CL 42

4 April 2003

Sir David Tweedie
International Accounting Standards Board
30 Cannon St
London EC4M 6XH
United Kingdom

Re: Exposure Draft ED 3: Business Combinations, and Amendments to IAS 36, Impairment of Assets, and IAS 38, Intangible Assets.

Dear Sir David,

We are pleased to provide our comments on the above Exposure Draft which reflect joint discussions between ourselves and BNP-Paribas and our own conclusions thereon.

We agree with some of the proposed changes in the accounting treatment for business combinations and intangible assets. In particular, in some situations, we find that using an impairment test approach instead of an amortisation approach for goodwill and intangible assets is appropriate. However, for conceptual and practical reasons, we have major concerns with the prohibition of an amortisation approach for goodwill in all cases as well as with the complexities introduced for the impairment test of goodwill.

We also would like to highlight our concerns with the current approach for the allocation of the cost of acquisition to individual items that have been acquired, based on fair value. This approach does not reflect the reality of business combinations and we believe that, in performing the allocation, the recognition and measurement of individual items should take account of the acquirer's intentions at the date of the acquisition.

Finally, we feel we must caveat our responses to this Exposure Draft, which represents solely Phase I of the Business Combinations project. Our responses could change as a function of the timing and potential content of Phase II of the project.

We detail in Appendix 1 our views on ED 3, IAS 36 and IAS 38.

If you have any queries regarding our comments, please do not hesitate to contact Veronique de La Bachelerie or Pierre-Henri Damotte at respectively : 33 1 42 14 49 86 and 33 1 42 14 04 10

Regards,

F. Oudéa

Appendix 1
Comments on ED 3 – Business Combinations, Impairment of Assets and Intangible Assets

Comments on 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?

We were confused by the drafting of the scope exclusion in paragraph 3(a) for joint ventures. We believe it is important that the Board clarifies that this exclusion applies specifically to the preparation of the financial statements of the joint venture itself and not to those of the two parties to the joint venture.

See also our comments at Question 2.

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?

We agree that where there is an acquisition (i.e. where an entity can be identified as taking control), the purchase method of accounting should be applied.

However, we believe that not all business combinations are acquisitions. Mergers of equals (i.e. where none of the combining entities can be identified as taking control) exist, albeit rare. In the case of a merger of equals, we would disagree that one of the combining entities should be designated as an acquirer and the other combining entity as an acquiree, resulting in the application of different types of accounting to each of the financial statements of the combining entities. It will not result in meaningful information. In such rare cases, we support that the combining entities apply similar types of accounting, namely the pooling of interests method.

We note that the IASB acknowledges that such rare cases may exist where an acquirer cannot be identified (see ED 3.BC20). We understand that the Board, having no sufficient time to discuss the accounting treatment for those transactions, decided that it should not make a specific scope exclusion for those cases because they are expected to be very rare. We disagree with this proposal and believe that while proper research has not been conducted for those types of combinations, it is inappropriate to impose an accounting treatment that does not result in relevant information. We believe that the current IAS 22 treatment for unitings of interests should still be applied to mergers of equals (where none of the combining entities can be identified as taking control).

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?

(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 size should not be a major factor in the determination of the acquirer. The biggest party to the business combination is not necessarily always the acquirer.

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We are concerned that the fifth sentence in ED 3.21 is not clear:

> "*Although legally the issuing non-operating entity is regarded as the parent and the operating entity is regarded as the subsidiary, the legal subsidiary is the acquirer with the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities.*"

We believe it is necessary to clarify that, in order to assess whether there is a reverse acquisition, there should be a consideration of whether the former shareholders of the legal subsidiary have actually obtained control of the legal parent. As it is currently drafted, ED 3.21 focuses on control being obtained by a legal entity rather than by the shareholders of that entity.

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

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.

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 disagree.

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We believe that the objective of the Standard should be to ensure the most relevant allocation of the cost of acquisition to the acquired assets and liabilities of the acquiree and other relevant items. To this aim, it may be necessary to allocate an amount of the cost of acquisition to assets/liabilities that were not recognised at the date of acquisition in the acquiree's financial statements, but that were taken into account in the determination of the acquisition price. Therefore, if it can be demonstrated and documented at the date of acquisition that a reduction for restructuring costs was taken into account in establishing the acquisition price, this element should also be taken into account in the allocation of the cost of acquisition if it gives rise to a liability at, or shortly after, the date of acquisition. ED 3.61 acknowledges that a twelve-month period may be needed to complete the initial accounting for the acquisition. We believe that this period should also apply for the recognition as a liability under IAS 37 for restructuring costs that were an element of the acquisition price. In other words, if the IAS 37's criteria for a restructuring provision are met within twelve months after the acquisition and it can be demonstrated that the restructuring costs to which the provision relate were taken into account in determining the acquisition price, then the restructuring provision should be recognised as an allocation of the cost of acquisition when the IAS 37's criteria are met (i.e. with a resulting effect on the goodwill amount). Conversely, if the IAS 37's criteria for a restructuring provision are met after twelve months after the acquisition, even if it can be demonstrated that the restructuring costs to which the provision relates were taken into account in determining the acquisition price, then the restructuring provision should be recognised as a post-acquisition expense when the IAS 37's criteria are met.

This proposal takes into account the fact that, in the case of a hostile take-over, it will be extremely difficult for the acquirer to organise with the acquiree the announcement by the acquiree of a future restructuring before the date of acquisition. This future restructuring may nonetheless have been an element of the price the acquirer was ready to pay for the acquisition. Under ED 3's proposals, in order to have a relevant allocation of the cost of acquisition, the acquirer will need to organise with the acquiree the announcement of the restructuring by the acquiree before the date of acquisition, so that the restructuring will be an element to which the cost of acquisition can be allocated. It is possible to do so (although it will require new business practices) only where there is no hostile take-over. We do not believe that the recognition of restructuring provisions during a business combination should be affected by the fact that the acquisition is or is not a hostile take-over.

We acknowledge that some may argue that our proposals for the recognition within twelve months from the acquisition of restructuring provisions that were an element of the acquisition price represents a departure from the Framework. However, as has the Board noted in the Basis for Conclusions in respect of the recognition of the acquiree's contingent liabilities (see our response to Question 6), it may be relevant in some cases to depart from the Framework in order to provide more meaningful information. We believe that the proposed recognition of restructuring provisions in a business combination would reflect the substance of how the acquisition price has been determined. This approach would be similar to the consideration given to contingent liabilities and their proposed consequential treatment.

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We note that the restructuring costs may relate not only to the acquiree's activities but also to those of the acquirer. This may occur when redundant capacity will result from the acquisition. For example, an acquirer may identify during the negotiation process that instead of closing one of the acquiree's plants it is more appropriate to close one of its own plants, which would become redundant on the acquisition of the acquiree's plant. In such a case, we believe that a restructuring provision for closing the acquirer's plant should be recognised as an apportionment of the cost of acquisition when IAS 37's criteria are met and if it is within twelve months from the acquisition. We believe that this approach is also consistent with the approach taken for performing the impairment test of cash-generating units: when businesses will be merged and will not generate independent cash flows, it is appropriate to perform the test at the merged level. The approach for the recognition of restructuring provisions should be similar.

We would like to illustrate the issue we raise with a real public life example. Very recently in France, bank Crédit Agricole announced its intention to acquire bank Crédit Lyonnais. However, when the French authorities examined the proposed acquisition, they indicated that they would authorise it only if approximately eighty branches of the combined entities in some designated areas were closed in France. Therefore, the acquisition is contingent to the closing of those branches, some of which may be those of Crédit Agricole and others belonging to Crédit Lyonnais. It is not a requirement that these eighty branches be identified at the date of acquisition. If the acquisition goes through, it would be relevant to us that an allocation of the cost of acquisition be made for the closure of those branches.

Our suggestions above reflect some of the current requirements of Regulation CRC 99-02 under French GAAP applicable to consolidated financial statements, except that the period during which the restructuring provisions can be recognised extends to the end of the first annual reporting period beginning after the acquisition date. The current requirements in paragraph 21122 of Regulation CRC 99-02 relating to the recognition of provisions are as follows:

*"**Provisions:** as at the date of acquisition, valuation of liabilities of the acquired enterprise is to take into account all liabilities and charges identified to this date but is not to take into account provisions for future operating losses relating to activities still to be pursued, except in the case of losses on contracts in progress. Moreover, recognition of provisions for restructuring costs may only be made with strict regard to the following conditions:*

- *Restructuring programs are clearly defined by the competent management bodies, and their cost is estimated in sufficient detail;*
- *A public announcement of the plans and their consequences was made before the close of the financial year begun after the date of acquisition, namely, before expiration of the time interval allowed for the parent enterprise to determine precisely the entry values of identifiable assets and liabilities.*

Furthermore, for the part of these programs concerning the parent enterprise, only the costs corresponding to a reduction in redundant capacity as a result of the *acquisition are to be taken into account and included in the acquisition cost of securities, for their amount net of corresponding tax savings."*

We believe that those requirements have been proven to work appropriately and give relevant information.

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 agree. The recognition of contingent liabilities reflects an element which was considered in determining the cost of acquisition.

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?

With respect to the measurement of minority interests, we agree that their measurement should be on the same basis as the measurement of the identifiable net assets acquired, i.e. at the minority's proportion of the net values assigned to those items at the date of acquisition.

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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?

We agree with the recognition of goodwill as an asset.

With respect to the amortisation or not of goodwill, we acknowledge that there are conceptual merits supporting both views.

We agree that, in some cases, it is more relevant to carry goodwill at its acquisition cost without amortisation and subject it to impairment tests on a regular basis.

However, we believe that performing ED 3's impairment tests on *every* goodwill on an annual basis and with the calculation of the implied value of goodwill when required could be extremely burdensome. According to our understanding of IAS 36.74 (see our response at Question 4 in the IAS 36 Invitation to Comment), in some cases, we may have to allocate goodwill to cash-generating units (CGUs) at a low level in our organisation. The amount allocated to goodwill may be material but not so significant. In such cases, it may be more appropriate to have an approach where goodwill could be amortised and, in addition, tested for impairment when there is an indication that it may be impaired. We do not believe that, compared to an amortisation approach, the benefits of implementing the revised IAS 36's impairment test of goodwill to allow the non-amortisation of goodwill justify the associated costs.

In sum, we believe that a combination of amortisation of goodwill (when it is not significant) and impairment testing when there is an event that indicates that there may be an impairment, is a more workable 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.

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?

Subject to the recognition of provisions for restructuring costs under our proposals and contingent liabilities, we agree with the immediate recognition in the income statement of any 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 ('negative goodwill'). This is because this treatment would normally reflect the negotiations that led to the purchase price.

However, if the restructuring provisions and contingent liabilities mentioned above are not included in the allocation of the cost of acquisition, then we believe that the current IAS 22 treatment should be retained with some modifications. Any 'negative goodwill', should be recognised as follows:

(a) to the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquirer's plan for the acquisition and can be measured reliably, but which do not represent identifiable liabilities at the date of acquisition, that portion of negative goodwill should be recognised as income in the income statement when the future losses and expenses are recognised (same as in IAS 22.61); and

(b) any remaining amount of negative goodwill should be recognised as income immediately.

Question 10—Completing the initial accounting for a business combination and subsequent adjustments to that accounting

The Exposure Draft proposes that:

(a) if the initial accounting for a business combination can be determined only provisionally by the end of the reporting period in which the combination occurs because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer should account for the combination using those provisional values. Any adjustment to those values as a result of completing the initial accounting is to be recognised within twelve months of the acquisition date (see proposed paragraphs 60 and 61 and paragraphs BC123-BC126 of the Basis for Conclusions).

Is twelve months from the acquisition date sufficient time for completing the accounting for a business combination? If not, what period would be sufficient, and why?

(b) with some exceptions carried forward as an interim measure from IAS 22, adjustments to the initial accounting for a business combination after that accounting is complete should be recognised only to correct an error (see proposed paragraphs 62 and 63 and paragraphs BC127-BC132 of the Basis for Conclusions).

Is this appropriate? If not, under what other circumstances should the initial accounting be amended after it is complete, and why?

We agree that twelve months from the acquisition date is sufficient time for completing the accounting for a business combination. Once this period is completed, we agree that any subsequent adjustment is a correction of an error. However, as we indicated in our comment letter on the Improvements Project, we disagree that all errors should be recognised retrospectively. We believe that errors that are not fundamental errors should be recognised in the income statement in the period in which they are discovered.

Other Comments

Measuring identifiable assets and liabilities at fair value at the date of acquisition

We disagree with the measurement of 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. We believe that the acquirer's intentions should be considered in determining the values to be assigned to identifiable assets, liabilities and contingent liabilities at the date of acquisition. For example, among the identifiable assets of the acquirer, there may be a brand for which a fair value could be assigned. However, the acquirer may have no intention of using this brand and, in negotiating the purchase price, discounted the value of the brand to zero. We believe that it would be inappropriate to recognise this brand at its fair value instead of zero at the date of acquisition. Indeed, if the brand is recognised at its fair value, an impairment loss will have to be recognised shortly after the acquisition for the brand because the acquirer will not use the brand. Assuming that the acquisition generated goodwill, there will be no offsetting entry in the income statement to reflect the fact that the acquirer properly negotiated with the seller the fact that it will not use the brand. We do not believe that this accounting gives a proper picture of the acquisition.

Indeed, during acquisitions, the purchase price is determined for the acquisition of a bunch of items in a single transaction, rather than based on an aggregation of the price of each item being sold. Some items may have a value for the seller and none for the acquirer. However, the reality of the transaction is that the seller accepts an overall price for the sale of all of the items. As we have indicated at Question 5, we believe that the objective of the Standard should be to ensure the most relevant allocation of the cost of acquisition to the acquired assets and liabilities of the acquiree and other relevant items. Therefore, there should be a consideration of the acquirer's intentions for the items acquired.

We also note that under the current literature, for deferred tax assets, the acquirer's intentions with respect to the utilisation of the acquiree's bases for deferred tax assets (such as tax losses) should be taken into account in valuing these deferred tax assets. This has consequences on the allocation of the cost of acquisition. Therefore, the consideration of the acquirer's intentions in determining the values of items acquired in a business combination is a concept that already exists in the literature.

In order to assess the extent to which the acquirer's intentions should be considered in determining the values to be assigned to the acquiree's identifiable assets and liabilities, an acquirer would need to demonstrate and provide the appropriate documentation at the date of acquisition that, in negotiating the purchase price, its intentions were already known and led to a quantifiable adjustment of the purchase price.

Recognition of deferred tax assets after the initial accounting is complete

We disagree with the outright requirement in ED 3.64 whereby, if the potential benefit of the acquiree's income tax loss carry-forwards or other deferred tax assets did not satisfy the criteria in ED 3.36 for separate recognition on initial accounting for the business combination, and is subsequently realised, then the acquirer shall reduce the carrying amount of goodwill (to restate goodwill as if the deferred tax asset had been recognised separately on acquisition) and recognise this reduction in goodwill as an expense.

While we agree with this treatment is appropriate during the twelve-month window that allows for readjustment of the carrying amount of goodwill that has been determined provisionally, we believe that if the benefit is recognised after twelve months from acquisition, goodwill should not be reduced unless it is impaired. Indeed, after twelve months, it is possible that the benefit represents post-acquisition added value arising from the acquirer's expertise in dealing with income tax loss carry-forwards, and therefore a consequential reduction of goodwill would just be arbitrary.

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Comments on 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?

We disagree. Impairment tests for all items of goodwill on an annual basis would be extremely burdensome, even in the light of IAS 36.96 (see our comments on Question 8 of ED 3). In the light of cost/benefit considerations, we would propose that, if the goodwill is material but not significant, an amortisation approach should be permitted to be complemented by impairment tests each time there is an indication that goodwill may be impaired (same approach as for intangible asset with a finite life).

If the approach under which goodwill is not amortised is finally retained, we believe that for goodwill that is material but not significant, a requirement that goodwill shall be tested for impairment over a three-year period on a rolling basis is a more workable solution, which takes into consideration the cost/benefit of the impairment test.

We agree that indefinite lived intangible assets and goodwill that is significant should be tested for impairment at the end of each annual reporting period (in the light of IAS 36.20A) and, if earlier, when there is an indication of the intangible asset or goodwill may be impaired. This is because the impairment test for intangible assets with indefinite lived intangible assets is much less burdensome than for goodwill.

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.

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?

We agree.

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?

As a preliminary comment, we are unsure how to interpret the requirements of IAS 36.74, particularly what is intended by requiring the identification of a cash-generating unit (CGU) at '*the lowest level at which management monitors the return on investment on assets that include the goodwill*'. There is uncertainty about the meaning of 'management'.

We considered the application of the proposed requirements to our organisation. We came to the following conclusions:

(a) the level of identification of CGUs should be, *at the very minimum*, at the primary segment reporting level in accordance with IAS 14 Segment Reporting;

(b) the level of identification of CGUs is most likely to be at one level of disaggregation below the primary segment reporting level (i.e. by business activity within each business segment); and

(c) on occasions, the level of identification of a CGU may be at a further level of disaggregation (two or more levels below the primary segment reporting level), due to clearly distinguishable cash inflows within a particular business activity, for example, as a result of different geographical sources of revenue.

(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?

We agree.

(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?

We agree.

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 agree.

(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 agree.

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

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

We disagree. We believe denominating the comparison between the carrying amount and the recoverable amount as a "screening mechanism" and then proceeding to a calculation of the 'implied' value of goodwill is inappropriate.

We disagree with the recognition of an impairment loss of goodwill based on its implied value for the following reasons:

(a) the purpose of the test should not be to measure the fair value of an asset or the amount that would be paid for it, but it should be to ensure that the entity will recover its carrying amount. We agree that recoverable amount is the higher of net selling price (to reflect recovery in the case of a sale) and value in use (to reflect recovery in the case of keeping the asset for use). There are only two choices for an entity: either keep or sell an asset;

(b) we agree that recoverable amount should be measured for an individual asset. However, if an asset works together with other assets and does not generate independent cash inflows, the assets should be grouped and the CGU to which they belong should be identified. It is the smallest group of assets that generate independent cash inflows from other groups of assets. Goodwill is an asset that does not generate cash inflows separately, therefore, its CGU must be identified;

(c) the calculation of the 'implied value' of goodwill treats goodwill as if it were an asset which is stand-alone from all the other assets of the CGU. IAS 36.C30 explains that the purpose of the approach is to reflect a method similar to the one that would be applied to determine goodwill, would an acquisition occur at the date of the test. As mentioned above, we believe that this should not be the purpose of IAS 36. The purpose of the impairment test should be to ensure that the entity will recover the carrying amount of the goodwill's CGU. Therefore, it is appropriate to calculate any impairment loss for the goodwill's CGU and then allocate this impairment loss within the assets of that CGU. In doing this allocation, which can only be arbitrary, we agree that the carrying amount of goodwill should be reduced first;

(d) the approach introduces an inconsistent treatment between intangible assets and goodwill whereas many intangible assets are of the nature of goodwill. This may give rise to accounting arbitrages;

(e) determination of fair values is a difficult, costly and sometimes subjective exercise. We do not see the benefits of undertaking this exercise, just for the purpose of determining the amount of an impairment loss to be allocated to goodwill when the goodwill's CGU is impaired, compared to a more simple method. Again, what we believe is key to ensure is that the carrying amount of the goodwill's CGU will be recovered altogether one way or the other;

(d) the exercise of determining the 'implied value' of goodwill is one step further towards using fair value measurement in the financial statements. We disagree with this approach as long as many major issues relating to fair value measurement have not yet been debated.

In sum, for conceptual and practical reasons, we believe that the current requirements of IAS 36 are appropriate and are sufficiently rigorous (i.e. measurement of an impairment loss for the CGU to which the goodwill belongs and then allocate the impairment loss according to the current IAS 36.88 and IAS 36.89).

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 disagree. Reversals of goodwill impairment should not be prohibited. The future cash flows based on management budgets reflect the position of the company within the economic cycle at a specific point in time. The management budgets are rarely projected over more than three to five years and are a key component of the impairment test because they are the basis for extrapolations. The establishment of management budgets at one point in time is highly influenced by the economic environment at that point in time. We usually note that management budgets may be over pessimistic when there is a crisis or over optimistic when the economy is booming. If there is a crisis, there is a risk that management may recognise a goodwill impairment that is not confirmed just because it projected cash-flows that were too pessimistic at one point in time. Two or three years later, the cash flows will have changed, not due to a given specific event, nor necessarily due to the existence of internally generated goodwill, but because the market environment at that time will not be the same, by force of economics. Management may simply have reassessed its earlier projections under the influence of the new economic environment and be less pessimistic. We believe that a reversal of the goodwill impairment should be permitted in such circumstances in the same way that any estimate is normally adjusted for a change in that estimate, if it can be measured reliably.

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?

The disclosure provisions are extremely onerous and we are not sure of the value to the users of the financial statements in all cases. We believe that the list of items required by paragraph 134 should be reduced.

We are also concerned that some of the items listed would in fact represent extremely sensitive and in some cases confidential data (% gross margin, % market share) and should not be made public.

Appendix 1
Comments on ED 3 – Business Combinations, Impairment of Assets and Intangible Assets

Comments on Amendments to IAS 38, Intangible 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?

We agree that separability and contractual/other legal rights are appropriate criteria for determining whether an asset meets the identifiability criterion in the definition of an intangible asset as prescribed in IAS 38.11.

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.

While it may be possible to identify intangible assets, we have doubts about the reliable fair value measurement of these identifiable intangible assets in all cases. Let's take the example of the acquisition of a bank. Using the draft Illustrative Examples, we should potentially identify the following intangible assets:

(a) trademarks

(b) customer lists

(c) customer contracts (such as customer management contracts)

(d) related customer relationships (such as our ability to sell other products in the future to existing clients)
(e) non-contractual customer relationships (such as our ability to sell products in the future to other individuals related to our clients – e.g. children, relatives, friends, etc.)

and other contract-based intangible assets (such as servicing rights) and technology-based intangible assets.

For the items listed above, we do not value them separately when we acquire a bank's business and we would not know how to determine their fair value reliably. As far as we understand ED 3 and the revisions to IAS 38, we would not be required to recognise them separately.

In addition, as we explained at Question 7 on ED 3, an intangible asset may have a value but this value may represent nothing to the acquirer because it will not use the existing asset. In such cases, we disagree that the intangible asset should be measured at its fair value. The acquirer's intentions, if appropriately documented at the date of acquisition, should be considered.

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.

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.

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.