

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN
COMMENTS ON EXPOSURE DRAFT 3 BUSINESS COMBINATIONS**

CL 38

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?

ICAP Comment (a) and (b)

Yes. Considering that transactions involving business combinations to form a joint venture or business combinations of entities under common control are distinct from the normal business combinations, a separate standard may be issued for the accounting of such transactions.

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?

ICAP comment

Yes. Allowing more than one method of accounting impairs the comparability of the financial statements.

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

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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?

ICAP comment

- (a) Agreed that appropriate description of the circumstances is given in the IFRS.
- (b) Agreed with the additional guidance provided.

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

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

Is this appropriate? If not, why not?

ICAP comment

Agreed with the proposal of identifying one of the combining entities as an acquirer.

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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?

ICAP comment

Yes. This would bring convergence with the requirements of IAS 37.

Question 6 – Contingent liabilities

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

Is this appropriate? If not, why not?

ICAP comment

Yes.

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?

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ICAP comment

Agreed. This way the minority interest holders would also be able to identify the fair value of their investment i.e. they will be in a position to quantify the effect of business combination on their investment.

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?

ICAP comment

No. To ascertain the impairment of goodwill would be difficult task. The entity formed after the business combination may have its internally generated goodwill. Bifurcation of acquired goodwill with the internally generated goodwill and its impairment would be a difficult task. Therefore, the acquired goodwill should be recognized as an asset and should be amortised.

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?

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ICAP comment

Yes.

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?

ICAP comment

- (a) No. Time period for completing the initial accounting for business combination should not be restricted. Business combinations involve lengthy procedures and the time lag between the date on which the acquirer effectively obtains control of the entity and agreement date may be such that the completion of accounting for business combination may not be completed within a year.
- (b) Yes.

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COMMENTS ON PROPOSED AMENDMENTS TO IAS 36

Invitation to Comment (IAS 36)

The Board would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

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?

ICAP Comment

Yes, but there is no mention of testing impairment whenever there is an indication that the intangible asset may be impaired as mentioned in paragraph 104(b) of ED of revised IAS 38.

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?

ICAP Comment

Agreed with the contention being appropriate.

In order to maintain the comparability and reliability of financial information it would be of immense use to adopt same method of determining recoverable amount and the treatment of impairment losses for all groups of identifiable assets irrespective of their life spans. For example, inability to accurately forecast the future cash flows associated with assets with indefinite useful lives is compensated by the yearly reviews of impairment testing. Adopting different method would impair the usefulness of information provided to users about entity's identifiable assets.

Question 3 – Measuring value in use

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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?

ICAP Comment

- (a) Agreed that it is appropriate to consider the elements listed in proposed paragraph 25A.
- (b) Agreed that the assumptions on which cash flows projection are based take into account both the past actual cash flows and management's past ability to forecast cash flows accurately.
- (c) Agreed that the additional guidance on present value techniques is appropriate.

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?

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- (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?

ICAP Comment

- (a) **The level of suggested by the ED is acceptable being appropriate, identifiable and easy to use for operational reasons.**
- (b) Yes. The goodwill associated with disposed operation should be included in the carrying amount of operation while determining gain or loss.

If the value of goodwill relating to a disposed operation could be measured reliably and separately from the unit, then that value should be used to measure the amount of goodwill to be excluded from the unit's total allocated goodwill and in determining gain or loss instead of using relative values.

- (c) Agreed with the proposition being appropriate.

Question 5 – Determining whether goodwill is impaired

The Exposure Draft proposes:

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

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

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

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

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

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

ICAP Comments

- (a) Agreed, as it is in line with measuring the recoverable amount of any other asset within the framework of IAS 36.
- (b) Agreed that screening mechanism proposed by Exposure Draft is appropriate for identifying potential goodwill impairment.
- (c) Agreed that the method for measuring impairment losses for goodwill proposed by Exposure Draft is appropriate.

Question 6 – Reversals of impairment losses for goodwill

The Exposure Draft proposes that reversals of impairment losses recognized 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?

ICAP Comment

Considering that recognition of internally generated goodwill is not allowed under IAS 38, it is appropriate to prohibit reversal of impairment losses recognized for goodwill.

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?

ICAP Comments

- (a) **Disclosures required by proposed paragraph 134 (e) and (f) would lead to lengthy and complicated information being made part of the financial statements. A number of users may not possess the level of specialized**

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knowledge and skill that would be required to understand the information included in the financial statements.

- (b) If the disclosures required under paragraph 134 (e) and (f) are finalized then a separate disclosure for a cash-generating unit should be made to report exceptions as identified in paragraph 137. However, reporting a cash-generating unit separately from its segment would mean further bifurcation of the assets based on a criteria other than the one specified in IAS 14 "Segment Reporting".

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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?

ICAP Comment

Yes.

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.

ICAP Comment

Yes, the probability criterion of future economic benefits attributable to an asset that will flow to the entity should always be satisfied for intangible assets acquired in Business Combination. There may be other intangible assets, such as specific management, technical talent, customer's and supplier's relationship and customer's loyalty, the fair value of these items is difficult to measure due to lack of sufficient information and should not be recognized separately from goodwill.

Question 3 – Indefinite useful life

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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?

ICAP Comment

Yes. The rebuttable presumption that an intangible asset's useful life cannot exceed twenty years did not seem appropriate as there are instances where economic benefits continued to flow towards the entity even after twenty years.

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)?

ICAP Comment

Yes. However, there is a possibility that despite a favorable expectation that future economic benefits will be received by the entity and the existence of the legal right of renewal, management does not intend to renew the contractual or legal rights for any reason. Therefore, management's intention for renewal of the legal rights should also be considered as an important factor while determining the useful life of the asset.

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?

ICAP Comment

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The suggested treatment may provide room for manipulation by the management of entities in assessing the useful life of an intangible asset as indefinite rather than finite, reassessment of the same at each year-end and testing the asset for impairment involves lot of judgment.

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