acquisition by clarifying that for all business combinations effected through an exchange of equity interests, the acquirer is the combining entity that has the power to govern the financial and operating 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?

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

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

Answer:

(a) We consider appropriate the description of the circumstances carried out in the IFRS X: *Business Combinations*, proposal for the accounting for the reverse acquisitions. This is because it places the economic substance of the transaction over its form, offering this way more useful information for the users of the financial statements.

(b) We consider that the additional guide is adequate since it provides the pertinent tools for the treatment of the reverse acquisitions.

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

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[1] Part of these considerations are presented in the paragraph 152, of the Discussion Paper "G4+1 POSITION PAPER: RECOMMENDATIONS FOR ACHIEVING CONVERGENCE ON THE METHODS OF ACCOUNTING FOR BUSINESS COMBINATIONS, A Discussion Paper issued for comment by the Staff of the International Accounting Standards Committee, DECEMBER 1998.

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?

Answer:

The IASB proposal requiring the use of the purchase method to accounting for all of the business combinations, implies that the acquirer entity will have to be identified in each combination.

We believe that the IASB position is appropriate when requiring that in those business combinations in which is created a new entity, one of the combining entities shall be considered as the acquirer.

We sustain our opinion in that, if IASB would consider to the newly created as the acquirer, in fact the *fresh-start method* would be applying, in which the recently formed entity is the acquirer and the combining entities are the acquired, such which the IASB affirms in the Basis for Conclusions. Therefore, if the IASB had allowed that the new entity was considered as the acquirer, it would be admitting an exception in fact to the purchase method.

Passing now to the analysis of the paragraphs BC42-BC46 of the Bases for conclusions of the ED 3, we believe necessary the following observations:

1. BC42 and BC43. We coincide with the content of the BC42. We consider correct the position pointed out in the last sentence of the paragraph BC43, for the one which the IASB expressed that the fact of considering as the acquirer to the newly formed entity would provide the users of the financial statements of the group, with better information that the focus in which one of the combining entities should be treated as the acquirer. This is not inconsistent with our position pointed out in the previous paragraphs, since it is owed it more to a flaw of the IASs of applying in a widespread way a model of fair values that to a problem characteristic of the purchase method, because if IASB considers under the purchase method to an predecessor entity like the acquirer, this last it would not be forced to apply fair values in the measurement of the assets and liabilities.

2. The paragraph BC44 deserves, in our opinion, the following considerations:

   (a) We recognize that the fact of considering one of the predecessor entities like the acquirer, it can give place in the practice to the inconvenience of determining which of them is the acquirer. But we don't believe that it should necessarily be carried out it in an arbitrary way. For this they could take into account the following approaches:

      (i) ownership interest of the combining companies;
      (ii) board control;
      (iii) key management representation;
      (iv) pre-combination market capitalization;
      (v) post-combination market capitalization;

(vi) Fair Value of net assets of the combined entity and the combining entities[2].

It is necessary to carry out two additional comments.
The first of them refers to that some of these approaches can give place to contradictory and difficult results of auditing.
The second it refers to that the identified approach up as (*vi*), it would be useful and that information is generally possessed when the ratio of exchange of the share participations is determined, with that which is not necessary to incur in more expenses to obtain it.

b) In connection with the last paragraph of the BC44 that indicates that the entity providing the purchase consideration is considered as the acquirer, and it would be considered as having the control of each one of the pre-existing combining entities, we don't believe that the case is always that the combined entity would be the controlling of the combining entities.

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?

Answer:

We believe that it is correct the position adopted in the ED 3 *"Business Combinations"*, since it should not be departure from the general approach settled down in the IASB's *Framework* for the recognition of a liability. In other words, we believe that the entities can only make the allocating the cost of the combination of the restructuring provisions for the activities from the acquired one to the date of the acquisition, only if it exists as a liability, i.e. it should also fulfil the IAS's 37 requirements. Therefore, the generating fact of the liability for restructuring of the activities of the acquired one should be previous to the date of the 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

[2] Most of these criteria were carried forward from Financial Accounting Series Nº 201-A of September 7 1999, Exposure Draft "Proposed Statement of Financial Accounting Standards. Business Combinations and Intangible Assets", paragraphs 162 and subsequent.

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?

Answer:

In function of our previous answers our opinion is supporting toward the measuring of the assets and liabilities to their fair values.

We don't find reason of the inconsistency outlined in the paragraph BC82 of the Basis for Conclusions among the concept of liability in the IAS 37 and of the IASB's Framework IASB, with their fair value measurement, since that the application of the concept of probability like criterion that it should satisfy a liability for its recognition.

Thus, since the concept of liability incorporates to the probable outflow of resources that it contains futures benefits economic necessary for its settle, while the fair value shows the assessments that the participants of the market make about the timing, amount and ***probability*** of the outflow of resources that contain futures benefits economic necessary to settle it.

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?

Answer:

So many times in these comments, we have indicated our position on two very important topics:

(a) The need for the widespread application of the model of fair values for the measurement of the assets and liabilities, and contingent liabilities, and

(b) The need to reduce the quantity of alternative treatments allowed in the IASs, since if exists a accounting treatment that offers more useful information that other, it would not be justified to maintain the alternatives, except in case the most appropriate treatment doesn't overcome the test cost-benefit.

We believe that the proposal contained in the ED 3, that the identifiable assets, liabilities and contingents liabilities of the acquired to be measured to fair values without considering the existence of a minority interest, is appropriate.

We believe that the benchmark treatment of the IAS 22, outlined in the BC89 of the ED 3, is incorrect since, besides not providing useful information for the users of the financial statements for the analysis of the future cash flows to be generated by the acquired net assets, it affects seriously to the comparability and reliance of the information given by the financial statements. This last because, for example, two entities that possess the same identifiable assets, liabilities and contingents liabilities, and that they are same in all the other respects, but that they differ in the ownership of the equity (we say, in the first one 100% of the equity belongs to a group of persons and in second there is a group majority shareholder that controls 80% of the equity, and an minority interest of 20%), in the consolidated financial statements they would differ the values of its identifiable assets, liabilities and contingents liabilities, what would not be representationally faithful.

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?

Answer:

The Framework issued by the IASC in 1989, states that for the recognition of an item in the financial statements, it must satisfy the following criteria indicated in the paragraphs 82, 83 and 84 of the Framework:

a) *Definitions*. It refers to that the item to be incorporated in the financial statements satisfies the definition of one of the elements of the same one, in others words, be an asset, liability, equity, income or expense.

b) *Measurability*. It refers to that the item has a cost or value that it can be quantified in a reliable way.

c) *Relevance*. It refers to the fact that the information about that item has the potential effect to make a difference in the user decisions.

d) *Economic benefits*. It refers to that the item in question should imply that futures economic benefits will flow from or toward the entity

Next we will pass to analyse each one of the four points above.

Regarding to *section a*) (*definition*), the goodwill acquired in a business combination is an asset. Just as it is expressed in the Basis for conclusions, the goodwill satisfies the necessary requirements for its recognition like an asset.

Some persons assert that the goodwill is not an asset, sustaining it in that it doesn't satisfies the requirement of the exchangeability, i.e. it cannot be sold separately from the business. We believe that the exchangeability, is not an essential requirement to define an asset since its essence it is given by the economic benefits that the goodwill will generate without consideration of if it makes through its sale separately from the entity or by means of its combined use for the production and/or sale of the goods or services that constitute the object from the entity to which belongs

Regarding to *section b*) (*Measurability*), a number of commentators expressed that generally the internally generated goodwill cannot be measured on an objective basis and for such a reason it is not recognized in the financial statements. However, in the case of the acquired goodwill in a business combination, the cost of this combination constitutes a base for the initial measurement of the purchased goodwill.

As well the IASB indicates in the paragraphs BC100-BC101 of the basis for conclusions of the ED 3 *Business Combinations*, the measurement of the *"core goodwill"* is complex and stiller to recognize separately to each one of its components identified in the paragraph BC97. However, we believe that it is preferable the recognition of the *goodwill* like an asset, although this contains the components (c) and (d) already mentioned in the before paragraph that to write-down immediately in the gains and losses account, since it improves the predictive and feedback value of the financial statements information.

Some persons say that the fact of recognizing as an asset to the purchased goodwill in a business combination and not to the one internally generated, it harms to the companies that internally grow with regard to those that make it for acquisition.

We believe that it is true and it affects the comparability of the financial statements of both entities negatively. But we believe that the fact of eliminating the recognition of the acquired goodwill in a combination would imply a significant loss of information for the users of the entity acquirer's financial statements; that it would not be compensated with a supposed bigger comparability with the financial statements of the entity that it grows internally.

Regarding to *section c*) (*relevance*), just as expressed the FASB[3] an important number of research studies has demonstrated the existence of a relationship between the recognized purchased goodwill and the capitalization of the company.

Regarding to the fact that the accounting for goodwill after its initial recognition at the cost less the accumulated impairment losses, we agree with it. We sustain our opinion in the following paragraphs, through an analysis of the alternatives identified in the paragraph BC104 of the ED 3, expressing the advantages and disadvantages related with each alternative, the critics that deserve them in our opinion and the reasons that support the selected alternative.

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[3] The mentioned studies are indicated in the footnote 33 of the Financial Accounting Series Nº 201-A of September 7 1999, Exposure Draft "Proposed Statement of Financial Accounting Standards. Business Combinations and Intangible Assets".

The paragraph BC104 of the Basis for conclusions of the ED 3, identifies three methods for accounting for goodwill:

(a) straight-line amortisation but with an impairment test whenever there is an indication that the goodwill might be impaired;

(b) non-amortisation but with an impairment test annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired; and

(c) permitting entities a choice between approaches (a) and (b).

We agree with the IASB as for that the alternative (c) it is not reasonable, since the fact that the entities can choose between the amortization and the impairment test annually and the only amortization of the goodwill, it diminishes the reliance and the comparability of the information given by the financial statements.

Like it will be seen later on, the approach of the non-amortisation but with an impairment test annually or more frequently, it gives more useful information that the approach (a).

The proponents of to straight-line amortisation of goodwill with an impairment test whenever there is an indication that the goodwill might be impaired, justify it through the following reasons (paragraphs BC106-BC108 of the Basis for conclusions of the ED 3):

1) It is consistent the amortisation for the goodwill with the amortisation of the other intangible and tangible assets that they don't have indefinite useful lives;

2) The purchased goodwill is consumed and replaced by the goodwill internally generated. The amortisation allows to eliminate to the purchased goodwill and it is avoided to recognize internally generated goodwill;

3) It is not known in a certain way the extension of the useful life neither the consumption pattern, to amortize the goodwill during an arbitrary period is the only practical solution.

These reasons deserve to us the following critics:

1) we consider inappropriate to the *rationale 1*) that assimilates to the goodwill to the other tangible and intangible assets with finite useful lives. The goodwill that is residual, usually contains some tangible and intangible assets whose measurement and recognition separately from the goodwill would be too expensive and complex. Some of these assets are usually non-wasting and for it cannot be amortised, for example, the excess that it is paid when buying a company that possesses a legal exclusivity license for the provision of a certain service that is renewable indefinitely and at a low cost and that it makes to the main activity of the entity; in this case, the goodwill is non-wasting neither can amortised.

2) Related to *rationale 2*), as it is indicated in a paper ***(Viewpoints)*** presented by Todd L. Johnson and Kimberley Petrone "Why Did the Board Change Its Mind on Goodwill Amortization?" available in the website of the FASB dated at December of 2000, of the

field test carried out by the FASB they conclude that most of that paid by the goodwill in many of the acquisitions is related with the "synergistic" goodwill instead of "going concern" goodwill. This is due to that majority of an acquiree's technologies, know-how, and the like can be leveraged by the acquirer, with the consequence being that the benefits of the purchased goodwill can be extended to the acquirer's assets therefore, it cannot separate to an acquired goodwill of one internally generated in the context of the reporting units that are involved in the combination. Thus, in our opinion the presumption adopted by those who support the amortisation of the goodwill acquired in a business combination, when expressing it would not be appropriate that the goodwill internally generated it replaces to the acquired goodwill. We believe that coexistence could be given both goodwill, although it doesn't imply to refuse that the acquired goodwill is a wasting asset.

3) Related to the *rationale 3*), although it is a practical solution for it not is appropriate, and it fails in to give a representational faithfulness of the decrease of the goodwill value. In this way, we believe correct the critic that the goodwill is not subject to a regular pattern of decline, in some periods it can diminish deeply, in other to diminish slightly, or not to have modifications.

As we already expressed above, the most appropriate method is the impairment test without amortisation. We support our opinion in:

1) The impairment loss is recognized for the goodwill when it happens, without to hold it to a systematic pattern and regulate of decline;

2) Regarding to subsequent cash flow test, we believe that it is not appropriate due to:

    a. it only considers the changes in the estimates of the cash flows (it replaces the values estimated by the current values), and it doesn't make the same with the other elements of the computation of the current value (like, for example, the discount rate);

    b. the test when having to be performed in each one of the years of the cash flows, can be burdensome; and

    c. we agree with the IASB (paragraph C74 of the Basis for Conclusions for revised IAS 36) in that the amounts of the impairment losses calculated according to this subsequent cash flow test are hypothetical because it doesn't take the current values of the cash flows for the remaining years.

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?

Answer:

The solution proposed by the ED 3: *Business Combinations*, it is appropriate. We believe that, just as the exposure drafts asserts, the sequence of steps to determine the excess it is the appropriate one to detect the existence of a gain or loss like consequence of the business combination.

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?

Answer:

(a) We agree with the acquirer initially must account for the combination using those provisional values, since it gives to the users financial statements estimated information of the combination, which would be preferable to the IAS's 22 alternative that provides information when the definitive values are obtained. Regarding if the period of twelve months is appropriate to conclude the initial accounting for business combination, the IASB should carried out a field study that contains the different types of business combinations and this way to be able to determine a reasonable term on objective and realist basis.

(b) We agree with the position taken by the IASB.

Invitation to Comment on IAS 36

Question 1 – Frequency of impairment tests

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

Answer:

In the first place it should be added in the proposed paragraph 9 revised of IAS 36 as part of the internal information regarding a possible impairment loss to the existence of recurrent negative operating results for financial performance for the reporting segment to which belongs the cash-generating units.

We don't agree with the paragraph 8A proposed in the revised IAS 36 since we consider that test for impairment to the acquired goodwill and the intangible assets with indefinite useful lives, still when some indication of impairment doesn't exist it would not be of a effective cost to make it.

Therefore, we believe that the revised IAS's 36 proposed paragraph 96 should be eliminated for that although that proposed in that paragraph would reduce of the costs of application of the impairment test, the benefits generated to the users of the financial statements coming from the information given by that test continue being less at those reduced costs, because it would be not probable that this impairment test detects a impairment loss.

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?

Answer:

For to give answer to this question, we believe necessary to carry out the analysis of two matters.

The first of them refers to the representation faithfulness. That is to say that similar things should be treated in a similar way, and to the inverse one, different things should be treated in a different way. Therefore, we believe that the intangible assets with indefinite useful lives are more similar to the goodwill instead of the tangible or intangible assets with limited and determinable useful lives on objective basis[4].

In this first point, it would seem reasonable that test for impairment to the intangible assets with indefinite useful life in two steps similar to the one carried out on the goodwill.

The second question refers to the practical possibility of implementing an impairment test of two steps on the intangible assets with indefinite useful life. We believe that it would be difficult the determination of an implicit value of this intangible asset with indefinite useful life separately from the implicit value of the goodwill. If on the contrary, the IASB would decide to use a fair value as recoverable amounts, they would be in that would be difficult to determine that fair value for the intangible assets that don't have a observable market in many cases.

For everything it, we believe that the best possible solution is to apply to these assets an impairment test of a single step, in a similar way to the others assets according to the revised IAS 36.

Question 3 – Measuring value in use

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

(a) should an asset's value in use reflect the elements listed in proposed 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?

<u>Answer:</u>

a. We agree since they are the same ones that those mentioned in the paragraphs 23 and 29 of the FASB's SFAC 7[5], being that the value in use is one of the applications in the accounting of present value techniques.

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[4] Some have manifested in this sense that the goodwill has a limited useful live and that far from decreasing its value along the time, it is increased. We do not agree with this position.

[5] *"Using Cash Flow Information and Present Value in Accounting Measurements"*, Statement on Financial Accounting Concepts 7 of Financial Accounting Standards Board, Norwalk, year 2.000.

We agree with the alternative presented in the paragraph 25A, either like adjustments to the discount rate or adjustments to the cash flows only in the cases in that a great uncertainty doesn't exist as for the timing and amount of the cash flows, ***and that in the cases of great uncertainty on cash flow timing and amount we are agree in that is only applied expected present value of the future cash flows***. This is because, if the present value techniques were applied correctly it would give a result that it would be a more faithfully representation.

b. We coincide with the position adopted by the IASB.

It is usual that the projection techniques used in the preparation of the financial budgets keep in mind the estimate errors made in prior periods (i.e., the differences between the estimated values and the current values of the predicted items), which allows to the management to incorporate in the estimates of the future values the knowledge obtained starting from errors (or on the contrary, the accuracy of the estimate carried out by the management) made in the past. When being based the present value technique on these financial budgets and projections, it incorporates within this current value all the circumstances mentioned in this paragraph (*b*).

c. In the first place we believe that one of the most important challenges that faces the accounting is how to carry out the determination of the present value of the cash flows for its use like primary measurement of certain assets and liabilities, and also for the determination of the value in use. It is our belief that a deep study of the topic should be made; just as the FASB made it and the same one gave place to the issue of the SFAC 7. Therefore, we believe that it is insufficient that treatment given by the IASB to the topic, when limiting it to a brief appendix to the revised IAS 36.

In second place, the Appendix B deserves us the following critics:

- The paragraph B2 outlines the existence of two alternative approaches to computing the present value of the future cash flows, the 'traditional' approach and the 'expected cash flow' approach. We believe that, in the measurement of the cash flows that they are subject to a bigger uncertainty regarding to the amount and opportunity of them, ***is more appropriate the use of the 'expected cash flow' approach because it will be more representationally faithful of the weighted average of all possible outcomes that it would be obtained***.

- It should be specified with more precision what are the necessary adjustments proposed by the paragraph B18 of the Appendix B, so that starting of the entity's weighted average cost of capital or the entity's incremental borrowing rate, arriving to the discount rate. It would be necessary to indicate, for example, how it is subtracted from the weighted average cost of capital the premium for financial risk and for business risk and how it is carried out the calculation of the rate associated to the risk of the cash flows generated by the asset to incorporate it in the discount rate

With the purpose to clarify our critics presented in the previous paragraphs we add the following development.

In the first place the 'traditional' approach consists on developing a better estimate of the cash flows and the selection in consequence of an appropriate discount rate. The experience has demonstrated that, except for the case of asset with observable market prices, it would be difficult to be able to determine that '*rate commensurate with the risk'*, especially when they are of assets whose cash flows don't have contractually determinated dates of perception, but based on estimates.

The 'traditional' approach incorporates within the estimate of the cash flows the effect of the future amount based on an only amount (the best estimate), but the decisions made by the users of the financial statements are based in the amount, opportunity and uncertainty of the cash flows to be generated by the assets. The difference is detected when the uncertainty and the opportunity of the cash flows are significant. The solution is the *'expected cash flow' approach*.

In addition, it is also difficult to find an only interest rate, *ex ante*, that capture the uncertainty and timing of the cash flows.

But it doesn't imply that the traditional approach should never be used. In the case of being financial assets that have markets with observables interest rates the determination of this rate is quite simple. The entities can use this rate for other assets in the extent to the timing and the amount of the cash flows to be generated by the assets are quite similar, and waiting that its similarities continues, the traditional approach it could give place to appropriate results at a reasonable cost. But not all the assets have cash flows with similar risks and opportunities to the existent ones in a market observable, and in these cases it is more appropriate the *'expected cash flow' approach*.

Another problem is that the weighted average cash flow for one period (*'expected cash flow' approach*) it can differ of the best estimate of cash flow (traditional approach), since it depends on the probabilities distribution of the cash flows as well as the time and the amount.

With the purpose to illustrate the aforementioned a figure is presented below, in which three possible groups of cash flows are represented for the cash-generating units (*cases 1, 2 and 3*). To each case it is assigned the following occurrence probabilities: case 1, *20%*; case 2, 60%; case 3, *20%*. Then for the different cash flows associated with each case and every period during which the cash-generating units produces them, different occurrence probabilities are shown. For the first period of the *case 3*, a *triangular distribution* it is shown (i.e., with three possible values) of a more probable case, the worst and the best case.

The *traditional approach* would take for the cash flows of every period (for example, for the case 3, Cf_1, Cf_2, Cf_3, Cf_4 *and* Cf_5) the most probable values and it includes in the discount rate the concepts of uncertainty associated to the cash flows (i.e. instead of the case 3, it occur the cases 1 or 2; and the probability that instead of the most probable cash flow for every period [Cf_{mp}] it happen the worst or the best case), the premium for the risk for the asset and the time value of money. Thus, the computation of the discount rate would be very complex and difficult to audit.

The *'expected cash flow' approach* adjusts the cash flows of the cash-generating units for the uncertainty associated to the timing of the cash flows (i.e., for the probability of the cases 1, 2 and 3). Also, the cash flow of every period is adjusted by the probability related with the different possible amounts (i.e., the probabilities of the Cf_{wc}, Cf_{mp} and Cf_{bc}). The present value of each cash flow is calculated according to a discount rate that is free of risk.

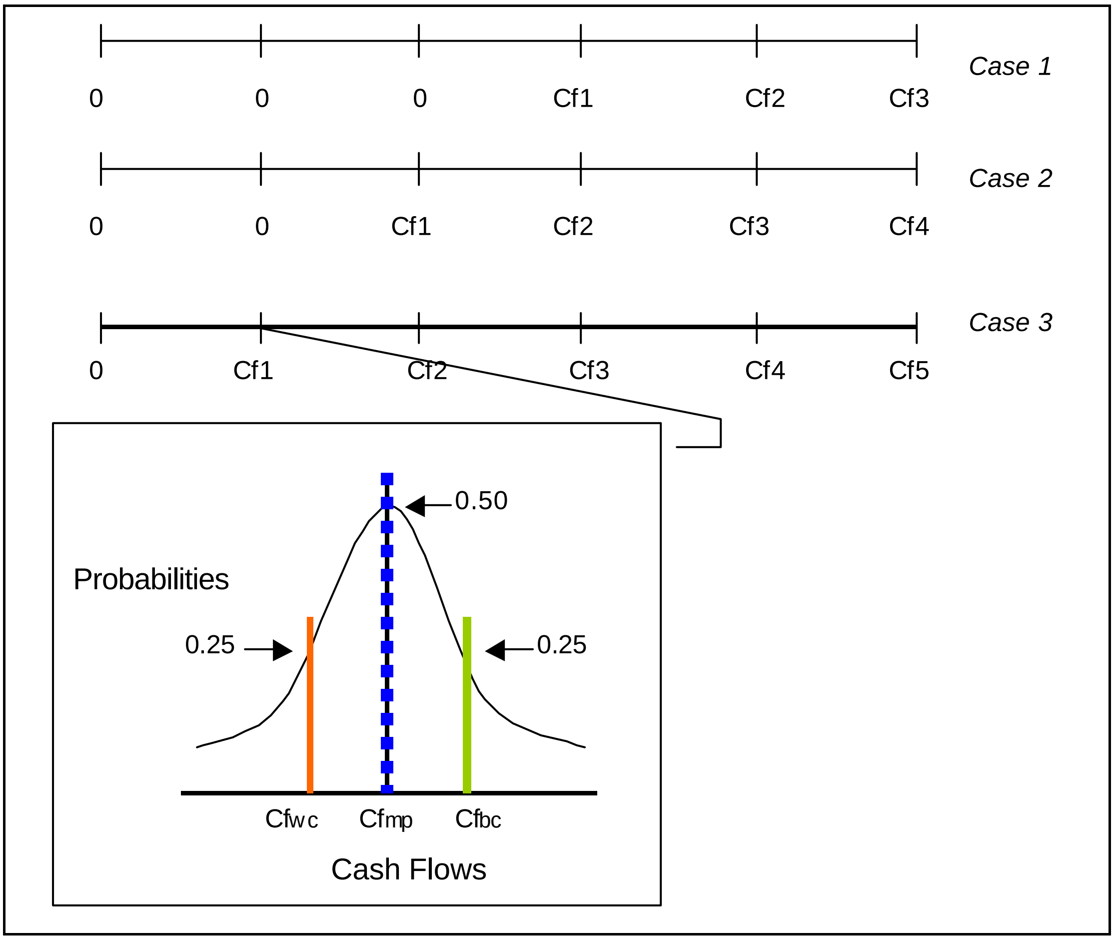

Exhibit 1

Managers can compute expected present value without undue effort and extraordinarily complex models.

In many cases, expected present value can be computed using information that is already part of existing estimates used in the preparation of financial budgets.

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?

Answer:

(a) We agree that to the purpose of the impairment test of goodwill acquired in a business combination to be assigned to each one of the cash-generating units that it cannot be larger than a segment based on the entity's primary reporting format determined in accordance with IAS 14 *Segment Reporting*.

We coincide with the rationale presented in the paragraph C20 of the Basis for Conclusions of the revised IAS 36.

(b) We agree with the proposed by the IASB, regarding to determination of the gain or loss for the disposal of the operation that constitutes a portion of the cash-generating unit, to be included in the cost of disposal of this operation the portion of the acquired goodwill.

However, ***we don't agree that*** the attributable portion to the acquired goodwill to be determined on the basis of the operation's disposal price *plus* the recoverable amount of the portion of the unit retained, since the same ones are not homogeneous values.

The example shown after the proposed paragraph 81 of the revised IAS 36, according to our opinion it is incorrect.

We believe that it is incorrect the proposed method since it adds different things. The operation's price of disposal contains the fair values of the sold assets *plus* a portion of the acquired goodwill *plus* a portion of the internally generated goodwill *plus* a gain for operation's disposal[6]. The recoverable amount of the portion of the unit retained contains: the cash flows to be generated by the retained assets *plus* the cash flows to be generated by the acquired goodwill attributable to the retained assets *plus* the cash flows attributable to the internally generated goodwill referred to the retained assets. Therefore, we can appreciate that the values to add don't contain the same elements.

[6] Some persons say that in many cases the excess of the price paid by the acquired assets is usually the salesman's gain, without being supported by the acquisition of futures benefits economic.

We propose that another methodology to be used because we believe it is more internally consistent. The proportion of the acquired goodwill attributable to the disposed operation would be calculated in the following way:

1. the recoverable amount attributable to the operation disposed would be determined by means of subtracting to the recoverable amount of all the operations that integrated the cash-generating unit before the disposal – calculated to the disposal time– the recoverable amount of the operations remainders that integrate the cash-generating unit –to the same date of the disposal–;

2. would be determined the quotient that results of dividing the recoverable amount attributable to the assets of the operation disposed –to the date of the disposal– divided by the recoverable amount of the total of the operations that integrated the cash-generating unit before the disposal;

3. the quotient (or percentage) determined in the *step 2*, it is applied on the carrying amount of the acquired goodwill.

As consequence and in our opinion, the proposed paragraph 81 clause b) should be modified so that it is presented in the following way:

81. If an entity disposes of an operation within a cash-generating unit and goodwill has been allocated to that cash-generating unit, the goodwill associated with the operation disposed of shall be:

(a) included in the carrying amount of the operation when determining the gain or loss on disposal; and

(b) measured on the basis of the relative values of the recoverable amount of the portion the operation disposed of, regarding to the recoverable amount of the cash-generating unit before the disposal.(modified according to our proposal)

Example (modified according to our proposal)

An entity sells for 150 an operation that was part of a cash-generating unit to which goodwill has been allocated. The recoverable amount of the entire cash-generating unit –i.e., including the operation disposed of– is 400. The recoverable amount of the portion of the cash-generating unit retained is 300

Therefore, the recoverable amount of the operation disposed of at this time, is 100 (400-300).

25% (100/400) of the goodwill allocated to the cash-generating unit is included in the carrying amount of the operation that is sold.

(c) We agree with the use of the relatives values approach to carry out the reallocation of the goodwill when the entity modifies the composition of one or more cash-generating units (CGUs) to which the goodwill has been allocated. We believe that it is insufficient the example presented after the revised IAS's 36 proposed paragraph 82, since this example doesn't explain each one of the steps that conform the proposed methodology appropriately.

We believe that revised IAS 36 should incorporate an illustrative example as an appendix to the Standard, detailing the process of the calculation method.

By virtue of the critic expressed in the previous paragraph, we present three possible methodologies[7].

Methodology 1: Goodwill allocation in function of the portion of the reallocated identifiable assets to each cash-generating unit.

Data:

Carrying Amounts before the reallocation:

CGU A's Carrying Amounts	
Goodwill (CGU A)	$ 25
Identifiable assets (UGE A)	$ 75
Total	$100

CGU's recoverable amounts before the reallocation:

CGU	Recoverable amounts	Carrying amounts
A	$ 110	$ 100
B	$ 150	$ 120
C	$ 200	$ 180
D	$ 250	$ 220
Total	$ 710	*$ 620*

[7] Between the same one cannot be exactly the proposed by the IASB, due to it is not very detailed the guide contained in the example mentioned.

Then, we proceed to reallocate to the CGU A's assets among the CGUs B, C and D.

Next, the table shows the carrying amounts of the identifiable assets attributed to each CGU:

CGU	*Carrying amounts of allocated identifiable assets*	*Percentage of participation of the assets received by each CGU on the reallocated total*
B	$ 15	20%
C	$ 45	60%
D	$ 15	20%
Total	$ 75	100%

After the reallocation of the CGU A's identifiable assets to the CGUs B, C and D, we have the following carrying amounts:

CGU	Carrying amounts
A	-
B	$ 120 + $ 15 = $ 135
C	$ 180 + $ 45 = $ 225
D	$ 220 + $ 15 = $235
Total	$ 595

Now, we proceed to reallocate the goodwill in function of the portion of the CGU A's identifiable assets to the CGUs B, C and D.

CGU	*Percentage of participation of the identifiable assets received by each CGU on the reallocated total*	*Carrying amount of goodwill attributed to each remaining CGU*
B	20%	$ 25 x 20% = $5
C	60%	$ 25 x 60% = $15
D	20%	$ 25 x 20% = $5
Total	100%	$ 25

After the reallocation, we have the following carrying amounts for each CGU:

CGU	Carrying amounts
A	-
B	$ 135 + $ 5 = $ 140
C	$ 225 + $ 15 = $ 240
D	$ 235 + $ 5 = $ 240
Total	*$ 620*

Methodology 2: Goodwill allocation in function of the recoverable amounts of the cash-generating units existent before the reallocation of the CGU A.

Data:
The data is the same that one to the previous methodology.
We proceed to reallocate the goodwill in function of the percentage that represents the recoverable amount for each CGU to which are reallocated the CGU A's assets, on the sum of the recoverable amounts of the CGUs B, C and D.

CGU	Recoverable amounts	Percentage
B	$ 150	(150/600) = 25%
C	$ 200	(200/600) = 33.33%
D	$ 250	(250/600) = 41.67%
Total	*$ 600*	*100.00%*

Then, the goodwill allocation to the different CGUs would be:

CGU	*Percentage of participation of the recoverable amounts of the CGUs B, C and D on their sum*	*Carrying amount of the goodwill attributed to each remaining CGU*
B	25%	$ 25 x 25.00% = $6.25
C	33.33%	$ 25 x 33.33% = $8.33
D	41.67%	$ 25 x 41.67% = $10.42
Total	*100.00%*	$ 25

As consequence, the carrying amounts of each CGU after the reallocation would be the following ones:

CGU	Carrying amounts
A	-
B	$ 135 + $ 6.25 = $ 141.25
C	$ 225 + $ 8.33 = $ 233.33
D	$ 235 + $ 10.42 = $ 245.42
Total	*$ 620*

Methodology 3: Goodwill allocation in function of the recoverable amounts of the cash-generating units existent after the reallocation of the CGU A.

Data:

The data is the same that one to the previous methodology.

We proceed to reallocate the goodwill in function of the percentage that the recoverable amount of the CGUs B,C and D represent (after the reallocation of the CGU A), on the sum of those values.

CGU	Recoverable amounts[8]	Percentage
B	$ 200	(200/740) = 27%
C	$ 252	(252/740) = 34%
D	$ 288	(288/740) = 39%
Total	*$ 740*	*100.00%*

Then, the goodwill allocation to the different CGUs would be:

CGU	*Percentage of participation of the recoverable amounts of the CGUs B, C and D on their sum*	*Carrying amount of the goodwill attributed to each remaining CGU*
B	27%	$ 25 x 27% = $6.75
C	34%	$ 25 x 34%= $8.50
D	39%	$ 25 x 39%= $9.75
Total	*100.00%*	$ 25

As consequence, the carrying amounts of each CGU after the reallocation would be the following ones:

CGU	Carrying amounts
A	-
B	$ 135 + $ 6.75 = $ 141.75
C	$ 225 + $ 8.50 = $ 233.50
D	$ 235 + $ 9.75 = $ 244.75
Total	*$ 620*

Critics:

We find the *methodology 1* inadequate since the fact of the goodwill distribution according to the percentages in that the CGU A's identifiable assets were allocated, it supposes that the goodwill can assign itself at a smaller level that the CGU, fact to which we oppose.

We find the *methodology 2* inadequate since it could not apply in case an only CGU is divided to form other new CGUs. The recoverable amounts that take are also those before the CGU A reallocation, with that which they don't contain to the goodwill.

For all of this, the *methodology 3* is the one that we find appropriate.

Question 5 – Determining whether goodwill is impaired

The Exposure Draft proposes:

[8] The recoverable amounts increase, not only for the CGU A's reallocation, but rather also for the synergy generated by the combination of the assets.

(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?

Answer:

a) There are two main approaches as for the determination of the recoverable amount:

1. the most profitable alternative use;
2. the most probable immediate destination.

The *first approach* establishes that the recoverable amount ***is the higher of an asset's its net selling price and its value in use***, being sustained in that a rational management will use that asset in the destination that allows to obtain the biggest value.

The *second approach* is based on the determination of the recoverable amount according to the immediate destination to which will be affected to the asset. In others words:

- if the asset is available for sale: to use the ***net selling price***;

- for the remaining assets: to use the ***value in use***.

The proponents of the second approach criticize to the first one, indicating:

a) it supposes that it is always available the possibility to use or to sell the asset, situation that it is not always present for the assets available for sale that don't have an value in use, or it is one very low;

b) it supposes that managers will take the necessary decisions to dedicate to the asset in the most profitable alternative, omitting to the possible barriers for the sale of certain assets;

c) it ignores the fact that the decision of keeping an asset can depend on the comparison of its net selling price with a value in use calculated in way different to that according to the International Accounting Standards, or by virtue of that the manager hopes in the future they will improve the prices and the sold quantities of products or services elaborated with the respective asset.

Regarding to the first critic (*clause a]* above), we believe that it is appropriately responded in the paragraph B29 of the Basis for Conclusions of the IAS 36 of June of 1998.

Regarding to the third critic (*clause c]* above), although it is correct the presented situation, since nobody remains in a business in a conscious way to see how their resources vanishes, it is omitted to consider the effect on the calculation of the value in use that would have that increase in the price and/or volume of sales. In other words, supposing that this future increase doesn't reach to compensate the current fall registered in the short term, the value in use would probably continue being smaller than the sale value with that which the person would lose money if decides to stay with that asset in that business.

Therefore, we support the application of the approach of determining the recoverable amount based on the base of the higher of an asset's its net selling price and its value in use. We believe that this approach should be retained and should be used inclusive to determine the recoverable amount in the case of the goodwill.

b) We believe that the use of the screening mechanism is appropriate, since it is based on a consistent and reasonable presumption that if there is a decrease in the value of the goodwill it would also be reflected in a decrease in the value of the remaining identifiable assets that integrate the CGU; in others words, there is a correlation between the impairment of the goodwill and the corresponding to the CGU's identifiable assets.

In addition, the screening mechanism allows achieving that the impairment test of two steps to be of a reasonable cost, since the calculation of the implicit value (the most onerous step) would be carried out when it exists an indicator that the CGU's recoverable amount is below the CGU's carrying amount.

c) We agree with the methodology proposed in the revised IAS 36. Despite of the "cushions" mentioned in the paragraphs C28-C40 of the Basis for Conclusions, we believe that of the available alternatives it is the best.

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?

Answer:

We agree with the position adopted by the IASB, and with that expressed in the paragraphs C62-C65 of the Basis for Conclusions of the revised IAS 36.

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?

Answer:

(a) It is appropriate that the entity has required disclosing the information indicated in the proposed paragraph 134, since the same one contributes to increase the available information for the users of the financial statements, with the purpose of evaluating the consistency of the presumptions used for the computation of the CGU's recoverable amount. Thus, we believe that none of the items mentioned in the proposed paragraph 134 should be eliminated.

(b) We agree with the disposed in the proposed paragraph 137 of the revised IAS 36.

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?

Answer:

We don't agree with the requirements to define to the intangible assets and those they are only if they fulfil the ‘identifiability’ criterion, and an asset satisfies that criterion when it is separable or arises from contractual or other legal rights.

We will base our opinion through the analysis of the definition of intangibles assets, the ‘identifiability’ criterion proposed in the revised IAS 38, the existence of some items that they would be outside of the definition of intangibles assets, and finally, the proposed definition.

Analysing the proposed definition of intangibles assets presented in the proposed paragraph 7 of the revised NIC 38, we can observe that the intangible assets are defined by exclusion, i.e. they are those non monetary assets, without physical substance, but that the most important element for their consideration like such it is the ‘identifiability’ criterion.

Therefore, it is very important the existence of a clear definition of the ‘identifiability’ criterion. In the proposed paragraph 11 of the revised IAS 38, the IASB expressed that an item fulfils the ‘identifiability’ criterion when it satisfies the following requirements;

a) It is separable; or
b) It arises from contractual or other legal rights.

The following exhibit summarises the aforementioned.

Criterion 2 / Criterion 1	It arises from contractual or other legal rights	It not arises from contractual or other legal rights
It is separable	*Yes, it is an intangible asset* according to the proposed paragraph 11 (for example, patent of invention of an industrial product).	*Yes, it is an intangible asset* according to the proposed paragraph 11 (for example, a non-patented production technology)
It is not separable	*Yes, it is an intangible asset* according to the proposed paragraph 11 (for example, license of broadcasting of a radio station that it cannot be sold separately from the station).	*No, it is not an intangible asset* according to the proposed paragraph 11 (for example, organization and pre-operating expenditures)[9]

Exhibit 2

Like we can observe in the above exhibit, those items that don't have physical substance, whose future economic benefits will flow to the entity, but they cannot be separated from the entity and

[9] These expenditures include mainly the payments made in the constitution of the reporting entity, for example, the fees of the professionals who participate in the constitution of the entity, the expenditures in the legal registration, etc.

they don't arise from contractual or other legal rights, ***according to the proposed paragraph 11 of the revised IAS 38 they are not intangibles assets.***

However, in the Argentine Republic, the Technical Resolution Nº 9[10] ***Second Part, Chapter III, paragraph A.6. Intangible Assets***, it includes to the organization and pre-operating expenditures within the intangible assets[11].

According to our opinion, the organization and pre-operative expenditures are intangible assets. Therefore, the IASB should modify the definition of Intangible Assets presented in the proposed paragraph 7 of the IA 38 revised to include to these expenditures.

The proposed definition would be the following one:

> ***An <u>intangible asset</u> is an identifiable non-monetary asset without physical substance <u>and those items that without being identifiable (neither they are separable neither they arise from contractual rights or other legal rights) but that they will generate probable benefits economic futures and its cost can be measured reliably (organization and pre-operating expenditures).</u>***

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.

<u>Answer:</u>

We don't agree with the IASB in that it should always exist enough information to measure the fair value of an intangible asset acquired in a business combination for its recognition separately from the goodwill after having fulfilled the 'identifiability' criterion.

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[10] "Normas Particulares de Exposición Contable para entes comerciales, industriales y de servicios" (modified by RT Nº19), issued by Federación Argentina de Consejos Profesionales de Ciencias Económicas, año 1987, Buenos Aires, Argentina.
[11] These assets will generate benefits economic futures during the life of the created entity since they allow their operation under legal conditions

In other words, we coincide with the Board member's view presented in the ED 3's paragraph AV20, ***that it is erroneous the assertion that equals identifiability with economic measurability***.

We believe that the problems as for the determination of the fair value of those intangible assets acquired in business combinations and that they fulfil the identifiability criterion, in most of the cases they are due to the lack of an active market where they are traded similar assets, or existing a market with willing buyers and sellers for active similar, the transactions are of characteristic peculiar of such way that it is not probable to carry out a transaction of sale of the asset in question.

To illustrate some of the indicated circumstances above we present some real examples, but that we have modified the names of the companies.

Example 1 - Case of an asset that doesn't possess an active market

A company, "Acquired Incorporated", it possesses a strategic business unit[12] dedicated to the telecommunications activities, more precisely electronic data interchange (EDI) inside a country Z. In addition, in the year 20X0 "Acquired Incorporated" acquired the government license for electronic data interchange (EDI) in 20.000. The use of this service is associated with the acquisition by the potential users of the technology and the equipment that should be imported and whose costs represent a significant investment. At the end of 20X1 and the first half of 20X2 takes place a devaluation of the country Z's currency of 250%, and a strong reduction in the potential users' sales.

By the middle of the year 20X3 the devaluation is stabilized, and the "Acquired Incorporated" has not been able to implement the service of electronic data interchange (EDI) for the causes mentioned above. In that same time, "Acquirer Incorporated" buys "Acquired Incorporated" in a business combination and inside the acquired assets it is the license of reference.

The license in spite of being a separable asset of the acquired entity, and arise from a legal right, since it was granted by the government (for example, Federal Commission of Telecommunications), given the delay by the potential clients in the incorporation of the necessary equipment and technology to use the service of electronic data interchange (EDI) - although perspectives of recovery of the business exist in the medium term- doesn't exist a market in which there are willing buyers for that license.

In accordance with that said in the previous paragraph, this license would not have a fair value although it fulfils the other criteria and it contains benefits economic futures due to the projections of recovery of the business of electronic data interchange (EDI) in the medium term.

Example 2 - Case of an asset that doesn't possess an active market

A chain of retail stores, "Retailers Incorporated", as consequence of the passes of a new tax act it should implement a new device or machine of registration of their sale operations in each one of their sale points. The tax act was passed in the beginning of 20X1. Those devices are

[12] The "Acquired Incorporated" possesses other strategic business units: 1) of exploration and extraction of oil and gas; 2) of civil constructions; 3) of iron and steel industry. The purchase operation (business combination) it includes to all the entity's strategic business units of the entity.

incompatible with the retail chain's general software. Therefore, it is necessary the development of a special software to coordinate to both systems to beginnings of 20X1.

At the end of 20X1, the Company B buys "Retailers Incorporated" in a business combination, and within the transferred net assets it is the software specially developed to coordinate to both systems. In the market of computer products, at the end of 20X1, the general software is already sold compatible with the new device or machine of operations registration. In this case, the special software developed by "Retailers Incorporated" could be sold in the market since other companies that have similar needs exist and that they would not find of an effective cost to buy the already general compatible software, but they would be willing to buy the special software. Thus, it would be of very difficult determination the fair value of the special software developed by "Retailers Incorporated", since the price will be negotiated by the buyer and the seller and it cannot settle down in a reliable way.

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?

Answer:

We coincide with the IASB as for the elimination of the rebuttable presumption that the useful life of the intangible assets cannot overcome the 20 years, for those that have finite useful lives as indefinite. We believe that it is more representationally faithful that the useful life of an intangible asset is determined in function of the period along which the asset in question will generate the future cash flows, without imposing an arbitrary maximum limit.

Who support the determination of a maximum period of amortization –for example, 20 years– they justify their position, mainly, in the following reasons:

a) planning horizons rarely go beyond 20 years and that the value of cash flows that are expected to be received more than 20 years hence would be nearly zero if discounted at virtually any appropriate discount rate;

b) a maximum amortization period for goodwill is necessary since it is not feasible to distinguish to the different elements of the goodwill;

c) it is necessary to establish a maximum limit because the product life cycles are becoming shorter and technology is changing more rapidly.

These reasons deserve us the following considerations:

1. Regarding to *reason a)* we can express that it is not so rare that it should be kept in mind a planning horizon of more than 20 years. If we observe in Latin America (and mainly the Argentine Republic) the transferring process to the private sector of many companies of the public sector (state enterprises) and the provision of the public services (railway, airports, water companies, etc) we can observe that the terms of the same ones rarely are less than the 30 years, with the possibility of its renewal. Thus, the planning horizons for these big companies overcome the 20 years.
   Regarding to the second part that is to say, that the present values of the futures cash flows to be generated when they rarely represent material nominal amounts they come nearly zero if discounted at virtually any appropriate discount rate. For example, a license that allows to operate an airport of a big city for 40 years, and that it is considered that the same one will generate a estimate annual cash flow of 20.000.000[13], the present value of the cash flow for the useful life of 20 years it is of $1.222.005,58[14], the current value of the cash flow of the year 30 is of $302.061,09[15] and for the cash flows of the year 40 it is of $74.664,89[16] and these values ***are not near to zero***.

2. Regarding to the *reason b)* we can express that the goodwill contains different elements. Some of them can have a longer, same or smaller duration to the 20 years limit. With the determination of a maximum of 20 years, it would be reduced or extended the useful life of those elements of the goodwill whose life useful would be longer or smaller, respectively that this limit. It would not be representationally faithful.

3. Regarding to the *reason c)* we can express that it is solved with an annual impairment test, once exists an indicator that the intangible asset could be impaired, without determinate a maximum limit to its useful life.

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)?

<u>Answer:</u>

Yes, we coincide with the IASB's position when it establishes that the useful life of an intangible asset that arise from of contractual rights or other legal rights should include the period(s) of renawal(s) of its rights in the extent to the renovation is carried out at a minimal cost. But always,

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[13] To simplify the calculations, let us suppose that the future cash flows along all of their useful life are the same.

[14] $[1/(1+0,15)^{20}]$ x 20.000.000.

[15] $[1/(1+0,15)^{30}]$ x 20.000.000.

[16] $[1/(1+0,15)^{40}]$ x 20.000.000

it will be had as limit the period during which is considered that the item generates future economic benefits.

In other words, the useful life of an intangible asset is the lower of the period that includes to the renewals of the contractual rights or other legal rights when it can make it to a minimal cost, and the period during which is expected that that intangible asset generates future economic benefits for the entity.

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?

Answer:

We agree with the IASB as for that if it is determined that an intangible asset possesses an indefinite useful life it should not be amortized, but rather it would be tested for impairment whenever exists an indication that it could be impaired.

We don't coincide with the proposed paragraph 104 (a) in the sense that an intangible asset should be test for impairment when it doesn't exist an indication that the same one could be impaired, otherwise it would not be of an effective cost. In this sense we have also expressed in the Answer to the question 1of the Invitation to Comment on the revised IAS 36.

Others issues

Issue 1

We believe that it has not been correct the modification to the definition of value in use contained in the revised IAS's 36 paragraph 5 that it expresses:

"Value in use is the present value of ~~estimated~~ the future cash flows expected to ~~arise~~ be derived from ~~the continuing use of~~ an asset or cash-generating unit ~~and from its disposal at the end of its useful life~~."

We consider that previous definition should stay unmodified. In this way, since it indicates which are the concepts that generate the cash flows to be considered.

Issue 2

In the proposed paragraph 36 of the IAS 38 (revised) reference is made to the recognition of the assets that they are acquired by way of a government grant. It is remitted the IAS 20 (reformatted in 1994) and in the revised IAS's 38 paragraphs proposed 26 and 27 two methods are presented for the recognition of a government grant related with capital assets that they were not still recognized in a systematic and rational way in the profit or loss in the period:

(a) Like a deferred income (paragraph 26);

(b) Like a reduction in the asset's carrying amount.

But the concept of deferred income would imply the existence of a liability, but that it would not fulfil the definition of liability since it doesn't imply ***a probable outflow of future economic benefits to cancel it (that IASC's Framework, paragraph 60 requires).***

And here an <u>*inconsistency*</u> would also be presented. The proposed paragraph BC117 of the Basis for Conclusions of the ED 3 *Business Combinations*, indicate that the negative goodwill doesn't fulfil the criteria for its recognition as a liability, we believe that in essence because it doesn't imply the existence of an obligation to provide assets or services to others (that is to say, it doesn't imply a future outflow of economic benefits) since it is a discount on the fair value of the acquired net assets. While the government grant with regard to the capital assets that neither will imply an obligation to give goods or to provide services to others (it would not be a government grant, rather than it would be a loan) it is allowed its recognition like deferred income. This, in our opinion is inconsistent, and it should be solved in this phase of the Project of Business Combinations.

For everything it, we believe that the alternative of the IAS's 20 (revised in 1994) paragraph 26 should be eliminated.

Issue 3

The proposed paragraph 82 of the revised IAS 38 expressed that, the difference between the carrying amount and the revalued amount, unless that it reverses a revaluation decrease of the same asset and that revaluation decrease was previously recognised as an expense, it shall be credited directly to equity. This is contrary to the approach of the paragraph 88 of revised IAS 1, ***since the gains shall not be credited directly to equity***.

In the same sense, the proposed paragraph 84 of the revised IAS 38 settle down that when the cumulative revaluation surplus included in the equity it passes directly to results accumulated without making t previously for the income statement[17], whenever the revaluation surplus is realized. We find this unacceptable and it would be contradictory with the IAS 1 (revised in 1997) paragraph 88. Moreover, this topic was clearly, in our opinion, considerate by the FASB and the G4+1[18] when it expressed:

> ***Revalued assets***
>
> 3.13 Present practice in those countries where revaluations of tangible fixed assets are permitted draws a distinction between gains and losses on fixed assets that are the result of revaluations, which are generally reported either in a second performance statement or as a movement in equity (a

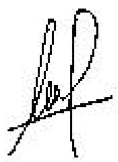
[17] It would be difficult to interpret for the readers of the financial statements that the retained earnings account that it contains the results of the different periods –shown for the respective income statements- that don't still have a specific destination, it contains a result that it didn't still go by the income statement that specifically should show it.

[18] Cearns, Kathryn and others, *Reporting Financial Performance: A Proposed Approach*, Special Report, FASB, 1999.

> reserve), and gains and losses that arise on disposal, which are reported in the income statement. However, the essential nature of the gain or loss seems not to differ between these two cases, it is simply that the timing and certainty of the recognition of the gains or losses is different. In short, revaluations simply recognise gains or losses piece-meal over time until final disposal[7] . It is therefore proposed that, in a system that permits revaluations, gains and losses arising on the revaluation or disposal of fixed assets should be reported in the 'other gains and losses' section of the single performance statement (unless losses are caused by impairments: see paragraph 3.15).[8] [footnote reference omitted].

For everything it, we believe that, in the countries where revaluations are permitted, they should be recognized in the financial performance statement, and not to present them directly in the equity.

Sincerely yours,



CPN Carlos Javier Subelet **CPN María Cecilia Subelet**