

11 April 2003

Dear Sirs,

**RESPONSE TO EXPOSURE DRAFTS ED 3 BUSINESS COMBINATIONS AND
PROPOSED AMENDMENTS TO IAS 36, IMPAIRMENT OF ASSETS AND IAS 38,
INTANGIBLE ASSETS**

The Council on Corporate Disclosure and Governance (CCDG) appreciates the opportunity to comment on the Exposure Draft ED 3 *Business Combinations* and the Exposure Draft of Proposed Amendments to IAS 36, *Impairment of Assets* and IAS 38, *Intangible Assets* published by the International Accounting Standards Board (IASB) in December 2002. Our comments are divided into General Comments and Responses to Specific Questions set out in the “Invitation to Comment” section. These comments are given in the context of the IASB’s Framework for the Preparation and Presentation of Financial Statements considering, *inter alia*, the recognition and measurement criteria therein, whether alternatives are permitted, and the adequacy of requirements or guidance.

General Comments

2. We strongly support the work of the IASB in its efforts to improve the quality of, and to seek international convergence on, the accounting for business combinations, so as to provide high quality, transparent and comparable information to users of financial statements.

Responses to Specific Questions

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).

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

The CCDG is of the view that the scope exclusions are appropriate. However, we would like to suggest that, in addition to providing guidance for identifying transactions that fall within the scope exclusions, the IASB could perhaps provide further guidance on how the excluded transactions should be accounted for.

- (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).

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

The CCDG is of the view that the definition and additional guidance are helpful in identifying transactions within the scope exclusion.

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).

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?

The CCDG is of the view that the elimination of the use of the pooling of interests method and the requirement to use the purchase method are appropriate.

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).

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?

The CCDG is of the view that the proposal is an appropriate description of the circumstances in which a business combination should 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?

The CCDG is of the view that the additional guidance is appropriate.

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

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

Is this appropriate? If not, why not?

The CCDG is of the view that the proposal on identifying the acquirer when a new entity is formed to effect a business combination is appropriate.

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).

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?

The CCDG is of the view that the proposal is appropriate.

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).

Is this appropriate? If not, why not?

The CCDG is of the view that the proposal is appropriate.

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).

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?

The CCDG is of the view that the proposal is appropriate.

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).

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?

The CCDG is of the view that the proposal is appropriate, but to the extent that the impairment test is carried out with the rigour that the IASB has intended. There are some concerns about the practical problems associated with the proposed impairment tests. The results of impairment tests depend largely on management's projections and assertions. This process could be abused and may result in goodwill remaining on balance sheets indefinitely or longer than it should be. Furthermore, the subjectivity of the impairment test would make it more difficult for users to assess the reasonableness of estimates, even with disclosure. This could lead to information being less comparable across companies and across different jurisdictions. The IASB may wish to consider proposing certain guidelines to minimise these practical difficulties.

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

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

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

(see proposed paragraphs 55 and 56).

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

The CCDG is of the view that the proposal is appropriate.

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).

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

The CCDG is of the view that the proposal is appropriate.

- (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).

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

The CCDG is of the view that the proposal is appropriate.

PROPOSED AMENDMENTS TO IAS 36, *IMPAIRMENT OF ASSETS*

Question 1 – Frequency of impairment tests

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

The CCDG is of the view that the proposal is appropriate.

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.

Is this appropriate? If not, how should the recoverable amount be measured, and impairment losses (and reversals of impairment losses) be accounted for?

The CCDG is of the view that the proposal is appropriate.

Question 3 – Measuring value in use

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

- (a) should an asset's value in use reflect the elements listed in proposed paragraph 25A? If not, which elements should be excluded or should any additional elements be included? Also, should an entity be permitted to reflect those elements either as adjustments to the future cash flows or adjustments to the discount rate (see proposed paragraph 26A)? If not, which approach should be required?
- (b) should the assumptions on which cash flow projections are based take into account both past actual cash flows and management's past ability to forecast cash flows accurately (see proposed paragraph 27(a)(ii))? If not, why not?
- (c) is the additional guidance in proposed Appendix 3 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?

The CCDG is of the view that this proposal is conceptually appropriate, but to the extent that the impairment test is carried out with the rigour that the IASB has intended. As highlighted in our response to Q8 of the main ED on Business Combinations, there are some concerns about the practical problems associated with the proposed impairment tests.

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)? 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)? 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)? If not, what approach should be used?

The CCDG is of the view that this proposal is conceptually appropriate, but to the extent that the impairment test is carried out with the rigour that the IASB has intended. As highlighted in our response to Q8 of the main ED on Business Combinations, there are some concerns about the practical problems associated with the proposed impairment tests. In addition, in the example appearing immediately after paragraph 81, there may be a built-in bias because of the different attributes, (i.e., market price and recoverable amount) that are used to compute the allocation of goodwill.

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).

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).

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).

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

The CCDG is of the view that these proposals are appropriate, but to the extent that the impairment test is carried out with the rigour that the IASB has intended. As highlighted in our response to Q8 of the main ED on Business Combinations, there are some concerns about the practical problems associated with the proposed impairment tests.

Question 6 – Reversals of impairment losses for goodwill

The Exposure Draft proposes that reversals of impairment losses recognized for goodwill should be prohibited (see proposed paragraph 123).

Is this appropriate? If not, what are the circumstances in which reversals of impairment losses for goodwill should be recognised?

The CCDG is of the view that the proposal is appropriate.

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).

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

The CCDG is of the view that the proposal is appropriate.

PROPOSED AMENDMENTS TO IAS 38, *INTANGIBLE ASSETS*

Question 1 – Identifiability

The Exposure Draft proposes that an asset should be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable or arises from contractual or other legal rights (see proposed paragraphs 10 and 11).

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?

The CCDG is of the view that the proposal is appropriate.

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). Therefore, as proposed in ED 3 *Business Combinations*, an Exposure Draft of a proposed 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 *Business Combinations*).

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? It would be appreciated if respondents outlining the specific circumstances in which the fair value of an intangible asset acquired in a business combination could not be measured reliably.

The CCDG is of the view that the proposal is appropriate. However, there may be practical considerations as precise measures may not be available to measure reliably the fair value of acquired intangible assets.

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).

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

The CCDG is of the view that the proposal is appropriate.

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).

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)?

The CCDG is of the view that the proposal is appropriate. However, the IASB may wish to consider amending the phrase in paragraph 85 “generate net cash inflows for the entity” to “generate future economic benefits for the entity” for reason of clarity and consistency both with the standard and the IASB Framework.

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).

Is this appropriate? If not, how should such assets be accounted for after their initial recognition?

The CCDG is of the view that the proposal is appropriate.

3. We shall be pleased to discuss our comments and views with the Board or its staff. Please contact Mr Ramchand Jagtiani, Deputy Director, at the Institute of Certified Public Accountants of Singapore via email at jagtiani@icpas.org.sg should you require further information. Thank you.

Yours sincerely,

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Chee Hong Tat
Secretary, CCDG