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ERT

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Business Combinations

Dear Mrs Kimmitt,

The International Accounting Standards Working Group of the European Round Table of Industrialists (ERT) wishes to comment on the IASB Business Combinations and Amendments to IAS 36 & 38 exposure drafts.

Convergence is key to IAS per se and particularly to business combinations and intangibles. Notwithstanding the efforts towards convergence which have already been made by the IASB on accounting in these areas, convergence remains an issue for business combinations as well as for other key questions.

The ERT Working Group offers the following comments:

1. Key issues

- It seems to us that the cost of acquisition has to be retained because it is the best way to measure the net assets acquired :
  - management has to remain accountable for the total investment decision and its implementation;
  - the restructuring costs which are incurred in the business combination as planned at inception have to be included in the cost of acquisition. A restructuring liability has consequently to be recognized as a part of the cost of acquisition, provided the conditions of IAS 37 are met before the end of the allocation period and also provided the restructuring costs result without question from the reduction of the acquiree's activities and the business combination;
  - good will is not measured on the grounds that have led to its recognition as an asset if the cost of acquisition does not include all costs incurred of all natures directly attributable to the combination.
- It seems important to us that management's will and intent be taken into consideration.
  - The fair valuation of assets should take into consideration management's intent whether it relates to continuing or ceasing operations;
  - Goodwill should not be allocated to the lowest level of cash generating unit at which management monitors return on investment. We consider that goodwill should be allocated to the level of the segment or to the reporting unit one level below for the following reasons :

- Comparability,
- Improvement of consistency over time,
- Convergence with US requirements, as stated before,
- It makes sense in terms of the business logic.

- We consider the proposed impairment test inappropriate, not least because the determination of the implied value of goodwill as defined would represent an unnecessary and costly burden.

  The impairment test required in IAS 36 is sufficient to ensure that no cash-generating unit is presented in the balance sheet in excess of its recoverable value.

  We also disagree with the suggestion that greater efforts should be made to segregate internally generated and acquired goodwill, as this looks impractical.

  We consider that an impairment test being performed systematically once a year is appropriate to strengthen the accounting for goodwill and switching from amortisation to impairment testing.

  The proposed screening mechanism is important and protects entities from unnecessary burden.

- Disclosures requested in the IASB proposal go too far and the requirements included in FAS 142 are sufficient.

2. Other issues

- The arbitrary designation of an acquirer where it happens that there is none (which is very rare) does not constitute an improvement. The elimination of the pooling of interest method could be agreed but not until an acceptable method is found. Appropriate criteria and definitions should be set up in order to avoid abuse.

- We support the fact that minority interest in the acquiree be stated at the minority's proportion of the net fair values of the identifiable assets and liabilities. Nevertheless, we must underline the risk that this would result in a divergence from US requirements and would be unfair to European companies as not offering the level playing field they are looking for.

- Contingent liabilities should be considered as part of the cost of acquisition unless they meet IAS 37 criteria during the allocation period. Here also, convergence with US GAAP in accounting for guarantees is necessary.

- We do not support the option impairment or amortisation. Impairment could be agreed only if we could rely on an effective impairment test. In fact, amortisation is more appropriate for SMEs. This should consequently be handled as a part of the SME project.

- Impairment testing of intangible assets, which have an indefinite useful life and goodwill, should be carried out as a part of one single procedure simultaneously and following the business planning cycle of the entity. Within the framework of this single procedure, assets should be tested for impairment first.

- We do not consider that management's ability to forecast cash flows reliably in the past should be reflected in the assumptions retained to measure value in use. The proposal is in contradiction with the requirement to base cash flow projection on the most recent forecast made by management, which is essential for an appropriate impairment test. Forecast updates are already reviewed by the entity's external auditors and therefore the requirement for additional disclosure is not appropriate.

- Management should have the right to establish forecasts on a pre-tax or a post-tax basis.

- Intangible assets with indefinite useful life and goodwill should have to be dealt with in the same way, otherwise this would result in an arbitrage between identifiable intangible asset and goodwill at the time the cost of acquisition is allocated. An impairment loss reversal should not be allowed for both intangible assets and goodwill.

The above reflects the views of the International Accounting Standards Working Group of the European Round Table of Industrialists who insist on the importance of convergence which, as already expressed by the ERT, is key for the adoption of IAS.

These views have been discussed by the Working Group with UNICE and we understand a similar letter has been sent to EFRAG on these points.

Finally we would add that, in our view, it would make more sense to be able to comment on all the combination project drafts at one time, rather than piecemeal as we do now in commenting only on phase 1.

Yours sincerely,

Wim Philippa

Secretary General