STAFF PAPER

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IASB Meeting

Project	**Goodwill and impairment project**
Paper topic	Identifying and measuring intangible assets acquired in a business combination

CONTACT(S)	Michelle Fisher	mfisher@ifrs.org	+44(0) 20 7246 6918

Objective of this paper

1. The purpose of this agenda paper is to help Board members:

   (a) continue their discussion from November 2015 and further develop their views about how to address the concerns raised about identifying and measuring intangible assets acquired in a business combination;

   (b) consider concerns raised by users about presentation and disclosure of these intangible assets: and

   (c) decide whether they need additional information before developing their views.

   The staff are not asking Board members to make any decisions on the approaches in this paper at this meeting because the staff think that decisions about potential amendments to IFRS 3 *Business Combinations* are best taken jointly with the US Financial Accounting Standards Board (FASB).

> Significant changes from November 2015 IASB Agenda Paper 18A:
>
> - New section on presentation and disclosure concerns (see paragraphs 58-68).
> - Additional discussion about the differences between internally generated intangible assets versus acquired intangible assets (see Appendix A).

Structure of this paper

2. This paper includes the following sections:

   (a) Overview of feedback during the Post-implementation Review (PIR) of IFRS 3 *Business Combination*s

   (b) History of IFRS requirements for intangible assets in a business combination

   (c) Options being considered by the US FASB

   (d) Part A: Identification and measurement of intangible assets in a business combination

      (i) Overall objective

      (ii) Approaches to consider

         1 No change to requirements

         2 Subsume some intangibles in goodwill for cost benefit reasons

         3 Remove statement that identifiable intangibles can always be measured reliably

         4 Allow further grouping of intangible assets

   (e) Part B: Providing guidance on customer relationship intangible assets

   (f) Part C: Addressing presentation and disclosure concerns

   (g) Summary of staff recommendations and questions for the Board

   (h) Appendices:

      (i) Appendix A: Differences between internally generated intangible assets and acquired intangible assets

      (ii) Appendix B: 2009 IFRIC agenda decision

Summary of feedback in the PIR (See appendix A of November 2015 IASB Agenda Paper 18C for more detail)

3. The Board's report and feedback statement on the PIR of IFRS 3 provided the following possible next steps to address identification and measurement of intangible assets:

Area of focus	Assessed significance	Possible next steps
Identification and fair value measurement of intangible assets such as customer relationships and brand names.	Medium/high	Research will be undertaken. We could consider whether particular intangible assets (for example, customer relationships) should be subsumed into goodwill. We could also consider what additional guidance could be given to assist in the identification of customer relationship intangibles and their associated measurement.

4. The PIR identified concerns that some intangible assets are costly (because of the need to use valuation specialists), complex and time-consuming to measure at fair value. The PIR also identified that some users of financial statements say that the valuations of some intangible assets are subjective and do not provide useful information. Customer relationship intangibles were the most frequently cited examples by preparers, users and other parties. Brands were also commonly cited. Consequently some participants think the benefit of the information provided to users about these intangibles does not justify the costs of separately recognising them. Nevertheless, some users support recognising these intangible assets separately because it provides an insight on why an acquisition was made and about the primary assets/value drivers of the acquiree.

5. Some participants also asserted that the following other intangible assets are challenging to measure (and also in some cases identify):

   (a) non-contractual intangible assets.

   (b) intangible assets that are not capable of being sold or licensed separately.

   (c) intangible assets for which there is no active market.

   (d) intangible assets in the early stage of development.

6. The main challenges identified during the PIR in measuring intangible assets were:

   (a) the assumptions used in valuation models and in estimating the useful life are difficult to determine and are subjective. Valuation models are sometimes sensitive to small changes in those assumptions.

   (b) there are various valuation methods and there is diversity on when/how they are used.

   (c) when there are multiple intangible assets, judgement is needed not only to value them individually but also to determine relationships between them. For example customer relationships are often incorporated in valuation methods applied to brands to which they relate, which could result in double counting.

History of IFRS requirements for intangible assets in a business combination

Pre 2004

7. IAS 22 *Business Combinations* required an acquirer to recognise any identifiable asset of the acquiree separately from goodwill if it was probable that that any associated future economic benefits would flow to the acquirer (probability recognition criterion) and the asset could be measured reliably (reliability of measurement criterion). At the time IAS 38 *Intangible Assets* clarified that an intangible asset must be identifiable to distinguish it from goodwill. IAS 38 did not define ‘identifiability’, but stated that an intangible asset could be distinguished from goodwill if it was separable, though separability was not a necessary condition for identifiability. Consequently, pre IFRS 3(2004), an intangible asset had to be recognised separately from goodwill if it was identifiable, reliably measurable and it was probable that any associated future economic benefits would flow to the acquirer.[1]

Changes in 2004

8. On issue of IFRS 3(2004), the requirements were changed to state:

   (a) an intangible asset meets the identifiability criterion only if it:

[1] Taken from paragraph BC88 of the Basis for Conclusions accompanying IFRS 3(2004).

(i) is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

(ii) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

(b) the probability recognition criterion is always considered to be satisfied for intangible assets in a business combination.

(c) the fair value of an intangible asset acquired in a business combination can normally be measured with sufficient reliability to be recognised separately from goodwill (including a rebuttable presumption that fair value can be measured reliably if the intangible has a finite life).

(d) that the only circumstances when it might not be possible to measure reliably the fair value of an intangible asset acquired in a business combination is when it arises from legal or other contractual rights and it either:

(i) is not separable; or

(ii) is separable but there is no history or evidence of exchange transactions for the same or similar assets and otherwise estimating fair value would be dependent on variables whose effect is not measurable.

Changes in 2008

9. IAS 38 was amended to state that if an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset. IAS 38 also clarified that separability does not depend on management's intent. Consequently, under the current requirements an acquirer must recognise, separately from goodwill, all identifiable intangible assets acquired in a business combination at their acquisition-date fair values.

Options being considered by the FASB

10. At the September 2015 joint meeting with the FASB, the FASB staff presented a paper that provided a summary of their outreach and work to date on accounting for identifiable intangible assets in a business combination for public business entities and not-for-profit entities (IASB Agenda Paper 13D/FASB Memo No 2 for that meeting). This paper noted that the FASB has discussed three primary views of how identifiable intangible assets acquired in a business combination could be accounted for (more detail was provided in their paper):

    (a) View A—All intangibles subsumed into goodwill (FASB decided to drop this view in its October 2015 discussions)

    (b) View B—Subsuming some intangible assets in goodwill. Four sub views:

        (i) View B1—Intangible assets only separately recognised if they are capable of being sold or licensed independently from other assets of a business.

        (ii) View B2 (PCC alternative)—Noncompetition agreements (NCA) would not be separately recognised and customer-related intangibles (CRI) would only be separately recognised if they are capable of being sold or licensed independently from other assets of a business. No change for other intangible assets.

        (iii) View B3—CRIs would only be separately recognised if they are capable of being sold or licensed independently from other assets of a business. No change for other intangible assets.

        (iv) View B4—Narrower definition of contractual CRIs. This alternative consists of narrowing the guidance on when a CRI meets the contractual/legal criterion for recognition to exclude ongoing customer relationships associated with purchase-order-based or at-will customers. No change for other intangible assets.

    (c) View C—No change to GAAP.

    A key element of Views A and B is required disclosure of the nature (but not fair value) of identifiable, but not separately recognised, intangible assets.

11. In 2014 the PCC reached a consensus that View B2 should be provided as an option for private entities. However if private entities elect the option, they are also required to apply the PCC option for subsequent accounting for goodwill (including amortisation of goodwill over ten years or less[2]).

12. Based on the discussion at the October 2015 FASB meeting, the staff think that the FASB is more focussed on View B2/B3 or View C. The FASB has also expressed an interest in working with the Board on this issue.

A) Identification and measurement of intangible assets in a business combination

Overall objective of looking at identification and measurement of intangibles

13. The staff think the overall objective of looking at identification and fair value measurement of intangibles is to determine:

    (a) whether subsuming any identifiable intangible assets acquired in a business combination in goodwill is supported by cost benefit reasons.

    (b) whether guidance or education material would help mitigate cost benefit concerns rather than change the requirements.

14. The staff think there needs to be a strong argument to support making further significant changes to IFRS 3. Since 2004 the Board has amended IAS 38 twice, each time requiring more intangible assets to be identified separately from goodwill (see paragraphs 7-9).

What approaches should we consider

15. The staff think there are four approaches to consider:

    (a) Approach 1—No change to existing requirements, but consider clarifying the requirements in IFRS 3/IAS 38 for customer relationships and possibly developing other guidance/education material.

[2] PCC alternative for goodwill. Amortise over 10 years or less if another useful life is more appropriate. Goodwill tested for impairment at the entity or the reporting unit level. Tested only when a triggering event occurs. Impairment loss measured as difference between carrying value and fair value of entity/reporting unit.

(b) Approach 2—Subsume some identifiable intangible assets in goodwill for cost-benefit reasons.

(c) Approach 3— Remove statement that acquirer can always reliably measure the fair value of identifiable intangibles acquired in a business combination (ie reverse change made in 2008).

(d) Approach 4—Allow further grouping of intangible assets, ie relax the requirement for when a group of complementary intangible assets can be recognised and measured as a single asset (currently only permitted if they have similar useful lives).

16. The staff have not considered an approach whereby all intangibles should be subsumed in goodwill. Intangible assets are becoming increasingly important in the economy and constitute an increasing proportion of the assets of many entities. For example a research report issued by the ACCA noted that in its sample of 544 companies, other intangibles (excluding goodwill) features as a separate class of intangible assets in the statement of financial position of 453 of the 517 companies (ie 87.6%). Furthermore, this type of asset represents, on average, 5.28% of companies' total assets and, for those companies with business combinations, on average 38.9% of the total purchase price was allocated to other intangible assets.[3] The staff think that in general separate recognition of intangible assets provides better information to the users of financial statements than subsuming them in goodwill. Concerns have been identified about costs and benefits of separately recognising some, but not all, intangible assets. Consequently the staff do not think there is any basis for the Board to consider including all intangibles in goodwill.

Approach 1: No change to existing requirements

Description

17. No change to existing requirements (and hence no change to the composition of goodwill). Consider clarifying the requirements in IFRS 3/IAS 38 for customer relationship intangibles.

[3] Source: ACCA Research Report 134 *Worldwide application of IFRS 3, IAS 38 and IAS 36, related disclosures, and determinants of non-compliance*. Considers disclosures in the first year of implementation of IFRS 3 (financial year 2010/11) of a sample of 544 non-financial listed companies selected from the EU, Australia, China, Hong Kong, New Zealand, Brazil, South Africa and Malaysia.

Advantages of not changing the existing requirements

18. The staff have identified the following as the key arguments for, and advantages of, not subsuming any identifiable intangible assets in goodwill (or at least being selective if we do consider subsuming additional intangible assets in goodwill):

    (a) When the Board amended IFRS 3 in 2008 it concluded separate recognition of intangible assets, on the basis of an estimate of fair value, rather than subsuming them in goodwill, provides better information to the users of financial statements even if a significant degree of judgement is required to estimate fair value (see paragraph BC174 of the Basis for Conclusions accompanying IFRS 3(2008)).

    (b) Intangible assets are becoming increasingly important in the economy. Subsuming additional intangible assets in goodwill will increase the amount of goodwill recognised. This is likely to further increase the concerns we heard during the PIR about overstatement of goodwill. Consequently this will increase pressure to make the impairment test of goodwill more stringent. It will also increase pressure to reconsider an amortisation approach for goodwill. The Board has consistently received feedback that amortisation of goodwill over an arbitrary period does not provide decision useful information for investors.

    (c) If goodwill included dissimilar intangible assets, with different useful lives, different risks and different cash flows it would not provide a faithful representation of the assets acquired in the business combination. Including finite-life intangible assets in goodwill that is not amortised would further increase this concern.

    (d) Separation of intangibles with different characteristics facilitates better analysis and enables better accounting for subsequent consumption and sale of those intangibles. For example, if an intangible asset subsumed in goodwill is sold, an entity's profit would not include the appropriate carrying amount for the calculation of the gain/loss on disposal of the asset. This would overstate the profit on sale and indicate goodwill is overstated. Also whilst some investors say that they do not find the fair value information about certain intangible assets useful, some of these users are still interested in any impairment of those intangibles. Such information could be lost if intangibles are included in goodwill.

(e) Users are generally interested in information about intangible assets that are significant to the business (ie key value-drivers) because it provides an insight on why a company purchased another company and helps in understanding the components of the acquired business, even if some users do not use information about other intangible assets. The key value drivers will vary depending on the type of entity and the industry it operates in. Consequently it would not possible to identify particular types of identifiable intangible assets that need to be shown separately (or could be subsumed in goodwill without loss of information) because the key value drivers will differ from industry to industry (and probably between entities within the same industry).

(f) Some users support the current practice because it permits comparison between different accounting policies that management chooses to make for intangible assets (for example, one entity may amortise customer lists over 5 years, whereas another entity may decide to amortise them over 10 years to reflect differences in the underlying customer base).

(g) Some stakeholders think management should identify and consider the fair value of all significant intangible assets when determining a reasonable acquisition price. They think the current requirements encourage acquirers to better analyse what they are buying.

(h) Some preparers note there are similar complexities in measuring the fair value of other assets in a business combination, for example inventories, plant and equipment. Consequently although subsuming some intangible assets in goodwill may reduce the cost for some entities, it may not have a significant impact on the overall cost and complexity of accounting for an acquisition. Furthermore some note that the costs incurred in valuing intangible assets separately in a business combination is a one-time cost, not an ongoing cost.

(i) There are often interrelations between intangible assets meaning it would be difficult to determine the fair value of one without determining the fair value of the other. Consequently allowing some intangible assets to be subsumed in goodwill may not reduce the overall cost of the valuation exercise.

(j) Some stakeholders have asserted that some intangible assets are not separable from the cash flows of the business as a whole. However, one could argue that all assets of a business are interrelated (ie they form an integrated set of activities). This interrelationship is generally considered to be a component of goodwill (ie the synergies realised from using the assets together). This does not mean that the assets are not separable from goodwill. Taken to the extreme, one could argue that a business would not exist without any of its intangible assets, such as the customer, brand names, technology etc. In such a scenario no intangible assets would be recognised separately from goodwill.

Disadvantages of not changing the existing requirements

19. The staff have identified the following as the key arguments for, and advantages of, subsuming additional intangible assets in goodwill:

(a) Many preparers say they find fair value measurement of some intangible assets difficult and time consuming, and often need to use independent valuation specialists which makes the exercise costly (paragraph 6 lists the main challenges identified). There is some evidence from the PIR that concerns about the cost of this exercise are a bigger concern for smaller companies. At the September 2015 joint IASB/FASB meeting the FASB staff presented a paper that provided summary of their outreach. In this paper the FASB noted that the FASB staff received different feedback from private company stakeholders than stakeholders of public benefit entities (PBE). Many private company stakeholders expressed concern about the cost and complexity of estimating the fair value of certain identifiable intangible assets. However most PBE preparers did not consider the one-time cost of determining the fair value of intangible assets acquired to be significant in the context of a business combination (see paragraphs 10 and 11 of September 2015 IASB Agenda Paper 13E).

(b) Subsuming additional intangible assets in goodwill would be consistent with the accounting treatment for:

    (i) intangible assets acquired in a business combination that are not recognised separately, for example an assembled workforce. Some think measurement of customer relationships and employee relationships involve similar considerations and should be treated the same way.

    (ii) identical intangible assets that are generated internally. Some think that having a different accounting treatment for similar items depending on whether they are purchased or internally generated impairs comparability.

(c) Some preparers view the purchase price allocation as a pure accounting exercise because they do not consider some of these intangible assets when assessing the transaction and agreeing the purchase price.

(d) Some users say they only find fair value information about intangible assets useful if it can be determined reliably. Some users say they disregard the fair values of some intangibles, for example because the assumptions used in the valuations are too subjective and there is diversity in the valuation methods used/valuations attained for similar intangible assets. Many of these users think a qualitative description of those intangibles may be sufficient. Some users are concerned that where valuations of intangibles are subjective, they are open to arbitrage opportunities during a business combination.

(e) Some users say that separate information about the intangible assets is only useful for a very short period of time, ie in giving them an understanding of what has been purchased at the date of acquisition. In subsequent periods the carrying value of the intangibles is not useful to them.

(f) Many users have concerns about separately identifying intangibles because of the effect of their amortisation on profits, rather than the fact they are recognised separately from goodwill. This is because they have concerns that amortising intangible assets that they consider to be continually replaced by the entity, such as brands and customer-related intangibles, results in double counting of expenses. This is because an entity will expense both amortisation and the expense incurred to grow new intangible assets or maintain existing ones, for example sales and marketing expenses. For this reason amortisation on these acquired intangibles (sometimes referred to as purchase price allocation (PPA) amortisation) is sometimes added back by preparers and users to derive an underlying earnings number. This point is addressed in Part C and Appendix A of this agenda paper.

(g) Some view recognising a large number of finite life intangibles separately from goodwill as a back door to goodwill amortisation. However, in contrast others think that some entities do not separately recognise all of their intangibles from goodwill to avoid amortisation. Some think that amortisation of goodwill should be reintroduced, to reduce concerns about subsuming some intangible assets in goodwill.

Staff analysis

20. As noted in paragraph 14, the staff think there needs to be a strong argument for the Board to reconsider the existing requirements. When the Board amended IFRS 3 in 2008 it concluded that separate recognition of intangible assets on the basis of an estimate of fair value provides better information than subsuming them in goodwill. Intangible assets are becoming increasingly more important in the economy and constitute an increasing proportion of the assets of many entities. Consequently information about them is likely to become more important going forward.

21. Subsuming additional intangible assets in goodwill will increase the amount of goodwill recognised. This could heighten concerns we heard during the PIR about overstatement of goodwill and give rise to pressure to make the goodwill impairment test more stringent, rather than consider ways to simplify or reduce costs associated with it.

22. Subsuming finite life intangible assets in goodwill is also likely to create further pressure for the Board to reintroduce an amortisation approach for goodwill. The Board has consistently received feedback that amortisation of goodwill over an

arbitrary period does not provide decision useful information for investors. In addition when developing the current requirements for goodwill, the Board observed that the useful life of acquired goodwill and the pattern in which it diminishes are generally not possible to predict with a satisfactory level of reliability (paragraph BC131E of IAS 36). The staff think that the more different intangible assets subsumed in goodwill (with different useful lives, risks and cash flows), the more difficult it would be to determine an appropriate amortisation method and period for goodwill. The staff note that if private companies in the US elect the PCC option to subsume additional intangible assets in goodwill (View B2 in paragraph 10), those entities must also elect the PCC alternative for goodwill (which requires amortisation) (ie the FASB made subsuming intangible assets into goodwill conditional on the private company choosing the option to amortise goodwill).

23. Users often want information about intangible assets that are very significant to an acquisition. Therefore the staff do not think it would be possible for the Board to specify particular types of identifiable intangible assets that must be shown separately (or could be subsumed in goodwill without loss of information) because the key value drivers will differ from industry to industry (and probably between entities within the same industry).

24. For the reasons in paragraphs 18 and 20-23 the staff do not support subsuming any identifiable intangible assets in goodwill.

The need for guidance

25. Nevertheless, the staff suggest that the Board should clarify the guidance in IFRS 3(2008) and the illustrative examples accompanying IFRS 3(2008) to address one of the main concerns about the requirements for customer relationships (see paragraphs 49-57 for more details). The staff think this should be done together with the FASB to avoid divergence.

26. The Board could also consider whether helpful guidance or education material could be developed to address other issues. For example, in their comment letter on the Request for Information issued as part of the PIR the European Securities and Markets Authority (ESMA) noted that sometimes the subsequent accounting for intangible assets is not consistent with assumptions used to determine their fair value at the

acquisition date. An example given was in the case of customer-related intangibles, the assumed churn-rate used in the fair value measurement to reflect the decreasing benefits from the acquired customer base is sometimes ignored in subsequent accounting (instead of a declining balance amortisation method, a straight-line method is applied). The staff think this type of issue could be addressed by guidance on determining an appropriate amortisation period and method.

27. The staff think the Board should focus only on developing guidance to help preparers understand the requirements in IFRS 3/IAS 38, and also considering whether the disclosure requirements in IFRS 3 are sufficient to help users understand the valuation models used and the assumptions used in those valuation models (disclosures are considered later in this paper). The staff note that there is already much publicly available guidance on valuing intangible assets. Consequently, the staff do not think it would be a good use of the Board’s resources to develop additional valuation guidance. In their comment letter on the Request for Information issued as part of the PIR, Duff & Phelps asserted that the primary challenges related to separate recognition of intangible assets arise from accounting determinations rather than valuation issues. They further assert that methodologies for valuing intangible assets have been, for the most part, fairly well established for a considerable amount of time.

Approach 2: Subsume some identifiable intangible assets in goodwill

Description

28. The Board could consider whether any of the following identifiable intangible assets should be subsumed in goodwill for cost-benefit reasons:

    (a) The main intangibles for which we have received feedback that separate measurement is complex and costly (and that some users do not find useful):

        (i) Some customer-related intangibles, in particular customer relationships

        (ii) Brand names

        (iii) Non-contractual intangible assets

(iv) Intangible assets that are not capable of being sold or licensed separately

(v) Intangible assets for which there is no active market

(vi) Intangible assets in the ‘early stage’ of development

(b) Indefinite life intangibles that are difficult to value on an individual basis (this would not increase pressure to amortise goodwill unless those indefinite life intangible assets would otherwise be reassessed as having a finite life at a future date.)

(c) The types of intangible assets that are would not be capitalised if they were internally generated, for example research, customer relationships, brands, etc. However, whilst this would result in consistent accounting with internally generated intangible assets it would result in an inconsistency with intangible assets that are acquired separately (see Appendix A for a comparison of the current accounting for acquired and internally generated intangible assets)

(d) Those being considered by the FASB:

(i) noncompetition agreements (NCA)

(ii) customer-related intangibles that are not capable of being sold or licensed independently.

General advantages and disadvantages of subsuming some identifiable intangible assets in goodwill

29. The general advantages and disadvantages of subsuming additional intangible assets in goodwill are listed in paragraphs 18 and 19.

Staff analysis

30. In Approach 1 the staff provided their reasoning for why we do not support subsuming additional intangible assets in goodwill. Nevertheless if Board members would like to pursue any of the approaches in paragraph 28 the staff would suggest the following:

(a) We should be extremely selective in which intangible assets we consider for the reasons given in paragraphs 18 and 20-23.

(b) We should consider if guidance or education material would help to mitigate some of the concerns before changing the requirements (as suggested for customer relationships in paragraphs 49-57).

(c) Based on the feedback received during the PIR, the staff think that customer relationships appear to be the most challenging intangible assets to measure separately from goodwill. There is also evidence from our outreach during the PIR that many users do not find information about these intangible assets as useful as other intangible assets. There are some concerns about brand names and the difficulties of measuring brands and customer relationships separately from each other.

31. The FASB are considering whether some customer-related intangibles should be subsumed in goodwill. Consequently, even though the staff prefer approach 1, the staff think the Board should discuss the merits of including some customer related intangibles in goodwill with the FASB to prevent divergence between the Board's converged Standards. Nevertheless the staff note that customer related intangibles often have short lives and so subsuming them in goodwill may increase pressure for goodwill to be amortised. The staff further notes that this discussion should be linked to discussions about developing guidance on customer relationships which may mitigate some of the concerns.

32. Nevertheless, the staff are unsure whether subsuming some customer related intangibles in goodwill would reduce the cost and complexity of the fair value allocation exercise enough to warrant the change. Furthermore, there are often interrelations between customer related intangibles and other assets. For example a customer relationship often arises as a result of brand loyalty, and we have received some feedback during the PIR that customer relationships are considered in determining the fair value of brands and are difficult to measure separately. Consequently the staff think that it may be difficult to determine the fair value of some brands without also determining the fair value of related customer relationships. In such cases subsuming customer related intangibles within goodwill, without also subsuming brands, may not reduce the overall cost of the valuation exercise.

33. If we also consider subsuming brands into goodwill, this may help to address the issue in paragraph 32. However, the staff notes that the FASB are not considering

subsuming brands in goodwill as part of their project (see paragraph 10). Consequently if the Board consider brands this could result in divergence between the Board's converged Standards.

34. The FASB are also considering noncompetition agreements. However, the staff notes that only one respondent to the PIR specifically referred to noncompetition agreements. Consequently, based on our feedback the staff do not think there is a strong basis for subsuming noncompetition agreements in goodwill.

Approach 3—Only separately recognise those intangibles for which fair value can be measured reliably

Description

35. IFRS 3(2004) only required an acquirer to separately recognise identifiable intangible assets of an acquiree that could be measured reliably. Some think that removing this criterion in IFRS 3(2008) has resulted in increased concerns that some intangible assets, such as customer relationships and brands, are complex and subjective to measure and do not provide useful information.

Basis for 2004 reliability of measurement criterion

36. Paragraphs BC97-BC101 of the Basis for Conclusions accompanying IFRS 3(2004) explain the Board's reasoning for including the reliability of measurement criterion in IFRS 3(2004). In the December 2012 Exposure Draft (ED 3 *Business Combinations*) the Board had concluded that except for an assembled workforce, sufficient information could reasonably be expected to exist to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity. However respondents to ED 3 generally disagreed arguing that:

(a) it might not always be possible to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity; and

(b) a similar presumption does not exist in IFRS for identifiable tangible assets acquired in a business combination.

37. After considering respondents' comments and the experience of field visit and round-table participants during the comment period for ED 3, the Board concluded that, in the following instances, there might not be sufficient information to measure reliably the fair value of an intangible asset separately from goodwill:

(a) those that arose from legal or other contractual rights and are not separable (ie could be transferred only as part of the sale of a business as a whole).

(b) those that arose from legal or other contractual rights and are separable, but there is no history or evidence of exchange transactions for similar assets, and otherwise estimating fair value would be dependent on variables whose effect is not measurable.

38. Nevertheless, even though IFRS 3(2004) included a reliability of measurement criterion, the Board noted that it remained of the view that the usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill, particularly given goodwill is not amortised. The Board also remained concerned that the reliability of measurement criterion might be inappropriately used. The Board observed when developing ED 3 that although intangible assets constitute an increasing proportion of the assets of many entities, those acquired in business combinations were often included in goodwill, despite the requirements in IAS 22 that they should be recognised separately.

Staff analysis

39. The staff have concerns, like the Board highlighted in paragraph BC101 accompanying IFRS 3(2004), that a reliability of measurement criterion might be too freely applied, resulting in many additional intangible assets being subsumed in goodwill. Furthermore, comment letters from respondents in the valuation industry during development of IFRS 3(2008) told us that all identifiable intangible assets can be measured reliably at fair value.[4]

40. The recognition criteria in the existing *Conceptual Framework* state that an entity recognises an asset or a liability if it has a cost or value that can be measured with reliability. However, in its Exposure Draft proposing a revised *Conceptual*

[4] Paragraph 71 of IASB Agenda Paper 2B for the September 2006 Board meeting.

Framework for Financial Reporting the Board proposes not to retain reliability of measurement as a recognition criterion. Instead it proposes that measurement uncertainty is discussed as an indicator that recognition in some cases may not provide relevant information. When the Board amended IFRS 3 in 2008 it concluded separate recognition of intangible assets, on the basis of an estimate of fair value, rather than subsuming them in goodwill, provides better information to the users of financial statements even if a significant degree of judgement is required to estimate fair value.

41. For these reasons the staff think if we choose to subsume additional intangible assets in goodwill it would need to be for cost-benefit reasons (ie Approach 2), not reliability of measurement.

42. The staff also note that one of the reasons for the removal of the reliability of measurement criterion in 2008 was to enable convergence with the US (see paragraph BC172-BC174 accompanying IFRS 3(2008)). The FASB are not considering introducing a reliability of measurement criterion as one of their views (see paragraph 10). Consequently pursuing Approach 3 would probably result in divergence between the Board's converged Standards.

Approach 4—Allow further grouping of intangible assets

43. Paragraph 37 of IAS 38 permits an acquirer to recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. We could consider relaxing the requirements in paragraph 37 of IAS 38 for combining intangible assets together as a single asset. This might permit accounting for intangible assets that are difficult to value on an individual basis together with other intangible assets (as a 'portfolio' of intangibles).

Staff analysis

44. Some respondents to the PIR suggested this approach because of concerns that relationships between some intangible assets make it difficult to value them separately from each other. However the staff are concerned that grouping dissimilar items together, with different useful lives, different risks and different cash flows would not be a faithful representation of the intangible assets acquired in the business

combinations. For finite life intangibles, incorporating assets together would also add complexity when determining an amortisation method and period that reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

45. For example there often interrelations between intangible assets such as customer relationships, customer lists and brands. However, one would expect that brands and customer relationships/lists could have dramatically different useful lives (a longer one for a brand and a shorter one for the customer relationships).

46. The FASB are not considering Approach 4. Consequently pursuing Approach 4 may result in divergence between our and the FASB's converged Standards.

47. The staff note that paragraph 36 of IAS 38 states that an intangible asset acquired in a business combination might be separable, but only together with a related contract, identifiable asset or liability. In such cases, the acquirer recognises the intangible asset separately from goodwill, but together with the related item. The staff think that no further relaxation of the requirements in paragraphs 36-37 of IAS 38 is necessary.

Staff view (Part A)

48. Staff support Approach 1. For the reasons in paragraphs 18 and 20-23 the staff do not support subsuming any identifiable intangible assets in goodwill. However, the staff propose clarifying the guidance on customer relationships (see paragraphs 49-57).

B) Guidance on customer relationship intangible assets

49. The staff suggest that one area where the Board should consider providing or clarifying guidance is on customer relationship intangibles:

   (a) In 2008/2009 the IFRIC[5] discussed a request to add an item to its agenda to provide guidance on the circumstances in which a non-contractual customer relationship arises in a business combination. The IFRIC suggested that this issue should be addressed by the Board and the FASB. The Board deferred

[5] The IFRS Interpretations Committee was previously called the IFRIC.

addressing the issue pending feedback from the PIR (See IFRIC agenda decision in Appendix B).

(b) Customer relationships are often asserted to be the most challenging intangible assets to measure separately.

(c) According to a report published by the European Securities and Markets Authority (ESMA)[6] in June 2014, on the basis of its review the most prevalent intangible asset recognised separately from goodwill related to customer relationships and customer relationships play a significant role in business combination.

50. Under the current requirements contractual customer relationships are always recognised separately from goodwill as they meet the contractual-legal criterion. However, non-contractual customer relationships are recognised separately from goodwill only if they meet the separable criterion. Consequently, determining whether a relationship is contractual or not could lead to a significantly different accounting outcome.

51. The submission to the IFRIC raised concerns that different views exist in practice about the classification of customer relationships as contractual or non-contractual and that it is not clear how broad a range of contracts the Board intended to cover. For example:

(a) A customer relationship normally requires the existence of a customer with a history of prior transactions. Under many jurisdictions transactions are considered to be contractual under common law, even in the absence of a formal signed contract. Consequently some think all customer relationships could be interpreted to be contractual.

(b) Another view is that the Board did not intend contractual customer relationships to cover such a broad range of relationships between entities and their customers, for example it may have intended there to be a formal written contract.

[6] ESMA Report: Review on the application of accounting requirements for business combinations in IFRS financial statements

52. The submission explained the contractual/non-contractual distinction under IFRS is crucial because the legal environment in many countries makes it impossible to sell groups of customers (ie they are not separable).

53. A staff survey of IFRIC members in 2008 confirmed that diversity appeared to exist in practice. In addition, it appeared valuation experts were taking different views, which could also be contributing to diversity in accounting. The main area of potential confusion appears to be when transactions with customers result from short term purchase order or retail sales rather than longer term contracts.

54. The IFRIC decided sufficient confusion and diversity in practice existed to warrant attention but that it should be resolved by referring it to the Board and the FASB with a recommendation to review and amend IFRS 3 by:

    (a) removing the distinction between ‘contractual’ and ‘non-contractual’ customer-related intangible assets recognised in a business combination; and

    (b) reviewing the indicators that identify the existence of a customer relationship in paragraph IE28 of IFRS 3 and including them in the Standard.

55. The staff think the Board should clarify its intent in IFRS for customer relationships, before deciding whether to subsume any customer relationships or other customer-related intangibles in goodwill. When clarifying its intent of which customer relationships should be measured separately from goodwill, the Board could consider including criteria that would narrow down those customer relationships that meet the contractual/legal criteria (the staff notes this may result in a similar outcome as View B4 of the FASB in paragraph 10(b)(iv)). This may relieve some of the concerns about separately measuring customer relationships without needing to directly change the requirements in IFRS 3.

56. Nevertheless the staff note that it would be difficult for the Board to directly clarify what it means by ‘contractual’ customer relationships in IFRS 3/IAS 38 because several other Standards already provide guidance on what is considered a contract. For example IFRS 15 *Revenue* defines a contract ‘as an agreement between two or more parties that creates enforceable rights and obligations’. Paragraph 13 of IAS 32

states that for the purpose of IAS 32 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.'

Staff view on Part B

57. The staff think the Board should clarify its intent in IFRS for customer relationships, before deciding whether to subsume any customer relationships or other customer-related intangibles in goodwill. The staff think that clarifying the guidance in IFRS 3(2008) would be best considered jointly with the FASB to avoid divergence in practice between the Boards' Standards.

C) Addressing presentation and disclosure concerns

Feedback from users of financial statements

58. The staff have identified the following as the two main concerns we have heard from users of financial statements during the PIR about the presentation and disclosure of intangible assets in a business combination:

    (a) Presentation of amortisation expense: Some users have concerns that amortising intangible assets that they consider to be continually replaced by entity results in double counting of expenses (see paragraph 19(f)). For this reason they want to add back the amortisation charge on these intangible assets to derive an underlying earnings number. However, they say they are often unable to differentiate between amortisation they want to add back and amortisation they wish to keep in profit.

    (b) Additional disclosure: Some users have told us that there is insufficient information about the assumptions used in valuations models for intangible assets and in the assessment of their useful lives. Some noted that it would be useful to require the disclosures in IFRS 13 *Fair Value Measurement* on valuation techniques and inputs (assets and liabilities acquired in a business combinations do not fall within the disclosure requirements of IFRS 13 on the date of acquistion).

Staff analysis

Presentation of amortisation expense:

59. The staff note that the concerns expressed by users in paragraph 58(a) relate to those intangible assets that are not capitalised if they are internally generated. The staff have analysed why users might think that amortisation of these intangible assets results in double counting of expenses in Appendix A.

60. The staff note that sufficient information should be available in the intangible asset reconciliation required by IAS 38 to enable users to add back amortisation on different types of intangible assets if they wish to do. IAS 38 requires the reconciliation to be provided by class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets (see paragraph 118(e) of IAS 38).

61. Nevertheless the staff acknowledge that some users have said this information should be available on the face of the statement of comprehensive income for the following reasons:

    (a) because of its importance (ie they think it should be given more prominence and be easier to find than in a reconciliation in the notes); and/or

    (b) because users want the distinction to be available in interim/quarterly reports where a note containing the reconciliation may not be provided.

62. In the light of these concerns, the staff note that the Board may wish to consider requiring companies to present amortisation on intangible assets that are capitalised if acquired separately, but not if they are internally generated, separately on the face of the statement of comprehensive income/income statement. This would highlight what may be perceived to be a special treatment of these assets if they are acquired rather than being internally generated.

63. Nevertheless, the staff note that there are likely to be many requests from users for additional information to be presented on the face of the statements and these will

vary by user and by industry. In particular, the staff has received feedback that some users want companies to present amortisation on internally generated intangibles separately on the face of the statement of comprehensive income/income statement because of the subjectivity in determining which expenses to capitalise for internally generated intangibles (and the effect of that on earnings).

64. Paragraph 85 of IAS 1 *Presentation of Financial Statements* requires an entity to present additional line items, headings and subtotals in the statement(s) presenting profit or loss and other comprehensive income when such presentation is relevant to an understanding of the entity's financial performance. The staff think management should apply judgement in deciding whether to provide some kind of disaggregation of amortisation expense on the face of the financial statements for users based on the own circumstances. Consequently the staff do not think the Board should add a specific requirement for entities to provide a disaggregation of amortisation on the face of the statement of comprehensive income/income statement.

Additional disclosure

65. Some users say that valuations of some intangible assets have little credibility because they are highly subjective. However the staff think that if disclosures about the assumptions used in valuation models and about the models themselves are improved, this will make the valuations more helpful to users.

66. The staff note that users are generally interested in information about intangible assets that are significant to the business (ie key value-drivers), even if some users do not use information about other intangible assets. Consequently the staff think the IFRS 13 disclosures should be required for any significant intangible assets acquired in a business combination.

67. The staff note that there is criticism by preparers that IFRS 3 already requires too much disclosure. Consequently in addition to considering whether we can add disclosures, we should also assess whether existing disclosure requirements in IFRS 3 are still relevant and justified from a cost-benefit perspective.

Staff view on Part C

68. The staff recommend requiring the IFRS 13 disclosures for any significant intangible assets acquired in a business combination. The staff think that management should

decide whether to show a further disaggregation of amortisation on the face of the statement of comprehensive income/income statement based on the entity's own circumstances, rather than having a requirement for all entities to do this.

Summary of staff recommendations and questions for the Board

69. The staff support Approach 1, not subsuming any identifiable intangible assets in goodwill (no change to the existing requirements). However the staff think that before making any decisions the Board should discuss Approach 2, in particular whether any customer related intangibles should be subsumed in goodwill, at a joint meeting with the FASB to avoid divergence between our and the FASB's converged Standards. The staff do not recommend pursuing Approaches 3 or 4 further.

70. The staff also suggest that the Board should work with the FASB to consider whether there is a need to clarify the requirements for customer relationships and also consider whether further guidance or education material could be developed to address other issues. If the Board considers this on its own it should limit considerations to education material to avoid divergence.

71. The staff also recommend requiring the IFRS 13 disclosures for any significant intangible assets acquired in a business combination.

72. The staff only asks the Board to discuss their views on the approaches at this meeting and to identify what additional information they require to be able to develop views on these approaches.

Questions
1) Do Board members need any further information before developing views on which of the approaches they would like to consider further?
2) Do Board members think they have enough information about these approaches, and have had sufficient discussion, to be ready for a discussion with the FASB?

Appendix A Differences between internally generated intangible assets and acquired intangible assets

A1. This appendix has been included to help to explain:

(a) the reason for the differences in accounting for internally generated intangible assets compared to acquired intangible assets; and

(b) why users may perceive amortisation of intangible assets that are recognised if acquired, but not internally generated, to result in double counting of expenses in profit or loss.

1) The reason for the differences in accounting for internally generated intangible assets compared to acquired intangible assets

Recognition of intangible assets

A2. Paragraph 21 of IAS 38 provides the general recognition criteria for all intangible assets, including acquired intangible assets and internally generated intangible assets. An intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

A3. The IASC Board's view was that there should be no difference between the requirements for:

(a) intangible assets that are acquired externally; and

(b) internally generated intangible assets, whether they arise from development activities or other types of activities.[7]

Application of the criteria in paragraph A2 to acquired intangible assets

A4. IAS 38 notes that the criteria in paragraph A2 is always satisfied for intangible assets acquired in business combinations (paragraph 33 of IAS 38):

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[7] See BCZ40 of the Basis for Conclusions accompanying IAS 38 which summarises the former IASC Board’s considerations

(a) If an asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of the asset.

(b) The effect of probability is reflected in the fair value measurement of an intangible asset.

A5. The criteria is also satisfied for a separately acquired intangible asset provided the cost can be measured reliably (paragraph 25 of IAS 38).

Application of the criteria in paragraph A2 to internally generated intangibles

A6. When intangible assets are acquired externally there is objective third party evidence of the amount paid for these intangible assets. In contrast paragraph 51 of IAS 38 notes that it is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

(a) identifying whether and when there is an identifiable asset that will generate expected future economic benefits; and

(b) determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

A7. For this reason the IASC Board included specific criteria in IAS 38 for internally generated intangible assets that expand on the general recognition criteria for intangible assets. The Basis for Conclusions accompanying IAS 38 notes that it is assumed that these criteria are met implicitly whenever an entity acquires an intangible asset. Therefore, IAS 38 only requires an entity to demonstrate that these criteria are met for internally generated intangible assets.[8]

A8. Under the specific recognition criteria for internally generated intangible assets, an asset is recognised if it results from the development phase of a project and meets all of the specific criteria in paragraph 57 of IAS 38 (the criteria includes technical feasibility, ability and intention to complete and use/sell, etc.).

[8] Based on paragraph BCZ42 of the Basis for Conclusions accompanying IAS 38 which summarises the former IASC Board's considerations.

A9. IAS 38 also specifically prohibits recognition of the following intangible assets because the IASC Board concluded they would be unlikely to meet the recognition criteria in paragraph A2:

(a) Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance (paragraph 63 of IAS 38). The IASC Board thought that internally generated intangible items of this kind would rarely, and perhaps never, meet the recognition criteria in IAS 38. To avoid any misunderstanding the IASC Board set out this conclusion in the form of an explicit prohibition.[9]

(b) Expenditure on research or on the research phase of an internal project (paragraph 54 of IAS 38). This is based on IASC Board's interpretation of the application of the recognition criteria in IAS 38 and the fact that it is sometimes difficult to determine whether there is an internally generated intangible asset distinguishable from internally generated goodwill.[10]

(c) Internally generated goodwill, because it is not an identifiable resource (ie it is not separable nor does it arise from contractual or other legal rights) controlled by the entity that can be measured reliably at cost (paragraphs 48 and 49 of IAS 38).

A10. Consequently as a result of the specific requirements in paragraphs A8 and A9, certain types of intangible assets are recognised in a business combination, or recognised if they are acquired separately, but are not recognised if they are internally generated. Examples include research, customer relationships, brands etc.

Future project on accounting for intangible assets.

A11. In 2007 the Board considered whether to add to its agenda a project on intangible assets. That project would have included looking at the initial accounting for identifiable intangible assets other than those acquired in a business combination, with a particular focus on internally-generated identifiable intangible assets. One

[9] Based on paragraph BCZ45 of the Basis for Conclusions accompanying IAS 38 which summarises the former IASC Board's considerations

[10] Based on paragraph BCZ46 of the Basis for Conclusions accompanying IAS 38 which summarises the former IASC's considerations.

consideration highlighted for this project was the suitability of recognising internally generated intangibles if they are identifiable (ie either separable or arise from contractual or other legal rights) without the specific recognition criteria outlined in paragraphs A7-A9. The project was put on hold because of the Board's limited resources to undertake such a significant project at that time.

2) Explaining the perceived double counting phenomenon

Concerns expressed

A12. A common concern expressed by users of financial statements is that the amortisation charge arising from intangible assets, such as brands and customer lists, appears to be double counting, because the cost of maintaining these assets is also expensed through the income statement as another cost, for example marketing and promotional expenditure (see paragraph 19(f)).

A13. These users often make the following distinction:

(a) Intangible assets that they perceive to be continually replenished by the entity, for example through marketing and promotional investment, and are difficult to separate from an entity's business (often referred to as 'organically replaced' intangible assets or 'non-wasting' intangibles)— Some users add back amortisation of these intangibles in their measures of earnings because of the perceived double counting of firstly amortisation of the acquired intangibles and secondly the associated maintenance cost. Some of these users think these intangible assets should be subsumed in goodwill and not amortised.

(b) Intangible assets that they consider to be contractual, have a finite life and separate from the overall business (often referred to as 'wasting' intangible assets), such as licences patents and software— These users think that separate recognition and amortisation of these assets is appropriate, because they are distinct assets and require large capital expenditure to be replaced.

Accounting for maintenance costs

A14. Paragraph 90(f) of IAS 38 notes that the level of maintenance expenditure required to obtain the expected future economic benefits from an intangible asset is considered in determining its useful life. The staff note these maintenance expenses can be thought of in a similar way to the costs of the day to day servicing of an item of property, plant and equipment (PPE), ie repairs and maintenance costs, which are expensed as incurred.

A15. The staff think that over time it may be hard to distinguish between genuine maintenance expenses on the acquired intangible asset and expenses incurred to either enhance the expected future economic benefits from that intangible asset or to generate a different intangible asset. Expenditure to enhance the acquired intangible asset beyond the expected benefits or to generate a new intangible asset results in an internally generated asset. Consequently this expenditure must be expensed unless it meets the criteria in paragraph 57 of IAS 38.

A16. Because these costs are required to be expensed, rather than capitalised, it may appear that there is double counting of expenditure on the acquired intangible. However these expenses relate to a different asset. Furthermore, expenditure to enhance an intangible asset or to create a new intangible asset is treated differently from expenditure to enhance an item of property, plant and equipment or to construct an item of PPE, because the PPE expenditure would normally be capitalised (if it meets the recognition criteria in IAS 16).

A17. The staff think if acquired intangible assets are genuinely continually replaced, ie the entity can maintain the asset and there is no foreseeable limit to the period over which that asset is expected to generate net cash inflows for the entity, the entity would classify those intangible assets as indefinite life intangible assets. For example, this might be the case for a strong brand name.

Example

A18. Consider Example 1 in the illustrative examples accompanying IAS 38:

> A direct-mail marketing company acquires a customer list and expects that it will be able to derive benefit from the information on the list for at least one year, but no more than three years.
>
> The customer list would be amortised over management's best estimate of its useful life, say 18 months. Although the direct-mail marketing company may intend to add customer names and other information to the list in the future, the expected benefits of the acquired customer list relate only to the customers on that list at the date it was acquired. The customer list also would be reviewed for impairment in accordance with IAS 36 by assessing at the end of each reporting period whether there is any indication that the customer list may be impaired.

A19. This example has been used to illustrate two different scenarios.

Scenario 1 (acquired customer list)

A20. A company acquires a customer list containing information about 100 customers on 1 January 2016. Assume the list is either acquired separately in an arm’s length transaction for CU100 or acquired during a business combination (fair value estimated as CU100). In making an assessment that the useful life of the customer list is 18 months the entity considers the level of maintenance expenditure, eg promotional expenditure, required to obtain the expected benefits from the information on the list (paragraph 90(f) of IAS 38)

A21. The customer list is capitalised at CU100 on 1 January 2016 and the CU100 would be amortised over the 18 months. Over that 18 months period the company incurs promotional expenditure. This includes the following:

(a) Promotional expenditure to obtain the expected benefits from the customer list (ie the maintenance expenditure explained in paragraph A14). The expenditure is expensed when incurred.

(b) Promotional expenditure incurred to add customer names and other information to the list. This expenditure relates to the generation of new assets (new customers and other information) and maybe also enhance the existing assets (enhanced information about the 100 customers). Thisd expenditure is not capitalised because it is expenditure that creates internally generated assets. This may appear to be double counting because if similar expenditure was incurred to enhance an existing item of PPE or construct a new item of PPE it would be normally be capitalised.

(c) Promotional expenditure incurred for other purposes, for example to maintain or enhance brands.

In practice it would be often be difficult to distinguish whether promotional expenditure relates to (a), (b) or (c).

Scenario 2 (internally generated customer list)

A22. The company develops a customer list of 100 customers over 2 years (1 January 2014-31 December 2015) through promotional expenditure. The asset representing these customers is not capitalised because it is an internally generated intangible asset. Consequently the cost of generating the customer list is expensed over the 2 years ended 31 December 2015.

Comparing the two scenarios

A23. The difference between Scenario 1 and Scenario 2 could be viewed as a deferral of expensing the cost of the customer list. In Scenario 1 it is expensed over 18 months from 1 January 2016- 30 June 2017. In Scenario 2 is expensed over 2 years from 1 January 2014-31 December 2015. The magnitude of the effect on profit or loss is the same, but the timing is different.

Appendix B: IFRIC agenda decision in March 2009 IFRIC update newsletter

B1. The following IFRIC agenda decision[11] has been extracted from the March 2009 edition of IFRIC update.

IFRS 3 Business Combinations—Customer-related intangible assets

The IFRIC[12] received a request to add an item to its agenda to provide guidance on the circumstances in which a non-contractual customer relationship arises in a business combination. IFRS 3 (as revised in 2008) requires an acquirer to recognise the identifiable intangible assets of the acquiree separately from goodwill. An intangible asset is identifiable if it meets either the contractual-legal criterion or the

[11] IFRIC agenda decisions are not Interpretations.

[12] The IFRS Interpretation Committee was previously called the IFRIC.

separable criterion in IAS 38 s. Contractual customer relationships are always recognised separately from goodwill because they meet the contractual-legal criterion. However, non-contractual customer relationships are recognised separately from goodwill only if they meet the separable criterion.

The IFRIC noted that the IFRS Glossary defines the term ‘contract’. Paragraphs B31─B40 of IFRS 3 provide application guidance on the recognition of intangible assets and the different criteria related to whether they are established on the basis of a contract. The IFRIC also noted that paragraph IE28 in the illustrative examples accompanying IFRS 3 provides indicators for identifying the existence of a customer relationship between an entity and its customer and states that a customer relationship ‘may also arise through means other than contracts, such as through regular contact by sales or service representatives.’

The IFRIC concluded that how the relationship is established helps to identify whether a customer relationship exists but should not be the primary basis for determining whether the acquirer recognises an intangible asset. The IFRIC noted that the criteria in paragraph IE28 might be more relevant. The existence of contractual relationships and information about a customer’s prior purchases would be important inputs in valuing a customer relationship intangible asset but should not determine whether it is recognised.

In the light of the explicit guidance in IFRS 3, the IFRIC decided that developing an Interpretation reflecting its conclusion is not possible. Noting widespread confusion in practice on this issue, the IFRIC decided that it could be best resolved by referring it to the IASB and the FASB with a recommendation to review and amend IFRS 3 by:

- removing the distinction between ‘contractual’ and ‘non-contractual’ customer-related intangible assets recognised in a business combination; and
- reviewing the indicators that identify the existence of a customer relationship in paragraph IE28 of IFRS 3 and including them in the standard.