CL 65

ED 3 BUSINESS COMBINATIONS

Question 1 –Scope

The Exposure Draft proposes:

(a) to exclude from the scope of the IFRS business combinations in which separate entities or operations of entities are brought together to form a joint venture, and business combinations involving entities under common control (see proposed paragraphs 2 and 3 and paragraphs BC9-BC11 of the Basis for Conclusions).
Are these scope exclusions appropriate? If not, why not ?

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

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

RESPONSE

(a) Yes we agree that these scope exclusions are appropriate as joint venture accounting is prescribed under IAS 31 and that it has been agreed to deal with business combinations involving entities under common control in the second phase of the project consideration.
(b) Yes , it is clear that for entities under common control, it is necessary for the combining entities or operations to be controlled by the same party or parties both before and after combination, and that control should not be transitory.

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?

RESPONSE

Yes, we agree that permitting two methods of accounting for business combinations impairs the comparability of the financial statements. We also agree that requiring more than one method of accounting for substantially similar transactions creates incentives for structuring transactions to achieve a desired accounting result ,particularly given that the different methods currently being used produce quite different accounting results.

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 BC&-B41 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?

RESPONSE

(a) Yes, the draft IFRS should require the acquirer to be identified on a consideration of all pertinent facts and circumstances, and not just the relative ownership interests of the owners of the combining entities, to determine which of those entities enjoys the power to govern the financial and operating policies of the other so as to obtain benefits from its activities.

(b) Yes.

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?

RESPONSE

Yes, as to do otherwise would impair the usefulness of the information provided to users about the combination, because both comparability and reliability would be diminished ,thereby placing the form of the transaction over its substance.

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 paragraphs 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?

RESPONSE

Yes, as this is seen as a liability incurred by the acquirer in exchange for control of the acquiree, provided that, within a limited time after the combination, the decision to terminate or reduce the activities of the acquiree is communicated to those likely to be effected, and a detailed formal plan for the restructuring is developed.

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?

RESPONSE

Although the 'probability' recognition criteria applying to liabilities in IAS 37 and the Framework is fundamentally inconsistent with any fair value or expected value basis of measurement, the Board decided that contingent liabilities should be excluded from the scope of IAS 37 and measured after initial recognition at fair value until settled or the uncertain future event described in the definition of a contingent liability is resolved.
Not doing so would result in some or all of these contingent liabilities inappropriately being derecognised immediately after the combination.

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 an 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?

RESPONSE
We agree that this approach is appropriate as it is consistent with the allowed alternative treatment in IAS22 and the consolidation approach adopted in IAS27 and enables users to better assess the cash generating abilities of the identifiable net assets acquired in the business combination. It also provides the users of financial statements with more useful information for assessing the accountability of management for the resources entrusted to it.

Question 8

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-bc 108 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?

RESPONSE

Yes we agree that goodwill meets the Framework definition of an asset in that it represents resources from which future economic benefits are expected to flow to an entity.
We agree that the useful life of acquired goodwill and the pattern in which it diminishes are not possible to predict and thus the amount amortised in any period is more likely to be an arbitrary estimate of the consumption of acquired goodwill during the period, Thus the approach in which goodwil is not amortised, but instead tested for impairment annually or more frequently if events or changes indicate, appears more reasonable.

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?

RESPONSE

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 period 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 – BC 132 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?

RESPONSE

(a) Yes
(b) Yes we agree that the initial accounting for a combination can only be adjusted to correct an error or where a business combination agreement provides for an adjustment to the cost of the combination contingent on future events and the adjustment is probable and can be reliably measured or where no adjustment is included in the cost of the combination and the adjustment becomes probable and can be measured reliably.

IAS 38 – Amendments to IAS 38, Impairment of Assets

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?

RESPONSE

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 44of 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.

RESPONSE

Yes, we agree that sufficient information should exist to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity. It is important to note that an asset, which has an underlying contractual or legal basis, is often associated with specific cash flow streams.

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?

RESPONSE

Yes, we agree that some intangible assets are based on legal rights that are conveyed in perpetuity rather than for finite terms and hence those assets may have cash flows associated with them that may be expected to continue for many years or even indefinitely.

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)?

RESPONSE

Yes, we agree that this is an appropriate basis provided that on renewal all applicable rules and regulations have been complied with.

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 the assets be accounted for after their initial recognition?

RESPONSE

Yes, we agree with the principle that such assets should not be amortised, but rather, as with all assets, be subject to regular impairment testing .We also agree that regular re-examinations should be required of the useful lives of such assets to determine whether circumstances continue to support the assessment that the useful life is indefinite.

IAS 36 – Amendments to IAS 36,Impairment of Assets

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?

RESPONSE

Yes, the recoverable cost concept, which focuses on the benefits to be derived from the asset in the future, provides the basis for the frequency of impairment testing.

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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 reversal 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?

RESPONSE

Yes, we agree that for the sake of comparability and reliability such assets should be accounted for consistently with other identifiable assets covered by IAS 36.

Question 3 – Measuring value in use

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

(a) should an asset's value in use reflect the elements listed in proposed paragraph 25A? If not, which elements should be excluded or should any additional elements be included? Also, should an entity be permitted to reflect those elements either as adjustments to the future cash flows or adjustments to the discount rate (see proposed paragraph 26A and paragraphs C66 and C67 of the Basis for Conclusions)? If not, which approach should be required?

(b) should the assumptions on which cash flows are based take into account both past 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 the 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?

RESPONSE

(a) Yes, the additional guidance is to clarify the elements that are reflected in an asset's value in use and that those elements can be reflected either as an adjustment to the future cash flows or as adjustments to the discount rate.

(b) Yes

(c) Yes, the additional guidance expands on the traditional and expected cash flow approaches to Present Value as well as the criteria for the selection of a discount rate.

Question 4 – Allocating goodwill to cash-generating units

The Exposure Draft proposes that for the purposes 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 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 reorganizes 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 paragraphs 82 and paragraphs C24 and C25 of the Basis for Conclusions)? If not, what approach should be used?

RESPONSE

(a) Yes, as acquired goodwill does not generate cash flows independently of other assets or groups of assets, it can be tested for impairment only as part of impairment testing the cash-generating units to which it relates.
(b) Yes, an allocation of goodwill should be required when part of the cash-generating unit being disposed of constitutes an operation. Yes, we agree with the basis of apportionment stated.
(c) Yes we agree that the use of the relative value approach would be correct.

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).

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

RESPONSE

(a) Yes, although some concern has been expressed over the measurement basis adopted in the standard for determining recoverable amount, the Board has agreed not to depart from that basis when measuring the recoverable amount of a unit whose carrying amount includes acquired goodwill.
(b) Yes, using a screen mechanism to identify potential goodwill impairments would not result in as many impairments of goodwill going unrecognised and would significantly reduce the costs of applying the goodwill impairment test.
(c) Yes, we agree that this treatment along with the practice of excluding from the measure of a unit's net assets any unrecognised value attributable to the unit's recognised identifiable net assets and including in the implied value of goodwill any pre-existing internally generated goodwill, would ensure that the carrying of acquired goodwill is recoverable from future cash flows expected to be generated by goodwill.

Question 6 – Reversal 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?

RESPONSE

Yes. It is not possible to establish the extent to which a subsequent increase in the recoverable amount of goodwill is attributable to the recovery of the acquired goodwill within a cash-generating unit, rather than an increase in the internally generated goodwill within the unit. Thus an impairment test in which the cushion created by pre-existing internally generated goodwill is removed would not be possible or practicable.

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?

RESPONSE

(a) Yes, we agree that the disclosure of key assumptions and estimates used to measure the recoverable amounts of cash-generating units whose carrying amounts include goodwill or indefinite life intangibles, the link between those assumptions and estimates and past experience and the sensitivity of the recoverable amounts of the units to changes in the key assump tions and estimates are all important.

(b) Yes, we agree with the practice of disclosure of information on an aggregated basis and separate disclosure where the basis, methodology or keys assumptions used to measure a cash generating unit's recoverable amount differ from those used to measure the recoverable amounts of the other units in the segment or the carrying amount of goodwill or indefinite life intangibles in the unit is significant in relation to the total carrying amount of goodwill or indefinite life intangibles.

Institute of Chartered Accountants of Zimbabwe