MONASH UNIVERSITY

Department of Accounting and Finance

29 March 2003

International Accounting Standard Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Submission on Exposure Drafts: Business Combinations and Amendments to IAS 36 and IAS 38

As you are no doubt aware, in December 2002, the Australian Accounting Standards Board (AASB) issued ED 109 which incorporates the proposals in IASB Exposure Draft 3 and the Exposure Drafts with proposed amendments IAS 36 and IAS 38. The AASB asked all respondent to ED 109 to forward a copy of their submission directly to the International Accounting Standards Board (the Board), accordingly I have attached a copy of my submission dated 28 March 2003. My submission on ED 109 was limited to a series of questions asked by the AASB and did not address all of my concerns about ED 3; those concerns are covered in this letter. I have serious concerns about both the drafting and technical requirements of ED 3.

Inappropriate drafting style

I am disappointed and perplexed by the poor drafting style and inattention to detail in ED 3. As the drafting deficiencies are wide spread it would have taken several weeks for me to provide a detailed commentary on them as I have in the

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past. Unfortunately, owing to more pressing responsibilities, I have been unable to find the time to do so.

Rule base *v* principle base accounting standards

While the Board claims to be putting forward principle based standards in ED 3 (and in ED 2), to me they look like rule based standards. Initial impressions on whether a rule based or principle based approach has been taken is coloured by the reader's experience with their domestic accounting standards. For example, if a resident of the United Sates of America (USA) compared the drafting of ED 3 with the drafting approach taken by the FASB, the reader may well conclude that ED 3 is fewer rules based and may be principle based. However, when one looks at what is said and they way it is said, the conclusion that proposed accounting standard is rule based rather than principle based is inescapable. As I understand it, the Board believes that its accounting standards must be principle based rather than rule based. If this is so, in the case of ED 3 it has failed abysmally.

Confusing standards, implementation guidance and basis for conclusions

In the following discussion, unless stated to the contrary, I use the term standard to refer to a specific requirement rather than the document; I use the term accounting standard to refer to the entire document. I support the approach to in paragraph 14 of the *Preface to International Financial Reporting Standards*, under which the standards imposing "main principles" are in bold text and other standards in plain text; implementation guidance and basis for conclusions being published in a separate document. Unfortunately, in ED 3 (as in ED 2) Board has apparently seen fit to abandon the separation. Much of the material included in the draft accounting standard is, in fact, implementation guidance or explains why a requirement is put in place (which surely should be in the Basis for Conclusions). This makes it extremely difficult for readers to "navigate" the accounting standard.

It is both unreasonable and improper for the Board to expect the reader to read five paragraphs of largely irreverent detail for every paragraph of "real" standard. Similarly, it should not be necessary to read the entire document to find out how to deal with one regulated issue. The inclusion of the "irrelevant detail" makes that task difficult, if not impossible for the reader to do so without reading the entire standard. The result is a document that is both inefficient and potentially ineffective as means of informing the reader of what is required.

Effective communication is further hindered by including several separate requirements in the one paragraph. This makes it difficult for the reader to find individual rules as they may be hidden in a paragraph that also puts in place another rule. Such an approach cannot be described as good practice, let alone (international) best practice.

What is the effect of the Board's decision to draft accounting standards in the way? In adopting this drafting style the Board effectively treats potential readers with disrespect if not contempt. It suggests to the reader that either the Board does not possess the skills and competencies that one would reasonably expect of professional standard setters or they just could not be bothered to do so. (The standard setters expected skill and competencies would include; the ability to clearly distinguish between and differentiate a standard from implementation guidance in respect of that standard, and the reason why the particular standard was put in place; to clearly and unambiguously express the requirements.)

Inexplicable failure to adopt (international) best practice

The drafting style adopted cannot be said to reflect international best practice. While no drafting style is likely to be perfect, some standard setters have developed drafting styles that are far more efficient and effective. For example, the drafting style adopted by the Australian Accounting Standards Board is user friendly. That style makes it easy to link the individual standards with any associated implementation guidance and with the reason why the Board decided to impose the particular standard. This imposes rigour on the drafting of standards which cannot be achieved with the approach adopted by the Board. The drafting style adopted by the Board can accurately be described as free form.

The only rationale I can think of for such a dysfunctional drafting style is that it resembles that used by the FASB and in order to get support from constituents in the USA the Board decided adopt a similar drafting style. If this is so, the consequent compromise cannot be sustained on a cost-benefit basis. Nothing is gained – and much will be lost – by bringing the FASB into the IASB fold if the resulting accounting standards are drafted in a manner that are almost impossible for the reader to read, understand and interpret.

Absence of rigour and defective technical requirements?

While it would be unreasonable to expect the Board to put forward proposals that I agree with on a technical level, it is not unreasonable to expect that they have been developed in a rigorous and logical manner. Many of the issues addressed in ED 3 would not need to have been addressed if the Board had approached the task in a rigorous and logical manner. For example, in deciding which entities are to be included in a business combination there are two key concepts; the first is that of **control** and the second is that of an **entity**. ED 3 contains a definition of reporting entity but not contain a definition of entity. We have a definition of **subsidiary** which depends on the undefined term entity; one entity (the parent) controls another entity (the subsidiary).

Failure to define “entity” and distinguish it from “party”

Does the failure to define “entity” matter? The answer to that question must be that it does. For instance, in ED 3 the Board has adopted the term “business combinations involving entities (or operations of entities) under common control”. In the definition of that term it is stated that more than one party can exercise control. (Interestingly, no attempt is made to differential “party” from “entity”; like entity “party” is not defined.) To a novice, it is difficult to comprehend why this concept is necessary. To me definition and use of term in ED 3 creates confusion rather than providing enlightenment. Indeed, I found both the material in the proposed standard and that in the basis for conclusions to unhelpful.

The approach taken in ED 3 suggests to me that we have three anomalies that need to be dealt with (see paragraph 5, 21 and 22):

1. the definition and use of “business combination involving …”;
2. identifying an acquiring entity in a reverse takeovers; and
3. identifying an acquiring entity when either one or two existing entities come under the control of a newly formed entity.

Each can properly be described as an anomaly as in each case it is implied that applying the proposed definition of “control” cannot deal with an observed phenomena. The existence of numerous anomalies that lead to exceptions or complex modifications to a theoretical construct suggests that the construct is flawed. If so, we must either abandon the theoretical construct or remove the flaw. Should we abandon “control” as the test for identifying a business combination? I do not think so. Is it possible to remove the flaw from our theoretical construct? It is my belief that is can be achieved with little effort. We can do this by adopting an appropriate definition of “entity”. For example, the definition of entity adopted in Australia precludes the need to introduce common control and control by one or more parties. In AASB 1024 entity is defined as:

> "entity" means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives;

This definition comprehends an entity that initially appears to be several parties or individuals. However, the nature of the relationship between them is such that an entity can be recognised that is both capable of, and in fact can, exercise control over another entity. If such an entity controls another entity, then it is a parent entity. If entity comprising such a parent and its subsidiaries is a reporting entity, then a consolidated financial report must be prepared for that entity. If it is not a reporting entity, then the issues raised in the ED are irrelevant.

In evaluating the requirements of ED 3 we must bear in mind the fact that a general purpose financial report is designed to provided information to assist in decisions and evaluations made by users; ***however*** we must also remember that the information is provided from the perspective of the entity (comprising the parent entity and its subsidiaries; the “consolidated entity”) and ***not*** from the perspective of those who own residual equity interests in the parent entity. That is we take an entity or parent entity approach rather than proprietary approach when dealing with a business combination. Accordingly, the application of “substance’ over form must be made in that context. Thus, if a new entity is formed and acquires by exchange of shares all of the shares in an existing entity, the fact that the individual shareholders are the same is ***irrelevant*** from the point of view of the consolidated entity. Although it is unclear from IAS 27 what approach is taken when the purchase method is applied, one thing is clear and that it that we are not taking a proprietary approach.

Can we distinguish an "acquiring entity" for a "parent entity?"

The suggestion that there can be a distinction between the identification of a parent entity in a consolidated entity and the identification of the acquiring entity when a new consolidated entity is formed is, on the face of it, outlandish. It would only be explicable if we were taking a proprietary approach to business combinations and consolidation. There is no suggestion anywhere in ED 3 or in IAS 27 that we are using a proprietary approach. Indeed, except when dealing with the three anomalies, both IAS 27 and ED 3 are incompatible with a proprietary approach.

Justifying the existence of the exception to the general rule (anomalies) on the basis of "substance over form" is not sustainable, since the alleged substance is contrary to the principles underlying the rejection of a proprietary approach to business combinations and consolidation. Resort to "substance over form" can only properly and ethically be made in the context of the objective to which the accounting standard is directed. Since the proposed accounting standard is not directed to implementing a proprietary approach to business combinations and consolidation, we cannot use a "substance over form" argument that is based on the proprietary approach and contrary to the entity (or parent entity) approach that has in fact been adopted. Accordingly, **resort to such an argument is completely indefensible** unless the advocate also supports adopting a proprietary approach – an approach that on the face of it is inconsistent with the use of control to define a consolidated entity.

In summary, since the rationale for consolidation is that one entity controls another, to characterise an entity other than the one through which the unifying control as the "acquirer" is as a matter of logic inconsistent and to do so "perverts" the meaning for control.

The objective in providing a general purpose financial report for a consolidated entity is to provide information on the consolidated entity's financial performance and financial position and to discharge accountability. Under ED 3, the composition of a consolidated entity is dictated by the control test, and that control is exercised by one entity over another; logically the accountably arises from that capacity to control. This must be so since the management of the controlling entity directly or indirectly controls the operation of the group entity to achieve common objectives or outcome. If the consolidation process does not reflect the pattern by which control is exercised, the information being provided cannot logically be in respect of the consolidated entity that is identified by the application of the control test.

Arguments in support of this “perversion” of control as the basis for recognising business combinations purport to be made in the “interests” of shareholders or from the perspective of shareholders. Unfortunately, shareholders – both as individuals and as a class – rarely participate in the due process for the development of accounting standards. Accordingly, those putting the “case for shareholders” will also be putting the case for some other constituency, be it preparers, auditors (public accounting firms) or corporate regulators. In the case of preparers, any claim that they a advocating a particular requirement in the interest of users or shareholders must be subject to close scrutiny to ensure the bona fides of the claim. In the past we would not treat with similar suspicion claims by public accounting firms that they were advocating a particular position in the interest of shareholders or other users of financial reports. However, in a post-Enron world we would be extremely foolish to take them at their word.

Are prepares of financial reports disinterested in the outcome? Clearly they are not. The result of adopting the “perverted” application of control is to use cost rather than fair value to measure assets which, in most cases, will result in lower expenses being recognised by way of depreciation and amortisation. There will be higher reported profits, a lower asset base producing significantly more favourable financial ratios.

If those advocating the perversion of the application of control are in fact preparers – or their stooges (albeit unwitting) – then we cannot accept the proposition in the absence of a well formulated, logical and rigorous argument, that is without defect or deficiency. If we adopt such a position on the basis of a defective argument there is a substantial risk of further besmirching the tattered reputation of the accounting profession and accounting standard setters in general.

Conclusion

In the post-Enron world, it is inexplicable to me how a responsible standard setter could contemplate a financial reporting procedure that appears on the face of it to be capable of facilitating false financial reporting without a rigorous, logical and compelling argument in support of doing so. The arguments presented in support of the “exceptions” are not – in my view – rigorous, compelling, or logical. Further, the fact that these similar exceptions may be included in the financial reporting frameworks of some countries is *completely irrelevant* even if that country be the United States of America. Standard setters in the United States of America until recently permitted the pooling of interest despite decades of concern that that method was being misapplied.

In the past standard setters may have been able to “afford” to cater to the wishes of prepares to the detriment of users of financial reports. That is, they accepted arguments that favoured the interest of preparers in absence of compelling arguments in circumstances where prepares would benefit and there was no apparent benefit to users of financial reports. To do so today in the post-Enron world can only described as reckless. If the proposals are adopted and they are subsequently implicated in a series of corporate collapses, some legislatures could ban the participation of the profession and preparers in the accounting standard setting process as part of a “takeover” of standard setting. Such an outcome is unlikely to be in anyone’s best interests, be it preparers, auditors or users of financial reports.

Overview

I am both shocked and disappointed by ED 3. It is **inexplicable, unacceptable** and **inexcusable** that the Board failed to define the key term of “entity”. Absent an appropriate definition of entity, the application of the control test in identifying the members of a consolidated entity and their interrelationship becomes problematic. Much confusion would also have been avoided if the Board had stated which approach to consolidation was being taken; while from IAS 27 and ED 3 it appears that an entity approach is taken, failure to expressly identify the approach has given rise to unnecessary confusion and the inclusion of arguments that become irrelevant once we agree that an entity approach is being taken rather than a proprietary or parent entity approach.

Effective communication would have been enhanced if the Board had given a "tag" to differentiate entities that are comprised of parent entity and its subsidiaries, from other entities; in Australia, the term "consolidate entity" is used. Also the definition "business combinations involving …" is unwieldy; surely a more concise tag could have been found. Its use mystifies and confuses rather than informs and assists the reader. A cynic would say that the term is used to add to the mystique of financial reporting and enhance the monopoly position of public accountants.

If the pooling of interest method is prohibited, and the anomalies are dispatched to the garbage bin where they belong, ED 3 becomes redundant. Anything that remains belongs in IAS 27 or a general accounting standard dealing with the acquisition of assets.

If technical staff of the Board wish to discussion any matter raised in the submission I can be contacted either by email:

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Yours truly,

Ian Langfield-Smith
Lecturer in Accounting

Department of Accounting and Finance

28 March 2003

Mr Keith Alfredson
Chairman
Australian Accounting Standards Board
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Victoria 8007

Dear Keith

Attached is my submission on ED 109. Unfortunately I have not had an opportunity to undertake a comprehensive review of the ED, however I have addressed the issues raised in the response document prepared by the Board.

While I understand that most of the technical content and drafting is outside the control of the Board, and that Financial Reporting Council has directed the Board to adopt standards made by the IASB and the old IASC, I would have though some critical assessment of the IASB's proposals would have been included rather than merely noting differences between the "international" proposals and the current Australian rules.

Having considered the technical content of ED 3 and the "amended" IAS 36 and the "amened" IAS 38, together with the drafting styles adopted and the way they are written, I have concluded that in making standards based on these documents the Board would be frustrating the achievement of most, if not all, of the objectives specified in section 124 of the AISC Act. Further, many of the requirements are incapable of providing a true and fair view of the matters required by the *Corporations Act 2001*, indeed they would in my opinion necessarily result a true and fair view not being given. While the Act recognises that in individual instances a standard may not give a true and fair view, this does not and cannot reasonably expected to override the requirement that the Board may not make a standard that is inconsistent with the Act.

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I urge the Board to reject not only the proposals in ED 3 but also the making of standards based on IAS 26 and IAS 38. In a post-Enron world I am amazed that a competent and professional standard setter would consider adopting regulations that appear not only facilitate false financial reporting but positively encourage it. The IASB is putting at risk its reputation and creating a risk of regulatory failure that would make recent financial reporting scandals in the United States and Australia pale into insignificant. One consequence of such a failure will be exclusion of profession from any role in standard setting because no politician in any country will sit back and accept what they would perceive as further "betrayal" by the accounting profession and the existing standards setting mechanisms.

If you or technical staff of the Board wish to discuss any of the matters raided in my submission my contact details are at the bottom of the first page of this letter.

Best wishes

Ian Langfield-Smith FCPA

AASB Request for Comments IASB ED 3 Response by Ian Langfield-Smith

5.2.1 IAS 36 “Impairment of Assets”

The following sections highlight other specific issues on which the AASB would value comments from constituents. Some are generic issues relevant to all sectors and some are sector-specific (for example, 5.2.1(b) relates to not-for-profit entities).

(a) Existing IAS 36 requirements to be retained within the proposed revised IAS 36

The IASB is inviting comments only on the proposed amendments to IAS 36. However, given that the AASB is considering adoption of the proposed revised IAS 36, the AASB encourages constituents to also include comments on existing IAS 36 requirements that the IASB intend to retain within the proposed revised IAS 36 in their responses to the AASB. Constituents are also strongly encouraged to send copies of these responses directly to the IASB.

The AASB would particularly value comments on the following:

(i) AASB Question 1 – Scope

The Exposure Draft proposes to include revalued assets within the scope of the revised IAS 36. (In contrast, ED 104 proposed that it would not apply to non-current assets measured at fair value in accordance with AASB 1041.)

Is the inclusion of revalued assets within the scope of the revised IAS 38 appropriate? If not, why not?

The inclusion is inappropriate. The problem is that IAS 38 applies the wrong measure for recoverable amount. The appropriate test is whether the carrying amount exceeds fair value. That is, the approach taken in AASB ED 99 is the correct one.

(ii) AASB Question 2 – Measurement of recoverable amount

The Exposure Draft proposes that if, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss. (See proposed paragraph 52). The recoverable amount of an asset is defined as the higher of its net selling price and value in use (see proposed paragraph 5 and 15).

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

Recoverable amount should be measured using fair value. Value in use (as defined) is not a measure; it does not relate to an existing state. An amount calculated by discounting expected future net cash inflows is not a measurement. It is merely a calculation which does not relate to the present in any meaningful way. As a matter of strict logic it is incorrect to describe such an amount as a measurement. It says does not depict current financial position or current period financial performance.
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There is no current economic condition that it can reasonably purport to provide information on.

Value in use is potentially relevant to predictions about the future, but says noting about financial position at reporting date. Fair value relates to the position at reporting date and is relevant to the decisions and evaluation made by users of financial reports.

In most circumstances, value in use fails to meet the minimum requirements for reliable measurement. In particular, it is susceptible to bias. It has such a high "measurement" error that it can only be used with extreme caution by "expert" users.

(iii) AASB Question 3 – Value in use calculation

The Exposure Draft proposes that value in use calculations only include the future benefits of capital expenditure that has been incurred rather than committed to (as is the case for restructuring) (see proposed paragraphs 37 – 42).

Is this appropriate? In particular, should the value in use calculation of an asset that is voluntarily scaled down to undergo a multi-period capital expenditure program exclude the future net benefits of capital expenditure that the entity is committed to but yet to incur? If not, why not?

As value in use is rejected as an appropriate measure, this question becomes redundant.

(iv) AASB Question 4 – Community service obligations

The Exposure Draft proposes that, where there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (see proposed paragraph 59).

Community service obligations are not specifically addressed in this Exposure Draft, but guidance is provided in the current AASB 1010/AAS 10 (paragraphs 5.3 and 5.3.2).

Does the concept of cash-generating units remove the need to explicitly provide guidance on calculating the recoverable amount of assets subject to community service obligations?

Undecided.

(b) Not-for-profit entities

As noted in section 1 above, the AASB has agreed that it should continue to issue one series of sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards peculiar to the not-for-profit or public sectors or that are purely of a domestic nature, the AASB intends to use IASB Standards as the "foundation" Standards to which it will add material detailing the scope and applicability of a converged Standard in the Australian environment and any other statements dealing with local requirements.

With regard to the proposed revised IAS 36, the AASB has prepared the "AASB IAS 36 Material: [Draft] Requirements specific to not-for-profit entities (refer section 6 below).

The AASB is seeking comments on the proposed AASB Material. The AASB would particularly value comments on the following:

(i) AASB Question 5 – Definition of a not-for-profit entity

A not-for-profit entity is currently defined within existing Australian pronouncements as follows:

"an entity whose financial objectives do not include the generation of profit".

The Exposure Draft proposes the following definition:

"A not-for-profit entity is an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls." (See IAS 36 AASB Material in section 6 below.)

Is this definition appropriate? If not, how should a not-for-profit entity be defined?

While the definition may be appropriate, in applying "special rules" for not for profit entities the question should be; Is the ***activity*** being reported on a not for profit activity?

(ii) AASB Question 6 – Assets of Not-for-Profit Entities that are Not Primarily Dependent on Net Cash Inflows

The Exposure Draft proposes that an asset's value in use, where a not-for-profit entity has an asset that is not primarily dependent on net cash inflows and whose future economic benefits the entity would replace if it were deprived of the asset, is the written-down current cost (depreciated replacement cost). (See IAS 36 AASB Material.)

Is this appropriate? If not, how should the value in use of such an asset be measured?

While a different measure may be appropriate, there is no obvious reason why written down current cost is the appropriate one. The appropriate measure is more likely to be the replacement cost of the remaining future economic benefits. Introduction of arbitrary depreciation allocations into the process can only mislead users of financial reports. The only argument that I can think of for including the gross amount is that it is indicative of aggregate future expenditures in replacing the assets. This is irrelevant to measuring current financial position. It should, of course, be disclosed prominently elsewhere in the financial report as it is useful in assessing future funding requitements.

(c) AASB Transitional provisions for entities that early adopt

The AASB is seeking comments on the proposed transitional provisions to be applicable for entities that early adopt. The AASB would particularly value comments on the following:

(i) AASB Question 7 – AASB transitional provisions

As discussed in the section 2.2.2(b) above, the AASB has considered a number of approaches with regard to transitional provisions to be included within the Australian converged Standard on impairment of assets.

The AASB considers a modified retrospective application of the Australian converged Standard as at the beginning of the reporting period to which it is first applied to be the most appropriate approach. Where this gives rise to initial adjustments which would otherwise be recognised in net profit or loss/result, the net amount of those adjustments, including any adjustments to deferred income tax balances, would be adjusted against retained profits (surplus) or accumulated losses (deficiencies) as at the beginning of the reporting period to which these proposals are first applied. (See section 4.2.3 above).

Are these transitional provisions appropriate? If not, why not?

It is not clear that the amounts of these adjustments would be disclosed – that is whether there will be a reconciliation with the amounts that would have been reported under the prior accounting policies. This information is essential.

5.2.2 IAS 38 "Intangible Assets"

The following sections highlight other specific issues on which the AASB would value comments from constituents. Some are generic issues relevant to all sectors and some are sector-specific (for example, 5.2.2(b) relates to not-for-profit entities).

(a) Existing IAS 38 requirements to be retained within the proposed revised IAS 38

The IASB is inviting comments only on the proposed amendments to IAS 38. However, given that the AASB is considering adoption of the proposed revised IAS 38, the AASB encourages constituents to also include comments on existing IAS 38 requirements that the IASB intend to retain within the proposed revised IAS 38 in their responses to the AASB. Constituents are also strongly encouraged to send copies of these responses directly to the IASB.

The AASB would particularly value comments on the following:

(i) AASB Question 1 – Research expenditure

The Exposure Draft proposes that no intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred (see proposed paragraph 46). The Exposure Draft takes the view that, in the research phase of an internal project, the entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.

Is the proposed treatment of research expenditure appropriate? If not, why not?

As a general proposition, the existence of future economic benefits cannot be determined or measured with a sufficient degree of reliability. It is better to rely on the general recognition criteria for assets rather than creating a plethora of special rules. At most all that is needed is an implementation guidance note referring to the asset recognition criteria and indicating that they will rarely, if ever, be satisfied for research activities.

(ii) AASB Question 2 – Development expenditure

The Exposure Draft proposes recognition of an intangible asset arising from development (or from the development phase of an internal project) if the entity can demonstrate the following:

- **it is technically feasible to complete the intangible asset so that it will be available for use or sale;**
- **the entity intends to complete the intangible asset and use or sell it;**
- **the entity is able to use or sell the intangible asset;**
- **the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset or, if it is to be used internally, the usefulness of the intangible asset;**
- **adequate technical, financial and other resources are available to complete the development and to use or sell the intangible asset; and**
- **the expenditure attributable to the intangible asset during its development can be measured reliably (see proposed paragraph 49).**

Are the proposed requirements appropriate for determining whether an intangible asset arising from development should be recognised? If not, what criteria are appropriate, and why? (Note not-for-profit specific questions in section 5.2.2(b)(i) below.)

These requirements are consistent with the recognition criteria for assets and address specific problems that are likely to be encountered where the recognition of a "development asset" is being considered. It would be preferable if it were clear that all that is being done is to clarify the application of the standard asset recognition criteria in a particular situation. This suggests that it may more appropriate for it to be in the implementation guidance rather than in the standard itself.

(iii) AASB Question 3 – Prohibition on the recognition of certain items as intangible assets

The Exposure Draft proposes that internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets (see proposed paragraph 55). The Exposure Draft takes the view that expenditure on these particular items cannot be distinguished from the cost of developing the business as a whole and therefore should not be recognised as intangible assets.

Is the proposed prohibition appropriate? If not, why not?

The prohibition is not appropriate. Two things are necessary for the recognition of any asset: First, that the definition is satisfied (which for present purposes can be assumed) and second that the recognition criteria are satisfied – the existence of the future economic benefits is more probable than not and there is a reliable measure (the relevant measure being the fair value of the controlled future economic benefits at reporting date).

(iv) AASB Question 4 – Revaluation of intangible assets

The Exposure Draft proposes that an intangible asset can only be revalued where there is an active market for that asset (see proposed paragraph 70). The Exposure Draft comments that active markets (as defined in the Exposure Draft) cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Furthermore, it is uncommon for an active market to exist for any intangible asset.

Is the proposed restriction on the revaluation of intangible assets appropriate? If not, why not?

The restriction is inappropriate. Provided a reliable measure of the fair value can be obtained, revaluation (remeasurement and restatement of carrying amount) should be permitted.

(b) Not-for-profit entities

The AASB is seeking comments on any issues relating to not-for-profit entities, including public sector entities, that may affect the implementation of the proposed revised IAS 38. The AASB would particularly value comments on the following:

(i) AASB Question 5 – Development expenditure in a not-for-profit entity

The Exposure Draft proposes recognition of an intangible asset arising from development (or from the development phase of an internal project) if the entity can demonstrate that certain criteria are satisfied (see 5.2.2(a)(ii) above for list of criteria).

Are the proposed requirements suitable for determining whether an intangible asset arising from development should be recognised by not-for-profit entities? If not, what criteria would be appropriate, and why?

Owing to the complexity of this issue and a lack of time to fully consider it, I abstain from making any comment.

(c) AASB Transitional provisions for entities that early adopt

The AASB is seeking comments on the proposed transitional provisions to be applicable for entities that early adopt. The AASB would particularly value comments on the following:

(i) AASB Question 6 – AASB transitional provisions

Assuming the proposals within the IASB's ED 1 are incorporated into an Australian converged Standard, upon first-time application of Australian Standards converged with IFRSs, Australian entities would be required to derecognise, as at the beginning of the annual reporting period to which it is first applied, the following:

- **all intangible assets that are not permitted to be recognised by the proposed Australian converged Standard;**
- **where an internally generated intangible asset is recognised at cost, the portion of the cost of the internally generated intangible asset that represents costs which are not permitted to be included in the cost of an internally generated intangible asset under the proposed Australian converged Standard; and**
- **all revaluations of intangible assets that are not permitted to be recognised by the proposed Australian converged Standard.**

Where this gives rise to initial adjustments which would otherwise be recognised in profit or loss/result, the net amount of those adjustments, including any adjustments to deferred tax balances, would be adjusted against retained profits (surplus) or accumulated losses (deficiencies) as at the beginning of the annual reporting period to which the proposed Australian converged Standard is first applied. In respect of revaluations of intangible assets that are not permitted to be recognised by the proposed Australian converged Standard, in the first instance, any initial adjustments would be made against the asset revaluation reserve to the extent, and only to the extent, that a credit balance exists in the asset revaluation reserve in respect of those assets. (See section 4.3.3 above).

Is this appropriate, particularly in relation to previously revalued intangible assets carried at deemed cost? If not, why not?

Owing to the complexity of this issue and a lack of time to fully consider it, I abstain from making any comment.

5.2.3 Other comments

In addition, the AASB would value comments on:

(a) whether the proposals are in the best interests of the Australian economy;

As many of the proposal result in false, misleading or inappropriate information being included in a financial report the proposals, in aggregate, cannot possibly be in the best interests of the Australian economy. Much of the information is, at best, of secondary relevance to users, and is so unreliable as to bring the financial reporting system into (further) disrepute.

(b) any other issues relating to not-for-profit entities, including public sector entities, that may affect the implementation of the proposals; and

(c) any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals.

The main regulatory issue is that applying many of the requirements would result in financial reports which would fail to give the requisite true and fair view. In particular some of the “measures” proposed necessarily result in information that is not comparable; those “measures” are inherently biased and in most circumstance will be so unreliable that they will result in erroneous decisions and evaluation by the users of financial reports. Making a standard with these requirements would frustrate most, if not all, of the objectives specified in section 224 of the *ASIC Act*.

IASB Request for Comment

ED3 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?

It is difficult to determine if the "common control" exception is appropriate as it is so poorly explained in the Basis for Conclusions and there does not appear to be an effective test. The problem is compounded by the use of an inappropriate definition of control and the absence of a definition of entity. I notice that entity is not defined in the Glossary in the IASB's *International Accounting Standards 2002*. In the circumstance it is understandable that rational and effective discussion of the issues involved is next to impossible. Given these difficulties there is no point in considering the issues raised in (b) below.

(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?

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?

The prohibition of the pooling of interest method is appropriate.

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?

Discussion of this issue is pointless given the critical role of the definitions of control and entity. In the absence of workable definitions of these terms there is no point in attempting to deal with them.

(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?

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?

Discussion of this issue is pointless given the critical role of the definitions of control and entity. In the absence of workable definitions of these terms there is no point in attempting to deal with them.

My initial response in that this proposal is complete nonsense.

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?

If the "rules" in IAS 37 have been properly formulated, then they should be applied in all circumstances. In that case, all that need be said is that IAS 37 is to be applied.

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?

The rules must be consistent with IAS 37; all that should be need is implementation guidance. If this is not sufficient, it suggest that IAS 37 is in need of improvement.

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?

Fair value is the appropriate measure.

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?

I do not believe it is an asset. Saying that it is possible to control something (in the case future economic benefits) without first being able to identify those benefits is nonsense. It is a payment made in expectation of future profits in excess of those that would ordinarily be expected. To try to justify asset recognition of an asset on the basis that we are to assume the difference is explained by unidentifiable intangible assets is nonsense and produces a series of consequential debates for which there is no rationale solution.

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?

The requirement in pargraph (a) is peculiar. If it means that we are merely ensuring that we have not made an error in measuring the fair value, the requirement is redundant as we should be no more careful when the fair value is less than acquisition cost that when it is more than acquisition cost. Dishonest mangers could use these words to justify recognising assets at less than their fair value or liabilities at more than their fair value as part of an earnings management scam.

The excess must be recognised as a revenue. It is nonsense to suggest that the amount should be deferred and amortised on the basis that we should recognise that we acquired a business that is unprofitable. To do so fails to hold management accountable for the decision to continue operating the business rather than liquidating the assets. It also creates a false impression of the ongoing profitability of the business. It come dangerously close to deliberate deception.

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?

Any time limit is necessarily arbitrary. We need a cut-off. I have not alternative to suggest.

(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?

My initial response is that this is appropriate. However, it is only a tentative conclusion.

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?

If the general impairment triggers in IAS 36 are incapable of dealing with this situation, it suggests that either those triggers are in need of revision or there is a fundamental problem with the approach taken to the measurement and recognition of intangibles and goodwill, or possibly both.

Question 2 – Intangible assets with indefinite useful lives

The Exposure Draft proposes that the recoverable amount of an intangible asset with an indefinite useful life should be measured, and impairment losses (and reversals of impairment losses) for such assets accounted for, in accordance with the requirements in IAS 36 for assets other than goodwill (see paragraphs C10-C11 of the Basis for Conclusions).

Is this appropriate? If not, how should the recoverable amount be measured, and impairment losses (and reversals of impairment losses) be accounted for?

The measure of impairment under IAS 36 is both misleading and deceptive. It is conducive to false financial reporting. The relevant measure of impairment is when an asset's carrying amount is greater than its fair value. The term loss is also inappropriate and potentially misleading. It is an **expense** and must be described as such. As impairment is an accounting estimate, any reversal must be recognised as revenue. (Such revenues and expenses must, of course, be included in calculating net profit).

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?

The use of "value in use" to determine the amount at which an asset is reported in the statement of financial position is improper. First, "value in use" amounts are non-additive, they are non-comparable, and are derived in a way that means they are unreliable (due to inherent risk of bias and the fact that it purports to measure something that does not currently exist). Thus, comparability is impossible within an entity, for an entity over time and between entities.

I note that PV techniques are not a measure, they are a calculation. If anything is being measured it is the future cash flow. Future cash flows are inherently incapable of measurement – you can only measure something that in fact exists now. We can estimate them, but this is not measurement as it is normally understood. If we are to include amounts that are derived from estimates of future cash flows, it must be demonstrated that in the past we have been able to reliably predict cash flows. It is unlikely that reliable prediction can be obtained more than two or three years ahead due to the rapid change in economic conditions and rapid changes in technology and consumer tastes. Even if we use expected values for the future flows, this is only acceptable if the alternative cash flows used are not very dispersed.

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?

As I do not believe goodwill to be an asset, accordingly the proposals are irrelevant.

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?

The measure of impairment should not depend on the asset being considered. In all instances it must be determined by reference to the asset's fair value (for example, see AASB ED 99).

(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?

Assuming recoverable amount is measured properly (fair value) then this would seem to be one trigger. If IAS 36 is properly structured, all that should be required here is implementation guidance.

(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?

The complexity of the proposal indicates that there is something seriously wrong with the way in which goodwill is characterised as being an asset.

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?

Owing to the inability to measure directly goodwill, it would rarely if ever be possible to establish that impairment is in fact reversed. For simplicity, we should prohibit reversal.

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?

No comment.

(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?

No comment.

Invitation to Comment (IAS 38)

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 – 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?

The absence of separability or the absence of legal rights does not mean there is no asset: that is, it dose not mean that there are no future economic benefits controlled by the entity. Consistent with SAC 4, all we need to do is make sure that we have sufficient appropriate evidence that the future economic benefits exist (at reporting date) and they are in fact controlled by the entity.

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.

There are conceptual difficulties in separating the question of whether the definition of an asset is satisfied and the application of the recognition criteria that the future economic benefits in fact exist. We can infer from an ability to directly measure the fair value of something that we have an asset candidate, about which the market has formed an expectation that it is probable that the controlled future benefits will be enjoyed by the entity controlling it. However, in the absence of an active market for the particular type/quality of intangible asset, such an inference cannot be made.

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?

This proposal cannot be supported. It confuses indeterminate with indefinite. The test applied is inherently subjective; this means it is not only susceptible to managerial manipulation but positively invites it. It is true that in many case we do not know the period over which the future economic benefits comprising an asset will be consumed or disappear. However, except in the case of land, there is no evidence to support the proposition that the useful life of an asset is not limited. (Even in the case of land, there are problems associated with degradation and contamination.) The fact that we do not know the quantity of future economic benefits or measure per unit of future economic benefits that is controlled does not mean that it is proper to assume that they are infinite and that we should not recognise an expense to reflect the economic benefit consumed or expiring in the reporting period. It is contrary to past experience and common sense to claim that useful life is, in substance, infinite merely because we cannot identify when the economic benefits comprising an asset will be exhausted.

In the absence of an active liquid market we cannot get a direct measure of the fair value of an asset. We can develop mechanisms to estimate that fair value. The question is how we can estimate that fair value. We can take an impairment approach, but in the absence of a active liquid market, when we have highly specialised assets (which most intangible are), it is difficult to measure impairment. It is necessary to make compromise to achieve a reasonable outcome. Since we cannot directly measure the fair value of these assets, what do we know about them? We can look to the past. Frequently the non-depreciation of intangibles is "justified" by way of example: for example, it is observed that the Coca Cola brand name has been around for over 100 years, and that it is (currently) a very successful brand, and it is claimed that in effect it has not depreciated and does not appear to be impaired. It is, of course, complete nonsense to use one instance to support a general proposition; it is a logical fallacy. The argument reduces to the following:

1 Coca Cola brand name is an intangible asset

2 The Coca Cola brand has been successful for over 100 years

3 This year we recognised an intangible asset Non Cola, therefore its useful life will be in excess of 100 years

What is being done is to use an outlier to predict the future. This is inappropriate. What is the ex post probability of a beverage brand existing in 1900 still being an asset in 2003? We can collect evidence of when the brands disappeared. We will also find some brand appeared after 1900 and no longer exist.

Past experience will inevitably reveal that brands disappear, and the probability of one lasting more that 50 years is relatively small. Look at the car brands that existed in 1950 which no longer exist: Morris, Studebaker, Rambler, Triumph and many others. Consumer preferences are changing far more rapidly than in the past and product life cycles are shorter and shorter. In this context it is nonsense to suggest that we should not recognise an expense merely because we cannot specify with any certainty the date on which the asset will disappear.

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)?

The useful life is less than or equal to the monopoly period. The issue is not whether the monopoly right can be extended or the cost of doing so; the question to ask is: Is it probable that *if* the monopoly right is renewed that the quantity of future economic benefits will increase. Only then is it necessary to consider if we should include those future economic benefits. What evidence exists? Whatever the evidence, logically the answer must be consistent with the recognition of a contingent asset under IAS 37.

Any past policy of rolling-over these monopoly rights is a dangerous basis for predicting future policy. This after all assumes that politicians will continue to acquiesce in such a process. If anything, the tendency is for legislatures to severely limit the ability to roll over, if not to prohibit them. Unless roll-over is due within a short period (say less than two years) it would be dangerous to assume that things will not have changed adversely by the time roll-over is "expected".

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?

For the reasons given above, since the argument about indefinite useful life is not sustainable, it is inappropriate not to depreciate (amortise) intangible assets.

If we find that one particular intangible is an exception, this is best reflected in direct remeasurement to fair value (assuming there is a reliable means of estimating fair value). For many intangibles, there are accepted techniques for estimating what is in substance their fair value and they, I understand, far more reliable than using unrestricted managerial expectations.