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2 April 2003

Dear Ms Crichton

IASB Proposals on Business Combinations, Impairment and Intangible Assets

CIPFA's Accounting and Auditing Standards Panel (the Panel) has considered the Consultation Paper on the *IASB Proposals on Business Combinations, Impairment and Intangible Assets.* The Panel decided that it would not be appropriate to comment on the questions raised in the ED, but that it would be worthwhile to highlight a few areas of concern and interest related .to the public benefit sector. Whilst the public benefit sector is outside the scope of the IASB, and notwithstanding the point that no decision has yet been taken on the extension Of international GAAP to entities which are not listed companies, there is a strong likelihood that changes to international GAAP will have an impact on the public benefit sector in the medium term.

The Panel note that entities under 'common control' are excluded from the scope of ED 3 and that the definition of control contained in ED 3 is consistent with the definition contained in UK accounting standards such as FRS 2. The Panel takes the view that many public sector business combinations relate to entities under common control. Such combinations would therefore be outside the scope of ED 3. The Panel notes that accounting for business combinations involving entities under common control is to be considered as part of Phase II of the IASB project. There is also an issue as to whether what might superficially appear to be mergers of central government departments are in substance simply the restructuring of segments and therefore outside the scope of both Phases of the IASB project.

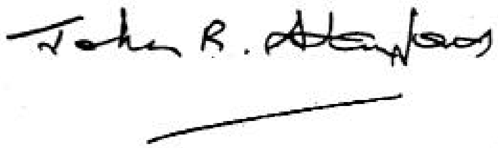
The implications for the UK public benefits sector of using acquisition accounting are potentially significant. In many cases it is unlikely that there will be consideration attributable to an acquirer. Therefore negative goodwill equal to the aggregate fair values of the identifiable net assets would arise. Under the proposals in ED 3 negative goodwill should be recognised immediately in the performance statement. The Panel has reservations that the recognition of negative goodwill in such a case will be difficult to understand and potentially misleading for users. The Panel therefore shares the reservations that the Board has about requiring the purchase method to be used for all business combinations.

ED 3 states that goodwill should not be subject to annual amortisation, but rather should be subject to annual impairment review. The Panel notes the Board's point on the lack of symmetry of the IASB proposals for goodwill and intangibles. The Panel is also not sure why the depreciation concept applied to all other fixed assets does not apply to goodwill, even if 'new goodwill' is being created to replace any using up of purchased goodwill. There are no specific public sector implications in relation to the IASB proposal. However, it is likely that amortisation rather than impairment would be more straightforward for public sector organisations accounting for goodwill arising from purchases / acquisitions. Once an amortisation schedule is established, it is generally followed year on year, whereas impairment requires a review to take place every year. The Panel therefore supports the Board's view that entities should be permitted to use amortisation rather than to have to go down the impairment route.

Under the revised IAS 38, separability would not be a criterion for identifying an intangible fixed asset. An intangible asset would therefore be considered as identifiable when it is separable, or, when it arises from contractual or other legal rights, even if those rights are not separable. In addition the proposal would require development expenditure to be capitalised if certain criteria are met.

This proposal is unlikely to have significant implications for much of the public sector, as most public sector organisations do not have intangible fixed assets. However for those organisations that do, such as the Ministry of Defence, they may be forced to recognise more intangible fixed assets than they do currently. The full implications of such recognition would need to be considered in due course.

Yours sincerely



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