LIBA

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3 April 2003

Annette Kimmitt
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London
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By email to: CommentLetters@iasb.org.uk

Dear Ms Kimmitt,

Exposure Draft ED 3 Business Combinations
Exposure Draft of Proposed Amendments to IAS 36, Impairment of Assets, and IAS 38, Intangible Assets

I am writing on behalf of LIBA (the London Investment Banking Association) to comment on the above Exposure Drafts. LIBA is, as you may know, the principal UK trade association for investment banks and securities houses; a full list of our members is attached.

While we generally support the Board's proposed approach, we do have a number of specific comments on certain aspects of the Exposure Drafts. These are set out below, and follow the structure of the questions in the "Invitation to Comment" sections of the Exposure Drafts. Please note that we have not responded to all of the questions.

Exposure Draft ED 3 Business Combinations

Question 2 – Method of Accounting for Business Combinations

We agree in principle that there are advantages to the adoption of a single method of accounting for business combinations. In particular, a single method helps to create a level playing field, both within and across accounting jurisdictions, and should enable the financial statements to provide greater transparency on the effects of business combinations.

We generally support the use of the purchase method of accounting for business combinations, based on its stronger conceptual merit and broader applicability. We believe, however, that the notion of a "merger of equals" should be retained, at least in the longer term. While the application of this concept should be tightly limited, its availability is important because the purchase method does not adequately embrace every type of business combination. We recommend that the IASB pursue this issue jointly with the FASB as part of a longer term agenda.

Question 8 - Goodwill

We believe the residual value (purchase price less the value of identified net assets) represents the value of the "going concern" element of a business (see paragraph BC97). This value includes all the amounts that the ED would recognise as goodwill and other purchased intangibles. For both categories we advocate an impairment only model, not simply because the going concern has an indefinite life, but because the value of the going concern must constantly be regenerated. The investment needed for this regeneration will be represented by costs (such as product development and technology) that are generally expensed as incurred. This expensing of the regenerating costs serves as a current cost proxy for the amortisation of the going concern value at acquisition. When adequate investment is not made to regenerate the going concern it becomes impaired. Compared with the amortisation model, an impairment model provides better comparability and is a better indicator of future performance, a principal objective of the model the Board wishes to put in place.

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

We agree that where the acquirer's interest in the fair value of the acquiree's identifiable net assets is greater than the cost of a business combination, the amount of the excess should be recognised immediately as a profit. This is because negative goodwill results from the business combination and as such the economic benefit derived from acquiring a company for less than the fair value of the net assets is realised at the point when the transaction occurs.

Given that negative goodwill should only occur in rare circumstances, we also agree that prior to recognising the excess in income, it is prudent to reassess the identification and measurement of the assets and liabilities acquired, and the measurement of the cost of the business combination.

Exposure Draft of Proposed Amendments to IAS 36, Impairment of Assets

Question 4 – Allocating goodwill to cash-generating units

We have significant concerns that the proposal for testing impairment at the level of a cash-generating unit will cause difficulties for both preparers and users of financial statements. Paragraph 74 clarifies that this should happen only when "the cash-generating unit represents the lowest level at which management monitors the return on investment in assets that include the goodwill", but it is unclear what level of management is being referred to. Requiring entities to allocate goodwill at a very low level will increase the likelihood that different entities will allocate goodwill in different ways (in line with differences in organisational structure & management), and thus impair comparability between them.

We are particularly concerned that the definition of cash-generating unit proposed in Paragraph 73 will in practice be unworkable for the banking and securities-trading sectors. In these sectors the assets are predominantly intellectual capital and cash, and the "smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent from other assets or groups of assets" could therefore be interpreted to mean a very low level, possibly as low as an individual trading desk.

We believe that it would be stronger to link the units of aggregation for impairment testing directly to the segments under IAS 14 Segment Reporting, which is similar to the US approach.

This approach would have several advantages. Testing at the higher level is conceptually consistent with the notion that goodwill represents synergies between acquirer and acquiree. The segmental reporting concept is widely understood and evaluating goodwill at the same level would take advantage of systems and procedures that are already in place. It would also enhance comparability since there is greater similarity across industries between entities at a segment level than at lower levels where unique organisational structures become more apparent. This can only enhance the usefulness and relevance of goodwill information to users of the financial statements.

Exposure Draft of Proposed Amendments to IAS 38, Intangible Assets

Question 5 – Non-amortisation of intangible assets with indefinite useful lives

We agree with the Board's decision to remove from IAS 38 the rebuttable presumption that the useful life of an intangible asset cannot exceed twenty years. However, we further believe that acquired intangible assets should in general not be amortised. This is because intangibles and goodwill share very similar characteristics. As described in our response to ED3 Question 8 above, they tend to be recreated and renewed as the business grows, with associated costs being expensed as incurred. Therefore, rather than amortising acquired intangible assets, we believe they should be tested for impairment in the same way as goodwill.

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I hope that these comments are helpful. We would of course be very pleased to expand on any particular points if there are aspects which you find unclear, or where you would like further details of our views.

Yours faithfully

Ian Harrison

Ian Harrison
Director

LONDON INVESTMENT BANKING ASSOCIATION

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31 March 2003