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Dear Sir David

Business Combinations Project (Phase I) of the IASB

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on IASB's Phase I of the Business Combinations Project (i.e. ED 3 *Business Combinations*, ED-IAS 36 *Impairment of Assets* and ED-IAS 38 *Intangible Assets*). We appreciate the opportunity to comment on the proposals.

The GASB welcomes the efforts of the IASB to establish uniform international accounting rules for business combinations in consolidated financial statements. The GASB explicitly supports the elimination of the uniting of interests method (**cf. ED 3/Question 2**), the withdrawal of the option to measure the fair value of the identifiable assets and liabilities acquired by reference to the acquirer's interest only (**cf. ED 3/Question 7**) and the proposed restriction in the situations where restructuring provisions can be recognised (**cf. ED 3/Question 5**).

While the GASB supports IASB's impairment-only approach for conceptual reasons, the proposed impairment test has practical weaknesses and offers a large degree of judgement. Therefore, the GASB proposes to adopt a transitional provision under which companies have the option between systematic amortisation and the impairment-only approach (**cf. ED 3/Question 8**).

The discussions on the Exposure Drafts, in addition, revealed further areas on which we do not fully agree with IASB's proposals.

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The GASB hereby submits its comments on IASB's questions relating to ED 3, ED-
IAS 36 and ED-IAS 38 (sections B-D). Additionally, a summary of the main
comments is given in section A.

Yours sincerely,

Dr. Frank Trömel
Vice President



Section A.

Summary of GASB's main comments on ED 3, ED IAS 36 and ED IAS 38

I. Elimination of application of uniting of interests method

The GASB welcomes the proposed elimination of the uniting of interests method. The ability to apply only one method to account for business combinations is essential for the comparability of financial statements. Elimination of the uniting of interests method will also restrict the scope of discretionary accounting.

II. Applicable measurement method for fair value adjustments

The GASB supports the elimination of a choice between the use of a proportionate and a full fair value measurement of the identifiable assets and liabilities acquired. This will help to improve the comparability of financial statements. It is consistent with the increasing importance of fair value measurement in IFRS only to allow the full fair value method. In addition, the use of proportionate fair value measurement results in mixed values. The full fair value method is also more in line with the efforts of the IASB to implement the entity concept. The GASB is of the opinion that it is consistent with the entity concept to recognise additionally the minority's share of goodwill.

III. Goodwill

1. Recognition and measurement

The GASB agrees that goodwill qualifies as an asset and therefore must be recognised as such. Given the general heterogeneity of goodwill, it follows therefrom that not all components of goodwill have asset character.

While GASB supports IASB's impairment-only approach for conceptual reasons, the impairment test as proposed has practical weaknesses (for example, annual impairment testing is a complex process which raises implementation difficulties in many companies) and offers a large degree of judgement (for example, with respect to the projection of future cash flows).

Therefore, GASB proposes to adopt a transitional provision under which companies have the option between systematic amortisation and the impairment-only approach; in case of adopting systematic amortisation the useful life of goodwill should not exceed twenty years from initial recognition. This option should be exercised uniformly for all goodwills of a group irrespective of whether acquired before or after the date the new IFRS is issued. This transitional provision should be limited to five years from the date the new IFRS is issued. During this period efforts should be undertaken to eliminate the implementation difficulties of the impairment test and make it more robust in order to be able to abolish the transitional option.



2. Allocation of goodwill to cash-generating units (CGUs)

The GASB does not agree with the proposed level for impairment testing of goodwill. IASB's proposal could lead to a significant number of units which qualify for the goodwill impairment test, so that time and cost to perform the determination of goodwill impairment would not be acceptable. Therefore, the GASB proposes to limit the allocation of goodwill to CGUs to the first level below the segment level for practical reasons. We suggest to define a CGU similar to a "reporting unit" as defined under SFAS 142.

The GASB agrees with the proposal that the portion of goodwill to be derecognised and the portion to be retained for the CGU in the event of a disposal of a sub-unit should be measured using a relative value approach.

Initial allocation of goodwill to CGUs and reallocation of goodwill if an entity reorganises its reporting structure basically give rise to the same problems. The GASB, therefore, suggests to allocate goodwill to CGUs using a relative value approach not only after a reorganisation of the reporting structure but also for the allocation of goodwill at the acquisition date.

IV. Excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination

The GASB does not agree with IASB's proposal. The excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the business combination cannot always be attributed to favourable circumstances at the time of acquisition. Irrespective of whether contingent liabilities should be recognised (as proposed by the IASB) or not, it is possible that the excess relates to future expected losses or expenses in conjunction with the acquired enterprise which are reflected in the purchase price. The proposed treatment (immediate recognition as income) does not adequately address the multifarious character of this item. The GASB therefore considers that the current IAS treatment should be retained unchanged in the new IFRS.

V. Intangible assets

1. Recognition

The GASB does not share the view of the IASB that the probability criterion for individually acquired intangible assets or intangible assets acquired in conjunction with a business combination is always satisfied. The rule proposed by the draft Standard is inconsistent with the Framework, which envisages that each asset must pass a probability test as a condition for recognition. In this respect, the IASB is introducing into the draft of IAS 38 an inconsistent treatment of purchased intangible assets on the one hand and self-generated and other assets on the other. This



affects conceptual questions which should be answered consistently for all assets as part of the revision of the Framework and not separately as part of the Business Combinations Project.

The GASB also doubts that the criterion of reliability of measurement of the fair value of intangible assets (as stated in the draft Standard) will always be fulfilled with the exception of the assembled workforce.

2. Measurement

The GASB considers that restricting the useful life of intangible assets to twenty years is arbitrary and welcomes the elimination of this rule.

The GASB does not, however, agree with the amortisation rules for intangible assets with indefinite useful lives. It is inconsistent on the one hand, as part of the consolidation process, to require fair value measurement of assets with an indefinite (but limited) useful life acquired in conjunction with a business acquisition, and on the other hand to eliminate systematic amortisation using the argument that the useful life of an asset is indefinite. This is inconsistent since one prerequisite for determining the fair value of an asset is that it is possible to estimate its useful life (unless, of course, in exceptional cases, the useful life really is unlimited). The GASB therefore considers that the useful life of intangible assets with limited useful lives (even where indefinite) should be estimated and used as the basis for systematic amortisation. Only intangible assets with really unlimited useful lives should not be amortized systematically, but be subjected to an “impairment-only approach”.

VI. Contingent liabilities and contingent assets

The GASB does not agree with the proposal of the IASB to introduce a requirement for contingent liabilities to be recognised in the balance sheet. The recognition of contingent liabilities is at variance with IAS 37 and the Framework. Apart from these conceptual objections, the recognition of contingent liabilities would lead to a different treatment in separate and consolidated financial statements. It is also undesirable for contingent liabilities arising from business combinations to be removed arbitrarily from the scope of IAS 37, in order to avoid later derecognition (unavoidable given the rules set out in IAS 37). This new rule should be rejected on the grounds of methodology.

In order to be consistent, both contingent liabilities and contingent assets would have to be recognised. In terms of the financial statement's objective to provide useful information, however, it remains preferable not to recognise assets and liabilities in the balance sheet which are not probable. This also raises the issue of verifiability.



VII. Disclosure requirements in ED-IAS 36

In general, the GASB agrees that certain disclosures should be made for segments that include goodwill, which is not amortised systematically, and for intangible assets with unlimited useful lives. However, some of the proposed disclosures could result in a significant competitive harm. In addition, some proposed disclosures seem to be excessive while not being decision useful. The GASB also has doubts with regard to the practicability of sensitivity analysis for key assumptions. Therefore, the GASB proposes to delete certain disclosure requirements.

For practical reasons and for the reason of competitive harm the GASB suggests that the information should be disclosed for the segment level only.



Section B. **GASB's comments on ED 3**

Question 1 – Scope

The Exposure Draft proposes:

- (a) *to exclude from the scope of the IFRS business combinations in which separate entities or operations of entities are brought together to form a joint venture, and business combinations involving entities under common control (see proposed paragraphs 2 and 3 and paragraphs BC9-BC11 of the Basis for Conclusions).*

Are these scope exclusions appropriate? If not, why not?

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

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

Response of the GASB

The GASB considers that the accounting treatment for “entities under common control” should be dealt with in a Standard on business combinations. However, transactions of this kind could not be accounted properly for in many cases using the proposed rules of ED 3. The GASB welcomes the fact that the IASB intends to incorporate more appropriate rules during the second phase of the project. For the transitional period up to date when the final rules are approved, the GASB agrees with the definition of common control and additional guidance.

The GASB agrees to the temporary exclusion of joint ventures from the scope of ED 3; until approval of a new rule, joint ventures should be accounted for, as up to now, in accordance with IAS 31.

Question 2 – Method of accounting for business combinations

The Exposure Draft proposes to eliminate the use of the pooling of interests method and require all business combinations within its scope to be accounted for by applying the purchase method (see proposed paragraphs 13-15 and paragraphs BC18-BC35 of the Basis for Conclusions).

Is this appropriate? If not, why not? If you believe the pooling of interests method should be applied to a particular class of transactions, what criteria should be used to distinguish those transactions from other business combinations, and why?



Response of the GASB

The GASB agrees with the proposals of the IASB. The ability to apply only one method to account for business combinations is essential for the comparability of financial statements. Elimination of the uniting of interests method will also restrict the scope of discretionary accounting.

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?

Response of the GASB

The GASB agrees with the description of the circumstances, under which a business combination should be accounted for as a reverse acquisition and considers that the additional guidance (in the form of an explanation in Appendix B and the illustrative examples) is appropriate and helpful.



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

The Exposure Draft proposes that when a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination should be adjudged the acquirer on the evidence available (see proposed paragraph 22 and paragraphs BC42-BC46 of the Basis for Conclusions).

Is this appropriate? If not, why not?

Response of the GASB

The GASB agrees with the proposed rule that one of the combining entities that existed before the combination should be adjudged the acquirer. Having said this, it can be difficult to adjudge an acquirer in some circumstances.

The GASB is of the opinion that the criteria listed in ED 3.20 f. to adjudge the acquirer in cases of doubt are not sufficient.

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?

Response of the GASB

The GASB welcomes the proposed rules to restrict the recognition of restructuring provisions, especially since the current rule in IAS 22 is not consistent with IAS 37. A further argument in favour of the new rule is that it enables greater objectivity with respect to the recognition of restructuring provisions compared to the current rule.



Question 6 – Contingent liabilities

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

Is this appropriate? If not, why not?

Response of the GASB

The GASB does not agree with the proposed separate recognition of contingent liabilities. Recognition is inconsistent with IAS 37 and the Framework. Furthermore, all other things remaining equal, it could give rise to goodwill or increase the carrying amount of goodwill. In view of the planned elimination of systematic amortisation of goodwill, this could encourage entities to identify as many contingent liabilities as possible. It would also mean, at least during a transitional period until IAS 37 is revised, that the recognition of contingent liabilities in separate and consolidated financial statements would be different.

It is also undesirable for contingent liabilities arising from business combinations to be removed arbitrarily from the scope of IAS 37, in order to avoid later derecognition (unavoidable given the rules set out in IAS 37). This proposed rule should be rejected on the grounds of methodology.

In order to be consistent, both contingent liabilities and contingent assets would have to be recognised. In terms of the financial statement's objective to provide useful information, however, it remains preferable not to recognise assets and liabilities in the balance sheet which are not probable. This also raises the issue of verifiability.

Irrespective of how the recognition of contingent assets should be resolved, it would still be the case that, for a transitional period – at least until completion of Phase II – that there would be a requirement to recognise contingent liabilities in the consolidated balance sheet, whereas there would be a prohibition to recognise contingent assets. This would entail an asymmetrical treatment of risks and rewards in consolidated financial statements and would impair their objective to provide useful information.

In summary, based on the reasons given above, the GASB concludes that recognition of both contingent liabilities and contingent assets should be rejected.

**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?

Response of the GASB

The GASB supports the elimination of a choice between use of a proportionate and a full fair value measurement of the identifiable assets and liabilities acquired since this improves the comparability of financial statements. It is consistent with the increasing importance of fair value measurement in IFRS only to allow the full fair value method. In addition, the use of proportionate fair value measurement results in mixed values. The full fair value method is also more in line with the efforts of the IASB to implement the entity concept.

The GASB is of the opinion that it is consistent with the entity concept to recognise additionally the minority's share of goodwill. In order to compute the total amount of goodwill to be recognised, goodwill attributable to the parent should be divided by the parent's interest in the subsidiary. This method could overestimate the minority's share of goodwill but measuring the full goodwill as the difference between the fair value of the acquired entity as a whole and the fair values of all of its identifiable assets acquired and liabilities assumed is in GASB's opinion too burdensome.

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?



Response of the GASB

The GASB agrees that goodwill qualifies as an asset and therefore must be recognised as such. Given the general heterogeneity of goodwill, it follows therefrom that not all components of goodwill have asset character.

While the GASB supports IASB's impairment-only approach for conceptual reasons, the impairment test as proposed has practical weaknesses (for example, annual impairment testing is a complex process which raises implementation difficulties in many companies) and offers a large degree of judgement (for example, with respect to the projection of future cash flows).

Therefore, the GASB proposes to adopt a transitional provision under which companies have the option between systematic amortisation and the impairment-only approach; in case of adopting systematic amortisation the useful life of goodwill should not exceed twenty years from initial recognition. This option should be exercised uniformly for all goodwills of a group irrespective of whether acquired before or after the date the new IFRS is issued. This transitional provision should be limited to five years from the date the new IFRS is issued. During this period efforts should be undertaken to eliminate the implementation difficulties of the impairment test and make it more robust in order to be able to abolish the transitional option.

Question 9 – Excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination

In some business combinations, the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of the combination exceeds that cost. The Exposure Draft proposes that when such an excess exists, the acquirer should:

- (a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and*
- (b) recognise immediately in profit or loss any excess remaining after that reassessment.*

(See proposed paragraphs 55 and 56 and paragraphs BC109-BC120 of the Basis for Conclusions.)

Is this treatment appropriate? If not, how should any such excess be accounted for, and why?

Response of the GASB

The GASB does not agree with IASB's proposal. The excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination cannot always be



attributed to favourable circumstances (“lucky buy”) at the time of an acquisition. Irrespective of whether contingent liabilities should be recognised (as proposed by the IASB) or not, it is possible that the excess relates to future expected losses or expenses in conjunction with the acquired enterprise which are reflected in the purchase price. The proposed treatment of any excess (immediate recognition in profit or loss) does not adequately address the multifarious character of this item. The GASB therefore considers that the current IAS treatment (IAS 22.59 et seq.) should be retained unchanged in new IFRS.

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?

Response of the GASB

re a)

The GASB welcomes the proposed change, firstly, since it shortens the period during which adjustments can be made, whilst still allowing a reasonable period of time. Secondly, the new rule would mean that all acquisitions would be treated similarly, whereas under the current rule in IAS 22 the maximum period for making adjustments depends on the date of acquisition.

Since it is intended to withdraw SIC-22, the GASB recommends that the Standard should be more specific in dealing with the technical aspects of subsequent adjustments, in particular with respect to the amount of goodwill initially recognised.



re b)

The GASB agrees that adjustments to the initial accounting for a business combination after the twelve month period (i.e. after completing the initial accounting) should be recognised only to correct an error.

Further comments of the GASB on ED 3

- **ED 3.84:**

Voluntary early application of the Standard should be prohibited in the opinion of the GASB, since otherwise the comparability of financial statements would be impaired; in addition, allowing voluntary early application would provide additional opportunity for discretionary accounting.

- **ED 3, Appendix A:**

The definition of goodwill should be expanded to include the fact that it is a residual amount. Self-generated goodwill should be explicitly excluded.

- **ED 3, Appendix A:**

A uniform definition of “probable” is necessary. The GASB is in favour of including a definition in the Framework which would then apply to all Standards. The GASB opposes inclusion of a separate definition in ED 3.



Section C.

GASB's comments on ED-IAS 36

Question 1 – Frequency of impairment tests

Are the proposals relating to the frequency of impairment testing intangible assets with indefinite useful lives and acquired goodwill appropriate (see proposed paragraphs 8 and 8A and paragraphs C6, C7 and C41 of the Basis for Conclusions)? If not, how often should such assets be tested for impairment, and why?

Response of the GASB

The GASB suggests a transitional provision to retain systematic amortisation of goodwill (cf. GASB's response to ED 3/Question 8). Systematically amortised goodwill should only be tested for impairment at the balance sheet date whenever there is an indication that it is impaired.

The GASB agrees that more stringent rules should be required for goodwill, which is not amortised systematically, and intangible assets with unlimited useful lives (however, not for intangible assets with indefinite but limited useful lives; cf. GASB's response to ED-IAS 38/Question 3) than for other assets. The GASB welcomes the proposal that goodwill, which is not amortised systematically, and intangible assets with unlimited useful lives should be subjected to an impairment test, even if there is no indication of impairment.

Nevertheless, the GASB raises the following points with regard to the new proposals.

- **The *timing* of the impairment test:**
For reasons of principle, the GASB opposes the proposal that the timing of the impairment test for goodwill, which is not amortised systematically, should be different from the timing of the test for intangible assets with unlimited useful lives. In addition the GASB is opposed to the proposal that the impairment test for goodwill, which is not amortised systematically, can be carried out for individual cash-generating units (CGUs) at different dates, albeit consistently for each CGU. The GASB believes that there should be a requirement for the impairment test for goodwill to be performed uniformly at the balance sheet date. This is the only way of ensuring that goodwill, which is not amortised systematically, will not be overstated or understated at the balance sheet date (balance sheet date principle). This rule would also be consistent with the requirement that an impairment test be carried out for intangible assets with unlimited useful lives at the end of each annual reporting period.
- ***Frequency* of the impairment test:**
The GASB is opposed to the proposal that the impairment test would, under certain circumstances, have to be performed more than once a year in the above mentioned cases. Given the proposed prohibition to reverse impairment losses on goodwill, this could result in an understatement of goodwill, which is not amortised systematically, at the year-end balance sheet date.



- In summary, the GASB is in favour of a mandatory impairment test for goodwill, which is not amortised systematically, and intangible assets with unlimited useful lives at the balance sheet date. The test should be required irrespective of whether there is any indication of impairment. The GASB opposes the requirement for an additional test during the year.

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?

Response of the GASB

The GASB agrees with the approach adopted in the draft Standard. The GASB sees no reason why there should be any deviation from the general rule in the case of intangible assets with unlimited useful lives (however, not for intangible assets with indefinite but limited useful lives; cf. GASB's response to ED-IAS 38/Question 3). In the opinion of the GASB, the impairment test should be performed for all assets other than goodwill on the basis of uniform rules.

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:

- 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?*
- 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?*
- 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?*



Response of the GASB

re a)

The GASB agrees that the elements listed in paragraph 25A should be taken into account in the measurement of an asset's value in use. The GASB does not believe, however, that an option should be given to reflect the elements mentioned in paragraph 25A(b), 25A(d) and 25A(e) either as adjustments to the future cash flows or as an adjustment to the discount rate. The GASB is in favour of adjustments to future cash flows; the discount rate should not be adjusted for risks. This is consistent with other IASB Standards (e.g. IAS 19) which prescribe a similar approach.

re b)

The GASB agrees with the proposals since these represent minimum requirements for reliable measurement of the value in use.

re c)

The GASB considers that the inclusion of additional guidance on using present value techniques is useful and that the scope of the explanations in Appendix B 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?*



Response of the GASB

re a)

The GASB does not agree with the proposed level for impairment testing of goodwill. IASB's proposal could lead to a significant number of units which qualify for the goodwill impairment test, so that time and cost to perform the determination of goodwill impairment would not be acceptable. Therefore, the GASB proposes to limit the allocation of goodwill to cash-generating units (CGUs) to the first level below the segment level for practical reasons. The GASB suggests to define a CGU similar to a "reporting unit" as defined under SFAS 142.

re b)

The GASB agrees with the proposal that the portion of goodwill to be derecognised and the portion to be retained for the CGU in the event of a disposal of a sub-unit should be measured using a relative value approach.

re c)

Initial allocation of goodwill to CGUs and reallocation of goodwill if an entity reorganises its reporting structure basically give rise to the same problems. The GASB, therefore, suggests to allocate goodwill to CGUs using a relative value approach not only after a reorganisation of the reporting structure but also for the allocation of goodwill at the acquisition date. Consequently, the GASB suggests to amend para. 73 of ED-IAS 36.

Question 5 – Determining whether goodwill is impaired

The Exposure Draft proposes:

- (a) *that the recoverable amount of a cash-generating unit to which goodwill has been allocated should be measured as the higher of the unit's value in use and net selling price (see proposed paragraphs 5 (definition of recoverable amount) and 85 and paragraph C17 of the Basis for Conclusions).*

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

- (b) *the use of a screening mechanism for identifying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as potentially impaired only when the carrying amount of the unit exceeds its recoverable amount (see proposed paragraph 85 and paragraphs C42-C51 of the Basis for Conclusions).*

Is this an appropriate method for identifying potential goodwill impairments? If not, what other method should be used?



- (c) *that if an entity identifies goodwill allocated to a cash-generating unit as potentially impaired, the amount of any impairment loss for that goodwill should be measured as the excess of the goodwill's carrying amount over its implied value measured in accordance with proposed paragraph 86 (see proposed paragraphs 85 and 86 and paragraphs C28-C40 of the Basis for Conclusions). Is this an appropriate method for measuring impairment losses for goodwill? If not, what method should be used, and why?*

Response of the GASB

re a)

The GASB welcomes the proposal for the measurement of the recoverable amount.

re b)

The GASB is conceptually in favour of a two-step impairment approach but is of the opinion that IASB's proposal has practical weaknesses and offers a large degree of judgement (cf. GASB's response to ED 3/Question 8). Despite of this concerns the GASB agrees with IASB's proposed impairment test for a transitional period of five years and suggests undertaking efforts to eliminate the implementation difficulties of the impairment test and make it more robust within this period.

re c)

The GASB agrees in principle with the proposal, but suggests that an illustrated example be included to explain paragraph 86b.

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?

Response of the GASB

The GASB agrees with IASB's proposal that reversals of goodwill impairment losses recognised for goodwill should be prohibited in order to avoid the recognition of internally generated goodwill.



Question 7 – Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

The Exposure Draft proposes requiring a variety of information to be disclosed for each segment, based on an entity's primary reporting format, that includes within its carrying amount goodwill or intangible assets with indefinite useful lives (see proposed paragraph 134 and paragraphs C69-C82 of the Basis for Conclusions).

- (a) Should an entity be required to disclose each of the items in proposed paragraph 134? If not, which items should be removed from the disclosure requirements, and why?*
- (b) Should the information to be disclosed under proposed paragraph 134 be disclosed separately for a cash-generating unit within a segment when one or more of the criteria in proposed paragraph 137 are satisfied? If not, why not?*

Response of the GASB

re a)

In general, the GASB agrees that certain disclosures should be made for segments that include goodwill, which is not amortised systematically (cf. GASB's response to ED 3/Question 8), and for intangible assets with unlimited useful lives (however, not for intangible assets with indefinite but limited useful lives; cf. GASB's response to ED-IAS 38/Question 3). However, some of the proposed disclosures could result in a significant competitive harm. In addition, some proposed disclosures seem to be excessive while not being decision useful. The GASB also has doubts with regard to the practicability of sensitivity analysis for key assumptions. Therefore, the GASB proposes to delete paras. 134(d), 134(e)(ii), (iv), (v) and 134 (f)(ii).

re b)

For practical reasons and for the reason of competitive harm the GASB suggests that the information should be disclosed for the segment level only. Therefore, para. 137 should be deleted.

Further comment of the GASB on ED-IAS 36

For conceptual reasons, the GASB suggests to calculate value in use using an after-tax approach, that means to estimate future cash flows with regard to taxes and to use an after-tax discount rate. Therefore, we propose to amend paras. 43 and 48 of ED-IAS 36.



Section D.

GASB's comments on ED-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?

Response of the GASB

The GASB agrees with the proposed identifiability criterion included in the draft; the new wording does not constitute a significant change to the current version of IAS 38. The new proposal is merely more specific than the previous version.

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.

Response of the GASB

The GASB does not agree that the probability recognition criterion for individual intangible assets or for intangible assets acquired in conjunction with a business



combination will always be satisfied. The rule proposed by the draft Standard is inconsistent with the Framework, which envisages that every asset must also pass the probability test to meet the recognition criterion. The proposal in draft IAS 38 would entail dissimilar treatment of acquired intangible assets on the one hand and self-generated intangible assets and other assets on the other hand. This affects conceptual questions which should be answered consistently for all assets as part of the revision of the Framework and not separately as part of the Business Combinations Project.

The GASB also doubts that the criterion of reliability of measurement of the fair value of intangible assets (as stated in the draft Standard) will always be fulfilled with the exception of the assembled workforce. Measurement of the fair value is not always possible where there are no market prices.

The GASB welcomes, in general, the additional guidance provided in the illustrative examples to ED 3 which list intangible assets which should be presented separately to goodwill. However, the list is open to criticism in that it contains elements where recognition is arguable (e.g. cancellable production backlog [paragraph B.2]). In addition, employment contracts would be recognised as intangible assets if they represent “beneficial contracts” from the view-point of the employer [paragraph D.9]; in practise, however, it is difficult to determine where the dividing line runs between such contracts and the assembled workforce. In addition, there is also a problem of how to measure certain elements (e.g. trade dress [paragraph A.3]).

Question 3 – Indefinite useful life

The Exposure Draft proposes to remove from IAS 38 the rebuttable presumption that an intangible asset’s useful life cannot exceed twenty years, and to require its useful life to be regarded as indefinite when, based on an analysis of all of the relevant factors, there is no foreseeable limit on the period of time over which the asset is expected to generate net cash inflows for the entity (see proposed paragraphs 85-88 and paragraphs B29-B32 of the Basis for Conclusions).

Is this appropriate? If not, under what circumstances, if any, should an intangible asset be regarded as having an indefinite useful life?

Response of the GASB

The GASB considers that restricting the useful life of intangible assets to twenty years is arbitrary and welcomes the elimination of this rule.

In GASB’s opinion, it is inconsistent on the one hand, as part of the consolidation process, to require fair value measurement of assets with an indefinite (but limited) useful life acquired in conjunction with a business acquisition, and on the other hand to eliminate systematic amortisation using the argument that the useful life of an asset is indefinite. This is inconsistent since one prerequisite for determining the fair value of an asset is that it is possible to estimate its useful life (unless, of course, in



exceptional cases, the useful life really is unlimited). The GASB therefore considers that the useful life of intangible assets with limited useful lives (even where indefinite) should be estimated and used as the basis for systematic amortisation. Only intangible assets with really unlimited useful lives should not be amortized systematically, but be subjected to an “impairment-only approach”.

Question 4 – Useful life of intangible asset arising from contractual or other legal rights

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

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

Response of the GASB

The useful life should take account of the renewal period from the outset, if there is evidence to support the ability of the entity to renew the term without significant cost. The GASB therefore agrees with the proposed approach.

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?

Response of the GASB

The GASB agrees that assets with unlimited useful lives should be subjected to a regular impairment test and not amortised systematically. Assets with indefinite but limited useful lives should be amortised systematically (cf. GASB’s response to ED-IAS 38/Question 3).