10 April 2003

Ms. Annette Kimmitt
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International Accounting Standards Board
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Dear Ms. Kimmitt,

IAS 36 Impairment of Assets, IAS 38 Intangible Assets, and ED 3 Business Combinations

In response to your request for comments, I am pleased to transmit on behalf of the International Actuarial Association (IAA), a draft of our comments on the Exposure Draft of the proposed Amendments to IAS 36 Impairment of Assets, IAS 38 Intangible Assets, and ED 3 Business Combinations.

The International Actuarial Association (IAA) is the organization representing professional actuarial associations internationally. We are not a trade association and we do not represent the interests of either clients or employers. As actuaries, we have developed significant experience and expertise in the assessment of the value of contingent cash flows. Using this experience, actuaries hope, as a profession, to continue to provide assistance to those involved in the enhancement of the standards of accounting on an international level, through the development of objective and meaningful standards which will command respect from users of financial statements. We stand willing to provide assistance deemed appropriate in the furtherance of this objective.

We encourage the general objective and intent underlying the large portion of this proposal. Nevertheless, we offer the attached comments in the hope of pursuing of enhancing the final revised standards. We hope that our comments are of value and we look forward to providing further assistance to the IASB in the future.

These draft comments have been prepared by a committee of the IAA, the members of which are listed in the submission by name and association, and are being circulated for approval to the member associations of the IAA listed in the Appendix as part of our due process procedures. Member associations expect to have three months to approve a public statement to be made on behalf of the IAA. I will let you know when these procedures have been completed and whether the draft has been approved in its entirety, or modified in any way.

Yours sincerely,

W. James MacGinnitie
President

Attachment: Draft comments

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(Draft Comments of the IAA, not having completed the required due process as of the date of submission)

International Actuarial Association
Comments on the Exposure Draft of the Proposed
Amendments to
IAS 36, Impairment of Assets,
IAS 38, Intangible Assets, and
ED 3 Business Combinations

THE INTERNATIONAL ACTUARIAL ASSOCIATION

The International Actuarial Association (the "IAA") represents the international actuarial profession. Our Full Member actuarial associations exceed forty-five in number, and represent more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact upon the areas of expertise of actuaries.

The IAA appreciates this and other opportunities to provide input to and assistance in the development of financial reporting standards. We commend the continuing efforts of the IASB in this very worthwhile effort.

DUE PROCESS

This is a draft version of the IAA's comments that has been prepared by the Insurance Accounting Standards Committee of the IAA, the members of which are listed below by name and association. The full member associations of the IAA are also listed below (in an Appendix to this statement). The final copy of this draft statement will be transmitted to the IASB as soon as this draft statement has passed through the IAA's due process.

MEMBERS OF THE INSURANCE ACCOUNTING COMMITTEE OF THE IAA

Sam Gutterman	(Chair)
Francis Ruygt	(Vice-chair)
Paul McCrossan	(Vice-chair)
Clive Aaron	Institute of Actuaries of Australia
William Abbott	Institute of Actuaries
Yutaka Amino	Institute of Actuaries of Japan
Félix Arias Bergadá	Col.legi d'Actuaris de Catalunya
Daniel Barron	Israel Association of Actuaries
Ralph Blanchard	Casualty Actuarial Society
Guy Castagnoli	Association Suisse des Actuaires
Morris Chambers	Canadian Institute of Actuaries/Institut Canadien des Actuaires
Paolo de Angelis	Istituto Italiano degli Attuari
Mariano Gongora Roman	Instituto de Actuarios Españoles
Steve Handler	Actuarial Society of South Africa
William C. Hines	American Academy of Actuaries
Antony John Jeffery	Society of Actuaries in Ireland
Liyaquat Khan	Actuarial Society of India
Ad A.M. Kok	Het Actuarieel Genootschap
Jean-Pierre Lassus	Institut des Actuaires Français
Craig Murison	Faculty of Actuaries
Markku Paakkanen	Suomen Aktuaariyhdistys
Richard Robinson	Society of Actuaries
Dieter Silbernagel	Deutsche Aktuarvereinigung e.V. (DAV)
Bjarni Thordarson	Félag Islenskra Triggingastærdfrærdinga
Wilma Torres	Instituto Brasileiro de Atuária (IBA)
Gérard Vandenbosch	Association Royale des Actuaires Belges
Robert E. Wilcox	Conference of Consulting Actuaries
Kevin Yah	Actuarial Society of the Republic of China
Jesús Zúñiga	Colegio Nacional de Actuarios A.C.

Overall, we believe that the Exposure Draft of proposed *Amendments to IAS 3*6, Impairment of Assets, IAS 38 Intangible Assets and ED 3 Business Combinations prepared by the IASB is an enhancement of the current versions of these standards. Our response to the questions raised in the Exposure Drafts address these needs.

IAS 36 - Impairment of Assets

Question 1 – Frequency of Impairment Tests

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

> ***Response:* We agree. However, as stated in the Basis for Conclusions, we believe it would be appropriate to include in the standard itself a requirement, where there is an indication that an impairment might arise, that an impairment test should be conducted any time during the year, rather than waiting for a year end test.**
>
> ***In addition, we suggest that the language in 8A(a) and 8B be made consistent – currently 8A(a) uses "at the end of each annual reporting period" while 8B uses "at least annually". We suggest that "at least annually" be considered for use in both paragraphs, although the testing should be conducted close to yearend, particularly in view of what might be rather complex and time consuming, procedures.***

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 IAS 36 for assets other than goodwill (see paragraphs C10-C11 of the Basis for Conclusions). Is this appropriate? If not, how should the recoverable amount be measured, and impairment losses (and reversals of impairment losses) be accounted for?

> ***Response: We agree that the recoverable amount of an intangible asset with an indefinite useful life should be measured in accordance with IAS 36 for assets other than goodwill.***
>
> ***We believe that the method used should not look to values generated over an infinite time horizon (such as future new business); this is consistent with recent AICPA guidance regarding the application of SFAS 142.***

Question 3a – Measuring Value in Use

Should an asset's value in use reflect the elements listed in 25A? If not, which elements should be excluded or should any additional elements be included? Also, should an entity be permitted to reflect those elements either as adjustments to the future cash flows or adjustments to the discount rate (see proposed paragraph 26A and paragraphs C66 and C67 of the Basis for Conclusions)? If not, which approach should be required?

> ***Response: We believe that it would be helpful to clarify 25A(a) to refer to the use of estimates relating to the entity in its normal operations. In addition, if it is the entity's intention to sell the asset but no commitment in that regard has been made at the time of measurement, the value should reflect its continued operation (entity-specific value).***
>
> ***Although recent financial budgets/forecasts can serve as useful sources of assumptions upon which to base an asset's value in use, such budgets/forecasts may have been***

developed for a purpose that may be inappropriate to reflect in the measurement of such an asset. For example, budgets can be developed in a "stretch" manner that may be quite optimistic. In addition, forecasts prepared for the purpose of executive compensation may not be appropriate for value in use measurement. Nevertheless, it would be reasonable to refer to internal financial budgets/forecasts as a useful starting point from which value in use measurement could be developed. It might be more appropriate to include the phrase from C66 – "must be based on reasonable and supportable assumptions that take into account both past actual cash flows and management's ability to forecast cash flows accurately."

We agree that that certain risks should be reflected in the cash flows and some risks should conceptually be reflected in the discount rate. The proposal is a practical approach to this problem.

Question 3b – Measuring Value in Use

Should the assumptions on which cash flow projections are based take into account both past actual cash flows and management's past ability to forecast cash flows accurately (see proposed paragraph 27(a)(ii) and paragraphs C66 and C67 of the Basis for Conclusions)? If not, why not?

Response: We agree. The accuracy of impairment testing may be undermined by overly optimistic cash flow projections. However, there is a need to differentiate between overly optimistic projections arising from bad management or projections deliberately biased for other reasons (e.g. demanding sales targets) or projections where the nature of the market means that managements forecasts will have had a high degree of error as the economic/market circumstances differ from that assumed.

Question 3c – Measuring Value in Use

Is the additional guidance in proposed Appendix B to [draft] IAS 36 on using present value techniques in measuring an asset's value in use appropriate? If not, why not? Is it sufficient? If not, what should be added?

Response: We agree that the guidance provided in proposed Appendix B is reasonable for the purpose for which it will be used. It might be appropriate in B21 to reverse the description of the determination of the discount rate. Since more than one cash flow duration is likely, it may be more appropriate to state that the discount rate(s) to be used should reflect the appropriate yield curve, unless it can be demonstrated that the application of a single discount rate would yield a substantially (or materially) similar measure. Appendix B appears to permit an entity to use either the traditional approach or the expected cash flows approach. The proposed standard should require entities to use the expected cash flow technique.

Question 4a: Allocating goodwill to cash-generating units

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

Response: Although we agree that impairment testing should be conducted at a level at or below the segment level based on an entity's primary reporting format, we would suggest, rather than using "the lowest level at which management monitors the return on the investment in that goodwill," to use the language provided in SFAS 60, paragraph 32 which indicates that for determining a premium deficiency, contracts "shall be grouped consistent with the enterprise's manner of acquiring, servicing, and measuring the profitability of its [insurance] contracts."

Although paragraph 73 requires that goodwill be allocated to one or more cash generating units, no principle is provided to guide the preparer as to the basis that should be used to allocate goodwill to the cash generating units. For reasons of consistency, we recommend that additional guidance be provided on the allocation of goodwill to indicate that goodwill may be allocated to existing cash generating units if they are expected to benefit from the business combination. However, we recognize that the development of such useful guidance may be difficult, particularly as applied to specific industries.

Question 4b: Allocating goodwill to cash-generating units

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

Response: We agree that any goodwill previously allocated to a cash-generating unit should be included in the carrying amount of the operation when determining the gain or loss on disposal.

Question 4c: Allocating goodwill to cash-generating units

If an entity reorganizes its reporting structure in a manner that changes the composition of one or more cash-generating units to which goodwill has been allocated should the goodwill be reallocated to the units affected using a relative value approach (see proposed paragraph 82 and paragraphs C24 and C25 of the Basis for Conclusions)? If not, what approach should be used?

Response: We agree with the proposed approach, although further guidance may be worthwhile to clarify the application of "relative value" where multiple cash generating units are involved, at the same time that a portion of one or more of the units gets disposed.

Question 5a: Determining whether goodwill is impaired

The exposure draft proposes that the recoverable amount of a cash-generating unit to which goodwill has been allocated should be measured as the higher of the unit's value in use and net selling price (see proposed paragraphs 5 (definition of recoverable amount) and 85 and paragraph C17 of the Basis for Conclusions). Is this appropriate? If not, how should the recoverable amount of the unit be measured?

Response: Although in general, the approach offered is reasonable, we believe that if a commitment has been made to keep the unit, then it should be measured in a manner

consistent with its value in use and that if a commitment has been made to sell the unit, then it should be valued at its expected net selling price. To be consistent, we would suggest the application of fair value (not incorporating transaction cost), rather than net selling price.

Question 5b: Determining whether goodwill is impaired

The exposure draft proposes the use of a screening mechanism for identifying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as potentially impaired only when the carrying amount of the unit exceeds its recoverable amount (see proposed paragraph 85 and paragraphs C42-C51 of the Basis for Conclusions). Is this an appropriate method for identifying potential goodwill impairments? If not, what other method should be used?

Response: We agree that this is an appropriate method.

Question 5c: Determining whether goodwill is impaired

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

Response: We agree. We do note that the reference in C32 to "best estimate" would be better phrased as "expected value," the probability weighted value of a range of possible outcomes.

In practice, when a cash generating unit includes a number of operations acquired in different business combinations over a number of years or when the acquirer and the acquired entity have relationships with the same customer, providing further guidance or illustrative examples for certain complex situations would be helpful.

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 and paragraphs C62-C65 of the Basis for Conclusions). Is this appropriate? If not, what are the circumstances in which reversals of impairment losses for goodwill should be recognized?

Response: Although in general we agree that reversals of goodwill should be prohibited, if the original impairment was due simply to a decrease in its fair value (e.g., due to a change in the discount rate), and the fair value subsequently increased in value in a corresponding manner, it seems reasonable to permit such a reversal, at least to the extent that the goodwill does not increase above the original amount of goodwill. If due to a change other than such a change in fair values, once a part of the original purchase price has been partially written off, any subsequent increase in value should not be attributed to the original purchase, even though exceptional circumstances might arise in which arguments for such attribution might be made. If goodwill is being amortized, it may be appropriate to augment the value of goodwill to include the value of applicable interest accumulation of prior measurements of goodwill.

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

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

1. 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?

2. Should the information to be disclosed under proposed paragraph 134 be disclosed separately for a cash-generating unit within a segment when one or more of the criteria in proposed paragraph 137 are satisfied? If not, why not?

Response: In general, we support increased disclosure and transparency. Nevertheless, the disclosures proposed in these paragraphs should be restricted to those assumptions and judgments that have a significant risk of causing a material adjustment to the financial statements and to any assumption where management has departed from the guidance in the proposed standard. We believe that neither the assumed long-term growth rate nor the recoverable amount should be required to be disclosed. We agree that meaningful disclosure should be made at the level of the cash generating unit within a segment.

Other Comments regarding IAS 36:

1. ***Scope for exempted financial liabilities. We recommend that the scope of this potential standard exclude the measurement of assets associated with insurance contracts, at least until Phase 2 of the IASB Insurance Contract project is completed. Our reason is that the fair value of liabilities for insurance contracts has not yet been defined.***

IAS 38 - Intangible Assets

Question 1: Identifiability

The Exposure Draft proposes that an asset should be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable or arises from contractual or other legal rights (see proposed paragraphs 10 and 11 and paragraphs B6-B10 of the Basis for Conclusions).

Is the separability and contractual/other legal rights criteria appropriate for determining whether an asset meets the identifiability criterion in the definition of an intangible asset? If not, what criteria are appropriate, and why?

> ***Response: We agree that there is a need for enhanced guidance in the identification and recognition of separate intangible assets. However, in some cases, the guidance provided might be difficult to apply in practice, e.g., recognition of the value of customer relationships and existing distribution systems. Since limited guidance on valuation methods is provided in the proposed standard, different methods will be used for similar situations. The Board should explicitly determine which is the desired approach.***
>
> ***Clear guidance should be provided with regard to both intangible assets acquired in a business combination and those assets acquired via other means, and if there is a reason to distinguish these situations, the principles underlying this distinction should be articulated.***
>
> ***The separate recognition of non-contractual customer relationships appears to be inconsistent with the prohibition of recognition of an assembled workforce. We believe that recognition of the value of a company's distribution system should be able to be recognized, regardless of whether it is achieved through agency contracts or a salaried workforce when performing similar economic functions.***

Question 2: Criteria for recognizing intangible assets acquired in a business combination separately from goodwill

This Exposure Draft proposes clarifying that for an intangible asset acquired in a business combination, the probability recognition criterion will always be satisfied and, with the exception of an assembled workforce, sufficient information should always exist to measure its fair value reliably (see proposed paragraphs 29-32 and paragraphs B11-B15 of the Basis for Conclusions). Therefore, as proposed in ED 3, an Exposure Draft of a proposed International Financial Reporting Standard *Business Combinations*, an acquirer should recognize, 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, 44 and ED 3).

Do you agree that, with the exception of an assembled workforce, sufficient information can reasonably be expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination? If not, why not? The Board would appreciate respondents outlining the specific circumstances in which the fair value of an intangible asset acquired in a business combination could not be measured reliably.

> ***Response: We agree that probability should be taken into account in order to reliably measure the value of acquired intangible assets.***
>
> ***In the case of an assembled workforce representing insurance distribution system, the value of future business expected to be produced by the individuals that make up the***

distribution system could be reliably measured, even though the human capital associated with that workforce itself may not be easily measurable.

The proposals in ED 3 and the revisions to IAS 36 and IAS 38 require different accounting treatments for goodwill and various categories of intangible assets. These differences make it desirable that a consistent approach to valuation that is generally accepted be applied by every entity. For insurance entities, it is essential that consistent guidance be developed in an expeditious manner for both IAS 39 investment contracts and future insurance contract standards, presumably on a fair value basis for use in business combinations, to be developed in an expeditious manner.

Question 3 – Indefinite useful life

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

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

Response: We agree that it is not appropriate to include a specific maximum period as an intangible asset's useful lifetime. Conversely, it should not be assumed that all intangible assets have an indefinite useful lifetime. The facts and circumstances of the individual case need to be examined for such determinations. An intangible asset should be regarded as having an indefinite life when there is no foreseeable limit on the period it is expected to generate net cash inflows. However, the proposed standard should include guidance on the circumstances and factors (such as legal, contractual, regulatory and competitive) that should be considered when determining whether an indefinite life expectation is appropriate. The principles that underpin the guidance reflected in the Appendices to IAS 38 could form the basis of such discussion in the proposed standard.

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

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

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

Response: It is appropriate to reflect renewal periods if the entity can do so without costs that are significant in the context of the value of the recognized asset. We would take this argument further to say that, if benefits are associated with such renewal, it should be assumed that such renewal occurs in a rational manner. We see no reason not to incorporate such renewal periods. The proposed standard should clarify the basis used to determine the fair value of a customer relationship and how this interacts with the determination of useful life.

Question 5 – Non-amortisation of intangible assets with indefinite useful lives

The Exposure Draft proposes that an intangible asset with an indefinite useful life should not be amortised (see proposed paragraphs 103 and 104 and paragraphs B36-B38 of the Basis of Conclusions).

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

Response: We believe that it is reasonable to reflect an indefinite useful life as long as that remains appropriate. As the useful life decreases, such reduced lifetime should be recognized in a manner consistent with an impairment test. In addition, we believe that the method used should not rely on values generated over an infinite horizon (such as future new business expected to be written in perpetuity), consistent with recent AICPA guidance ("Auditing Fair Value Measurements and Disclosures") regarding the application of SFAS 142.

ED3 - Business Combinations

Question 1 – Scope

The Exposure Draft proposes:

(a) to exclude from the scope of the IFRS business combinations in which separate entities or operations of entities are brought together to form a joint venture, and business combinations involving entities under common control (see proposed paragraphs 2 and 3 and paragraphs BC9-BC11 of the Basis for Conclusions). Are these scope exclusions appropriate? If not, why not?

Response: We agree with the scope of this proposed IFRS. Financial reporting for the formation of a joint venture should be considered in a similar manner, whether in conjunction with this exposure draft or in Phase II (of the IASB Business Combination project). The scope of Phase II should cover all transactions or combinations other than acquisitions that result in the formation of a new entity. These include those rare business combinations where an acquirer cannot be identified, such as the combination of mutual entities and the transfer of state owned assets to private ownership. In addition, issues associated with business combinations involving entities under common control should be addressed.

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

Response: We agree that the definition of business combinations involving entities under common control and the additional guidance provided are helpful. Further guidance on accounting for such transactions should be included here or in Phase II.

Question 2 – Method of Accounting for Business Combinations

The Exposure Draft proposes to eliminate the use of the pooling of interests method and require all business combinations within its scope to be accounted for by applying the purchase method (see proposed paragraphs 13-15 and paragraphs BC18-BC35 of the Basis for Conclusions). Is this appropriate? If not, why not? If you believe the pooling of interests method should be applied to a particular class of transactions, what criteria should be used to distinguish those transactions from other business combinations, and why?

Response: We agree that it is reasonable to eliminate the use of the pooling method. This would result in increased comparability in financial reporting.

Nevertheless, the Board should consider whether the use of the pooling method might be appropriate in the rare cases in which an acquirer cannot be identified, such as the case of two or more mutual (non-shareholder) insurance companies that represents a true merger of equals, in which case policyholders of each company retain full and equal "ownership" rights to the merged entity. We recognize that to define this situation, further research might be necessary.

Question 3 – Reverse Acquisitions

Under IAS 22 *Business Combinations*, a business combination is accounted for as a reverse acquisition when an entity (the legal parent) obtains ownership of the equity of another entity (the legal subsidiary) but, as part of the exchange transaction, issues enough voting equity as consideration for control of the combined entity to pass to the owners of the legal subsidiary. In such circumstances the legal subsidiary is deemed to be the acquirer. The Exposure Draft:

(a) Proposes to modify the circumstances in which a business combination could be regarded as a reverse acquisition by clarifying that for all business combinations effected through an exchange of equity interests, the acquirer is the combining entity that has the power to govern the financial and operating policies of the other entity (or entities) so as to obtain benefits from its (or their) activities. As a result, a reverse acquisition occurs when the legal subsidiary has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities (see proposed paragraph 21 and paragraphs BC37-BC41 of the Basis for Conclusions). Is this an appropriate description of the circumstances in which a business combination should be accounted for as a reverse acquisition? If not, under what circumstances, if any, should a business combination be accounted for as a reverse acquisition?

(b) Proposes additional guidance on the accounting for reverse acquisitions (see proposed paragraphs B1-B14 of Appendix B). Is this additional guidance appropriate? If not, why not? Should any additional guidance be included? If so, what specific guidance should be added?

> ***Response: We agree with the proposed change. With respect to guidance proposed in (b), we would support an attempt to converge with the guidance provided by SFAS 141, paragraph 17. Further guidance might be needed to cover cases of a business combination with no single entity holding more than fifty percent of ownership (where more than two entities are involved).***

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 combinations should be adjudged the acquirer on the evidence available (see proposed paragraph 22 and paragraphs BC42-BC46 of the Basis for Conclusions). Is this appropriate? If not, why not?

> ***Response: Yes, this is appropriate (except possibly in the rare case that the acquirer cannot be determined, such as the merger of "equal" mutual companies referred to our response to question 2.***

Question 5: Provisions for Terminating or Reducing the Activities of the Acquiree

Under IAS 22, an acquirer must recognize 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 recognize 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 recognized in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (see proposed paragraph 40 and paragraphs BC55-

BC66 of the Basis for Conclusions). Is this appropriate? If not, what criteria should an acquirer be required to satisfy to recognize a restructuring provision that was not a liability of the acquiree as part of allocating the cost of a combination, and why?

> ***Response: We agree that only existing commitments that exist at the time of purchase should be recognized in the allocation of the cost of a business combination. The proposed standard should require that the acquired entity's restructuring plan be in existence before the commencement of negotiations for the business combination. Management of the acquirer must be demonstrably committed to the restructuring plan at or before the date of acquisition.***
>
> ***In what we believe to be isolated instances, a third party such as a regulator (whose approval is required for the acquisition to be completed) may require further commitment for an acquisition to be approved. The additional cost of such a requirement that reduces the value of the acquired company should be able to be reflected in the acquisition cost. An example is the German insurance regulator who has required additional guaranteed bonuses to policyholders in order to approve a combination.***

Question 6: Contingent Liabilities

The Exposure Draft proposes that an acquirer should recognize separately the acquiree's contingent liabilities at the acquisition date as part of allocating the cost of a business combination, provided their fair values can be measured reliably (see proposed paragraphs 36 and 45 and paragraphs BC80-BC85 of the Basis for Conclusions). Is this appropriate? If not, why not?

> ***Response: To the extent that they can be reliably measured, we believe that it would be appropriate to reflect the fair value of both the acquiree's contingent liabilities <u>and</u> its contingent assets, reflecting applicable probabilities. We have not seen persuasive justification for ignoring contingent liabilities or assets in a fair value calculation. If not recognized separately, contingent assets would be incorporated in goodwill, when conceptually they should be separately recognized. If so provided, it might be worthwhile for the IASB to review IAS 37 (and the IASB Framework) for consistency in its guidance for business combinations and non-business combination situations in the recognition and measurement of contingent liabilities and assets.***

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 recognized as part of allocating the cost to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree will be stated at the minority's proportion of the net fair values of those items. This proposal is consistent with the allowed alternative treatment in IAS 22 (see proposed paragraphs 35 and 39 and paragraphs BC88-BC95 of the Basis for Conclusions). Is this appropriate? If not, how should the acquiree's identifiable assets, liabilities and contingent liabilities recognized as part of allocating the cost of a business combination be measured when there is a minority interest in the acquiree, and why?

> ***Response: We agree with the proposed treatment requiring that the minority share be measured in proportion to the minority's interest. In certain cases, the minority interests***

involved may be complex and not just a simple percentage or proportionality, e.g., certain policyholder participating rights in insurance contracts if policyholders are thought of as having minority interests.

Question 8: Goodwill

The Exposure Draft proposes that goodwill acquired in a business combination should be recognized as an asset and should not be amortized. Instead, it should be accounted for after initial recognition at cost less any accumulated impairment losses (see proposed paragraphs 50-54 and paragraphs BC96-BC108 of the Basis for Conclusions). Do you agree that goodwill acquired in a business combination should be recognized as an asset? If not, how should it be accounted for initially, and why? Should goodwill be accounted for after initial recognition at cost less any accumulated impairment losses? If not, how should it be accounted for after initial recognition, and why?

Response: We agree that explicitly identified goodwill associated with a business combination should be recognized as an asset. It is reasonable for subsequent measurement to recognize the effect of applicable impairment tests. Such tests should be performed recognizing the value in use of the asset. Goodwill is more likely to lose value as a result of changing economic conditions or the actions of the acquirer, rather than as a result of the passage of time. A robust and consistently applied impairment model reflects this and therefore provides a better representation of any loss in value. Since goodwill is a residual, it is unlikely that entities will be able to estimate with accuracy the useful life of economic benefits that cannot be identified separately. The allocation of a useful life to goodwill is arbitrary and the resulting amortization charge has little meaning. Further guidance regarding principles underlying the impairment tests may be needed in order to enhance consistency of application across companies.

Note that, although technically correct, the use of the term "impairment" does not seem to properly convey some of the likely circumstances in which the value of such an asset would be reduced, as it implies that the value of the asset has been damaged, rather than the value reduced as a result of changed circumstances or a reduction in value compared to that assessed at time of combination. We urge a review of the term to be more consistent with the likely circumstances.

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 recognized 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) recognize immediately in profit or loss any excess remaining after that reassessment.

(See proposed paragraphs 55 and 56 and paragraphs BC109-BC120 of the Basis for Conclusions.) Is this treatment appropriate? If not, how should any such excess be accounted for, and why?

Response: We agree with the proposed approach to the treatment of what would otherwise be negative goodwill. Although it should not be necessary to remind the preparer to

validate their assumptions (a), we do not object to this guidance. If goodwill has been measured on a reasonable basis, we do not believe that it would be appropriate to continue to carry a negative goodwill (or liability) associated with a past purchase, and therefore agree with the immediate recognition in income of this financial effect of the purchase.

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 recognized within twelve months of the acquisition date (see proposed paragraphs 60 and 61 and paragraphs BC123-BC126 of the Basis for Conclusions).

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

Response: Although we agree with the use of provisional values in the case in which reliable measurement cannot yet be determined, we encourage sufficient guidance to be provided to assist in distinguishing between the use of provisional values based on inadequate information or complex models that are applied but may not be completed at the time of purchase, and changes in estimates based on subsequent information. In order to do this, the measurement aspects that are considered to be provisional at the time of the combination reporting should be reassessed as more refined information or models become available. Provisional values should be adjusted (in the income statement) only as a result of the acquirer obtaining further information about fair values at the date of acquisition and not to reflect changes in circumstances after the date of acquisition. Note that by being in favor of the use of provisional values, we do not encourage the use of such provisional values, but rather recognize that in certain cases the detailed calculations necessary to split recorded goodwill and intangible assets can take some time to complete.

The twelve month period identified is reasonable.

(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 recognized only to correct an error (see proposed paragraphs 62 and 63 and paragraphs BC127-BC132 of the Basis for Conclusions).

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

Response: We agree that this is appropriate.

Other comments regarding ED 3

1. ***Paragraph 26 indicates that the published price at the date of exchange is an unreliable indicator of the fair value of the purchase consideration only when it has been affected by "the thinness of the market". The proposed standard should provide further guidance on what is meant by "thinness of the market".***

   The cost of acquisition when there is no published price for equity instruments included as the consideration for the purchase is determined by reference to the fair value of the acquired entity or the acquirer. Further guidance should be provided with respect to "estimated by reference to their proportional interest in the fair value of the acquirer or their proportional in the fair value of the acquiree obtained, whichever is more evident." Consideration of alternative sources should be permitted, including the use of models such as option pricing models.

2. ***Paragraph 28 requires that costs directly attributable to the business combination should be added to the purchase cost. There should be further guidance relating to incremental costs (including both external and internal costs that are directly attributable to the combination),should be added to the cost of the business combination.***

3. ***Paragraph 64 asserts that goodwill should be adjusted whenever a deferred tax asset not recognized at the date of the business combination is recognized subsequently. We believe that adjustments to deferred tax should be treated in a manner consistent with other adjustments to the identifiable assets and liabilities acquired.***

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