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7 April 2003

The Project Manager
International Accounting Standards Board
30 Cannon Street
LONDON
EC4M 6XH
United Kingdom

Dear Sir or Madam

ED 3 Business Combinations

Staff of the Institute of Chartered Accountants of New Zealand is pleased to submit its comments on Exposure Draft 3.

The staff submission focuses on the specific questions raised in the Exposure Draft. In addition, comments are also provided in respect of some of the proposals not specifically addressed by the questions.
If you have any queries, or require clarification of any matters in the submission, please contact me.

Yours faithfully

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ED 3 *Business Combinations*

1 GENERAL COMMENTS

Staff generally supports the proposals contained in ED 3 *Business Combinations*.

Request for Executive Summary
We request that where a document is lengthy, the IASB prepare an executive summary for each exposure draft (ED).

Inviting comments on specific issues
We also recommend that where a project is ongoing (such as this one) and the IASB seeks input on its current views or tentative decisions, an invitation to comment be issued that would address specific issues and comments be invited on those issues only. It is not clear from a full-blown exposure draft what issues are still under consideration and might change in the near future.

2 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?

We agree with these exclusions.

However, we recommend that "operations" be clarified. For example, is the acquisition of debtors the purchase of an asset (the debtors) or an operation (the debtors plus an intangible component)?

(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?

We agree that the definition of business combinations involving entities under common control and the additional guidance on identifying such transactions are helpful.

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 9-12 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 transaction from other business combinations and why?

We agree with the elimination of the pooling of interests method and the requirement for all business combinations to be accounted for by applying the purchase method.

However, there are rare circumstances when fresh start accounting may be applicable. For example, where two entities merge to form a new entity and neither entity can be identified as the controlling entity it will be more appropriate to adopt fresh start accounting rather than purchase accounting or the pooling of interests. However, we acknowledge that these circumstances are extremely rare and therefore accept that purchase accounting should be adopted in all circumstances for the purposes of consistency.

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. 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 operation policies of the other entity (or entities) so as to obtain benefits for 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?

We agree with the description of the circumstances in which a business acquisition could be regarded 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?

We agree that the additional guidance on the accounting for reverse acquisitions is appropriate.

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?

We agree 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. However, we refer you to our previous comment in relation to fresh start accounting.

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?

We agree 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, recognised an existing liability for restructuring in accordance with IAS 37.

Question 6 – Contingent liabilities
The Exposure Draft proposes that an acquirer should recognise separately the acquiree's contingent liabilities at the acquisition date as part of allocating the cost of a business combination, provided their fair values can be measured reliably (see proposed paragraphs 36 and 45 and paragraphs BC80-BC85 of the Basis for Conclusions).

Is this appropriate? If not, why not?

We disagree with the proposed recognition of the acquiree's contingent liabilities at acquisition date as part of allocating the cost of the business combination.

We note:
- that the proposed requirement to recognise the contingent liabilities of an acquiree at acquisition is inconsistent with the IASB Framework; and
- the asymmetrical treatment of the recognition of contingent liabilities and contingent assets of the acquiree at acquisition date.

We have concerns regarding the practical implications of recognising the contingent liabilities of the acquiree, although we acknowledge that contingencies are considered when the acquisition price is determined.

We understand that:
- the IASB Framework is to be amended to remove the inconsistency of the recognition of contingent liabilities; and
- the asymmetrical treatment of contingent liabilities and contingent assets is to be remedied in the Business Combinations Phase II project.

We would support the proposal provided the above inconsistencies are remedied.

We have major concerns about the way in which the IASB introduces some new concepts or major changes to existing concepts. Some of the requirements in ED 3 contain new concepts or will result in substantial amendments to existing concepts, e.g. recognition of contingent liabilities. Any amendment to the IASB Framework to allow for this new concept of recognising contingent liabilities will have wide implications and should be undertaken through the normal due process. A separate invitation to comment should be issued with questions specifically relevant to the new or amended concepts rather than addressing the issue in the questions on an entire subject-specific exposure draft. We consider that changes should not be made in isolation (i.e. only relating to business combinations) but should be made throughout all the relevant standards. In this case the principle in IAS 37 regarding the recognition of contingent liabilities should have been amended.

We also consider that when the asymmetrical treatment regarding the recognition of contingent liabilities and contingent assets has been remedied, the proposed standard should specify that the recognition of a contingent asset of the acquiree cannot create an excess (discount on acquisition).

Question 7 – Measuring 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 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?

We agree that the minority interest of the acquiree's identifiable assets and liabilities and contingent liabilities recognised as part of allocating the cost should be measured initially at fair value at the acquisition date.

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 as 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?

We agree that goodwill acquired in a business combination should be recognised as an asset. However, we have concerns regarding the proposed subsequent accounting of goodwill. The tentative view of staff is that we strongly support the amortisation of goodwill.

The proposed impairment testing of goodwill acquired in a business combination will effectively, over time, permit the recognition of internally generated goodwill. This is inconsistent with the requirements of IAS 38, which prohibits the recognition of internally generated goodwill (current paragraph 36 and proposed paragraph 40) and could be regarded as a "back-door approach" to the recognition of internally generated goodwill.

It will also lead to inconsistent treatment of internally generated goodwill between entities. Entities involved in business combinations will be allowed to recognise internally generated goodwill, but other entities are prohibited to recognise internally generated goodwill. We do not support this inconsistent treatment for similar items and consider that such a fundamental change to a concept or standard should be addressed in the revision of IAS 38. Until the principle in IAS 38 relating to internally generated goodwill is changed, entities should not be allowed to recognise internally generated goodwill through a goodwill impairment test.

We also consider that the acquired goodwill generally decreases in value over a relatively short period and, therefore the goodwill arising on acquisition should be amortised. Impairment testing in accordance with the model proposed in IAS 36 may be expensive and difficult to apply in New Zealand and many other countries because of the thinness of trading. We prefer amortisation but if impairment testing is the required treatment, then we support the one-step approach.

This tentative view of staff will be discussed at the FRSB meeting to be held on 15 April 2003. Staff will forward the FRSB decision to you after the meeting.

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 tentative decision of staff is that the proposed requirement to reassess the identification and measurement of the acquiree's identifiable assets and liabilities where an excess emerges is too weak. If the initial assessment of the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination is accurate, which one can presume is the case, the reassessment is not likely to be different from the first assessment. Furthermore, the proposed requirement involves immediate recognition of income as the result of the purchase of assets and is therefore inconsistent with conventional accounting for the purchase of assets.

We recommend that, to the extent that the excess does not exceed the fair values of recognised identifiable non-monetary assets, the fair values of the recognised identifiable non-monetary assets be reduced proportionately until the excess is eliminated, and the non-monetary assets acquired must then be recognised at the reduced amounts. To the extent that the excess is not eliminated, that portion of the excess is then recognised as income immediately.

This tentative view of staff will be discussed at the FRSB meeting to be held on 15 April 2003. Staff will forward the FRSB decision to you after the meeting.

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 these 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 paragraph 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?

The tentative vies of staff is that 12 months from the acquisition date is insufficient time for completing the accounting for a business combination. We recommend a period of up to the next reporting date (whether that be an interim or annual reporting date), plus 12 months to provide sufficient time to determine the initial accounting. The rationale behind this recommendation is that the completion of the initial accounting will then be aligned with the reporting dates of the acquirer.

We also discussed the difference between updating fair values of assets and liabilities recognised on acquisition within the 12 month timeframe and recognising assets and liabilities that did not meet the recognition criteria on acquisition but subsequently did within the 12 month period. We request that the IASB clarify if this requirement applies to both situations and, if not, that the IASB clarify which situation it applies to.

This tentative view of staff will be discussed at the FRSB meeting to be held on 15 April 2003. Staff will forward the FRSB decision to you after the meeting.

(b) with some exceptions carried forward as an interim measure from IAS 22, adjustment 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?

We do not support any adjustment to the initial accounting for a business combination after that accounting is complete.

The FRSB expressed its support for the proposal put forward under the Improvements to IAS 8 that changes in accounting policies and corrections of errors should be accounted for retrospectively. However, the FRSB wishes to reiterate its concern that this treatment could lead to misuse, as history has proved in New Zealand.

Other issues

Paragraph 9 – Business combinations involving entities under common control

We were concerned about the potential for avoiding the application of ED 3 by arranging a business combination in such a manner that the combination met the requirements of a business combination involving entities under common control but then relinquish control shortly after the combination is finalised. The concern was that control after the business combination was only temporary. We consider that the requirement in paragraph 9 that the control before and after the business combination "is not transitory" may be intended to address this issue.

Paragraph 34 – Cost

We are concerned about the content of paragraph 34 relating to changes in the value of assets given, equity instruments issued or liabilities incurred by the acquirer in exchange for control of the acquiree. We consider that the obligation should be measured at the date the obligation arises, which is consistent with the requirements of ED 2 and that any subsequent change in the value of the consideration given is not relevant to the business combination. If the change related to, for example, an option granted as part of the consideration given, the possibility of change would have been factored into the value of the consideration given.

Paragraphs 36 and 37 – Fair value of assets

We recommend that the guidance in paragraph 37 be expanded to explain that the fair value of the assets acquired becomes the new 'cost' of the assets and that the useful lives of the assets acquired should be reassessed for the purposes of calculating depreciation. For the purposes of the consolidated financial statements, there should be zero accumulated depreciation on acquisition.

Disclosures

We are concerned about the volume of disclosures required. We consider that some of the disclosures are excessive and/or are open to manipulation, for example, paragraph 69(b) which requires disclosure of "the profit or loss of the combined entity for the period as though the acquisition date for all business combinations effected during the reporting period had been the beginning of the period." Such disclosure is tantamount to the proforma type disclosure that the USA is currently trying to overcome.

Identified assets – Deferred tax assets

We are concerned about the inconsistent treatment between deferred tax assets and other assets that were not separately identified at acquisition. ED 3 allows deferred tax assets subsequently realised by the acquirer to be recognised as outlined in paragraph 64, but does not permit the recognition of other assets that were included in goodwill at acquisition date. Paragraph 64 requires the carrying amount of goodwill to be reduced by the amount of any deferred tax assets subsequently realised by the acquirer.

We recommend that the inconsistency be removed and also that the term "realised" in paragraph 64 be adequately explained.

3 Amendments to IAS 36 *Impairment of Assets*

General Comments in relation to IAS 36

We consider that fair value is the most appropriate measurement basis for determining the recoverable amount of an asset because fair value provides a more reliable and objective measure of recoverable amount than value in use.

On acquisition, an asset is recognised at its cost of acquisition. The purchase consideration is a measure of the asset's fair value (the amount for which the asset could be exchanged between knowledgeable willing parties in an arm's length transaction). The cost of the asset at the date of acquisition is, therefore, its fair value at that date. If an asset is initially recognised at fair value, fair value should also be used as the basis for determining whether an asset is impaired and, if the asset is impaired, the amount of that impairment.

We consider that the recoverable amount of an asset should be measured as the asset's fair value where the asset is held for continuing use and its fair value less costs of disposal where the asset is held for disposal.

We also consider that if fair value is adopted as the measurement basis for recoverable amount, then assets measured at fair value should be excluded from the scope of IAS 36 Impairment of Assets because impairment losses will automatically be accounted for.

Measuring an asset's recoverable amount at the higher of value in use and net selling price can be subjective. Value in use includes assumptions made by management rather than assumptions necessarily made by the market and this provides scope for management to exercise discretion in identifying whether an asset is impaired and the extent of that impairment. Comparisons within an entity over time are hindered because assumptions made by management about future net cash flows generated by an asset are likely to change as management's intention regarding the use of the asset changes. Comparability between entities may also be hindered as a result of the assumptions made by an entity's management not being the same as those of another entity's management in respect of a similar asset.

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?

We agree with the concept of annual impairment testing but are concerned about the potential cost of complying with this requirement. The preferred approach is an annual review of the carrying amount of the asset taking into account the sources of information that are relevant in determining whether or not an asset may be impaired. Requiring annual impairment testing of goodwill and indefinite life assets will also result in inconsistency with the treatment for other intangible assets and property, plant and equipment which are only reviewed for impairment on an annual basis.

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?

We agree with the proposal that intangible assets, other than goodwill, with indefinite useful lives should be measured and accounted for in accordance with 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 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?

As mentioned earlier, we consider that fair value is a more appropriate measurement basis for the recoverable amount of an asset than value in use.

However, we consider that the additional guidance on measuring the value in use of an asset is appropriate.

Question 4 – Allocating goodwill to cash-generating units

The Exposure Draft proposes that for the purpose of impairment testing, acquired goodwill should be allocated to one or more cash-generating units.

(a) Should the allocation of goodwill to one or more cash-generating units result in the goodwill being tested for impairment at a level that is consistent with the lowest level at which management monitors the return on the investment in that goodwill, provided such monitoring is conducted at or below the segment level based on an entity's primary reporting format (see proposed paragraphs 73-77 and paragraphs C18-C20 of the Basis for Conclusions)? If not, at what level should the goodwill be tested for impairment, and why?

(b) If an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, should the goodwill associated with that operation be included in the carrying amount of the operation when determining the gain or loss on disposal (see proposed paragraph 81 and paragraphs C21-C23 of the Basis for Conclusions)? If not, why not? If so, should the amount of the goodwill be measured on the basis of the relative values of the operation disposed of and the portion of the unit retained or on some other basis?

(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 already noted we support the amortisation of goodwill and disagree with only impairment testing goodwill. We are of the view that the allocation of goodwill to one or more cash-generating units can be complex. However, if the proposed impairment testing is retained, we agree with the proposals. We also acknowledge that the allocation of goodwill to one or more cash-generating units can be complex.

We consider the proposed standard should limit the smallest unit to one level below a segment, in accordance with the guidance in SFAS 142 "Goodwill and Other Intangible Assets", paragraphs 30 and 31.

We agree with the proposal to include the goodwill associated with such a "smaller unit" in the carrying amount when determining the gain or loss on disposal. We also agrees that goodwill should be reallocated on a relative value approach when the entity reorganises its reporting structure in manner that changes the composition of one or more of these "smaller units".

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?

We do not agree with the proposals and consider that the recoverable amount of a cash-generating unit to which goodwill has been allocated should be measured at fair value.

(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?

We do not agree with the proposals and consider that the existing one-step approach to the impairment testing of goodwill should be retained.

(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?

We strongly support the amortisation of goodwill for the reasons explained. Nevertheless, if the IASB decides to retain the proposals for impairment testing of goodwill, then the one-step approach is supported.

We do not agree that the amount of any impairment loss for goodwill should be measured as the excess of the goodwill's carrying amount over its implied value measured in accordance with the proposals in paragraph 86. Application of the proposed two-step approach can result in the adjusted carrying amount of the cash-generating unit being reduced to less than the recoverable amount of the cash-generating unit.

Under the current one-step approach, the impairment loss of the cash-generating unit as a whole is allocated against any goodwill that has been allocated to that unit before the values of the individual assets of the unit are reduced. Therefore, the goodwill is reduced to zero before any impairment loss is allocated to the individual assets of the unit. This means that the carrying amount of the unit will not be reduced to or below its recoverable amount until the goodwill has been written off in total.

Under the proposed approach, the impairment loss to be allocated to the goodwill of the unit may be higher than the impairment loss of the cash-generating unit as a whole. This can arise because the carrying amount of the goodwill exceeds the implied value of the goodwill, determined in accordance with the proposals, by more than the impairment loss of the cash-generating unit as a whole. In such circumstances, the carrying amount of the cash-generating unit could be less than its recoverable amount.

The FRSB considers that the current one-step approach to impairment testing of goodwill should be retained as this approach represents a simple and cost-effective approach and ultimately ensures that the carrying amount of the cash-generating unit is equal to its recoverable amount (i.e. its fair value) after an impairment writedown.

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?

We agree with the proposal to prohibit the reversal of impairment losses for goodwill, but recognise that there is an inconsistency between impairment reversals for goodwill and impairment reversals for other assets.

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?

We consider the disclosures to be excessive.

4 Amendments to IAS 38 *Intangible Assets*

General comments

The FRSB issued ED-87: *Accounting for Intangible Assets* for comment in April 1999. The exposure draft was a direct copy of IAS 38 *Intangible Assets* except for some minor amendments to its terminology and format to ensure that ED-87 was consistent with other New Zealand pronouncements.

Two of the major concerns raised by constituents in their submissions were:

- The definition of assets contained in the IASB Framework should be applied consistently. Constituents considered that intangible assets meet the definition of an asset as provided in paragraph 49(a) of the IASB Framework and were strongly opposed to the prohibition on recognising internally generated intangible assets.
- The recognition of an intangible asset if only its cost can be reliably measured is inconsistent with the definition in the IASB Framework that also allows recognition if the value can be measured reliably (paragraph 83 requires recognition of an element if "(b) the item has a <u>cost or value</u> that can be measured with reliability" and paragraph 89 requires recognition of an asset when "…the asset has a <u>cost or value</u> that can be measured reliably).

In light of the widespread negative comments from constituents, particularly in relation to the blanket prohibition on the recognition of internally generated brands, the exposure draft was not issued as a standard in New Zealand.

We acknowledge that the current exposure of IAS 38 relates to amendments resulting from ED 3 and was not intended to be a review of the detailed principles of IAS 38. However, these comments could be useful in future considerations of, and amendments to, the principles of IAS 38.

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?

We agree that the separability and contractual/other legal rights criteria are appropriate for determining whether an asset meets the identifiability criterion in the definition on an intangible asset.

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.

We agree that sufficient information can reasonably be expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination.

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?

We agree with the proposal to remove the rebuttable presumption that an intangible assets useful life cannot exceed twenty years.

Question 4 – Useful life of intangible asset arising from contractual or other legal rights
The Exposure Draft proposes that if an intangible asset arises from contractual or other legal rights that are conveyed for a limited term that can be renewed, the useful life shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost (see proposed paragraphs 91 and 92 and paragraphs B33-B35 of the Basis for Conclusions).

Is this an appropriate basis for determining the useful life of an intangible asset arising from contractual or other legal rights that are conveyed for a limited term that can be renewed? If not, under what circumstances should the useful life include the renewal period(s)?

We agree with the inclusion in the useful life of an intangible asset of the limited term renewal period(s) arising from contractual or other legal rights only if there is evidence to support renewal without significant cost.

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?

We agree that an intangible asset with an indefinite useful life should not be amortised.

5 Consequential Amendments

IAS 12 *Income Taxes*
(ii) Temporary differences arising on business combinations
The FRSB recommends that an additional paragraph (e.g. 21(c)) be added to IAS 12 to include the guidance in SIC 21 that the measurement of a temporary difference is dependent on the probable method of recovery of the asset's carrying value. Where the asset is recovered through sale, the tax rate applying to a sale of the asset should apply. Where the asset is to be recovered through use, the tax rate applying to the income generated by the use of the asset should be used. The non-depreciation/amortisation of the asset does not affect the recognition of a deferred tax liability.

The reason for the recommended guidance is to clarify whether a deferred tax liability will arise where brands or other intangibles are acquired and not amortised (as permitted by the amendments to IAS 38).