CL 118

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Dear Annette

We are writing in response to the invitation to comment on Exposure Draft 3 *Business Combinations* and *Proposed Amendments to IAS 36 Impairment of Assets and IAS 38 Intangible Assets* We have long advocated the harmonisation of Irish/UK accounting standards with their international equivalent and therefore in general welcome the proposals in these exposure drafts. There are a few issues we disagree with and these are noted in our responses to the specific questions asked.

Should you have any queries please do not hesitate to contact me.

Yours sincerely,

Michael Kavanagh

**Michael Kavanagh B.Comm CPA**
**Chairman**
**Financial Reporting Sub-Committee**

## EXPOSURE DRAFT 3- 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 are happy to see these issues deferred until the second phase of the Business combinations project is considered by IASB***

(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 BC 12- BC15 of the Basis for Conclusions).

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

**Response**

***Yes we feel the definition and additional guidance is 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 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 see no reason why the pooling of interests method should not be eliminated. Under FRS 6 of the Irish/UK ASB accounting standard, merger accounting can be used if 5 criteria are meet. Many of the entities that meet the definition of a merger under FRS 6 are, in reality, acquisitions of one company by another. Allowing two methods of accounting for business combinations can cause confusion and lead to a lack of comparability.***

***However, we do not consider the acquisition method appropriate where, in those very rare cases, an acquirer is not identifiable In these cases, which should be very strictly defined, the fresh start method is a possible alternative.***

**Question 3 - Re 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?

**<u>Response</u>**

***(a) We are in agreement with the proposals for accounting for reverse acquisitions, which gives clear guidance on an area that is not covered in current Irish/UK accounting standards***

***(b) We regard the proposed additional guidance together with the illustrative examples as 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 and paragraphs BC42- BC46 of the Basis for Conclusions).

Is this appropriate? If not, why not?

**Response**

***We agree that one of the combining entities that existed before the combination should be determined to be the acquirer on the evidence available***

***In most cases the new entity formed to issue equity instruments has limited substance and should not be adjudged the acquirer.***

**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 Provision Contingent Liabilities and Contingent Assets (see proposed paragraph 40 and paragraphs BC55- BC66 of the Basis for Conclusions).

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

**Response**

***We are in agreement with the proposal as it is bringing the treatment into line with the strict requirements of an existing standard — FRS 12 and IAS 37, which we support***

**Question 6 Contingent liabilities**

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

Is this appropriate? If not, why not?

**Response**

***We are somewhat concerned at this proposal as it is inconsistent with accounting for a contingent liability, which is not subject to a business combination (FRS 12 and IAS 37) This may cause confusion and is potentially open to abuse. The nature of a contingent liability does not change as a result of an acquisition***

***The proposals are also inconsistent in that contingent liabilities are required to be recognised but not contingent assets. We do not agree that contingent liabilities should be recognised but, if this is to be the case, then, for consistency, contingent assets should also be recognised***

***We also feel more guidance is needed on measuring the fair value of a contingent liability. We actually believe a reliable fair value measurement does not exist for a contingent liability.***

**Question 7 - Measuring the identifiable assets acquired and liabilities and contingent liabilities assumed**

IAS 22 includes a benchmark and an allowed alternative treatment for the initial measurement of the identifiable net assets acquired in a business combination, and therefore for the initial measurement of any minority interests. The Exposure Draft proposes requiring the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree will be stated at the minority’s proportion of the net fair values of those items. This proposal is consistent with the allowed alternative treatment in IAS 22 (see proposed paragraphs 35 and 39 and paragraphs BC88- BC95 of the Basis for Conclusions).

Is this appropriate? If not, how should the acquiree’s identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of a business combination be measured when there is a minority interest in the acqutree, and why?

**Response**

***We agree with the proposals but we draw attention to our reservation regarding contingent liabilities as outlined above.***

**Question 8 Goodwill**

The Exposure Draft proposes that goodwill acquired in a business combination should be recognised as an asset and should not be amortised Instead, it should be accounted for after initial recognition at cost less any accumulated impairment losses (see proposed paragraphs 50- 54 and paragraphs BC96- BC108 of the Basis for Conclusions).

Do you agree that goodwill acquired in a business combination should be recognised as an asset? If not, how should it be accounted for initially, and why? Should goodwill be accounted for after initial recognition at cost less any accumulated impairment losses? If not, how should it be accounted for after initial recognition, and why?

**Response**

***We agree that Goodwill should be treated as an asset and this is consistent with the current FRS 12 and IAS 22 While not strictly an asset such as other tangible and intangible assets, Goodwill has the characteristics of as asset in that it is a resource acquired by an entity from which future economic benefits are expected to flow.***

***We are unhappy with the proposals for an annual impairment test While, theoretically more correct it imposes a potentially complicated and onerous calculation on the company. Annual amortisation is simpler and, provided that***

***Goodwill is impaired when there is an obvious decrease in value, will give the same result as annual impairment, in the long term. Ultimately, we feel that Goodwill is an asset with a finite useful economic life and should be amortised. This is consistent with the cost allocation principle, which forms the basis for the depreciation of Tangible Fixed Assets.***

**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 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 proposals and/eel the proposed method makes more sense.***

**Question 10 Completing the initial accounting for a business combination and subsequent adjustments to that accounting**

The Exposure Draft proposes that:

(a) if the initial accounting for a business combination can be determined only provisionally by the end of the reporting period in which the combination occurs because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer should account for the combination using those provisional values. Any adjustment to those values as a result of completing the initial accounting is to be recognised within twelve months of the acquisition date (see proposed paragraphs 60 and 61 and paragraphs BC123 - BC 126 of the Basis for Conclusions).

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

(b) with some exceptions carried forward as an. interim measure from IAS 22, adjustments to the initial accounting for a business combination after that accounting is complete should be recognised only to correct an error (see proposed paragraphs 62 and 63 and paragraphs BC127 - BC 132 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?

***We are In agreement with the above proposals***

## 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 SA 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 are in agreement with the proposals for intangible assets with indefinite useful lives but attention is drawn to our response to Q8 of ED 3 with regards to Goodwill***

### Question 2 Intangible assets with indefinite useful lives

The Exposure Draft proposes that the recoverable amount of an intangible asset with an indefinite useful life should be measured, and impairment losses (and reversals of impairment losses) for such assets accounted for, in accordance with the requirements in IAS 36 for assets other than goodwill (see paragraphs C10-C11 of the Basis for Conclusions).

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

**Response**

***We are in agreement with the proposals.***

### 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 and paragraphs C66 and C67 of the Basis for conclusions)? 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) and paragraphs c66 and C67 of the Basis for Conclusions)? If not, why not?

(c) 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?

(a) ***We felt that element (d) of paragraph 25 (A) will prove difficult to measure and/or may be too subjective.***

(b) ***Agree***

(c) ***Yes the additional guidelines seem appropriate and sufficient and we feel that the two techniques employed to calculate present values arrive at similar results***

**Question 4 Allocating goodwill to cash-generating units**
The Exposure Draft proposes that for the purpose of impairment testing, acquired goodwill should be allocated to one or more cash-generating units.

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

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

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

**Response**

***We are in agreement with the proposals for (a) to (c)***

**Question 5— Determining whether goodwill is impaired**
The Exposure Draft proposes:

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

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

(c) that if an entity identifies goodwill allocated to a cash-generating unit as potentially impaired, the amount of any impairment loss for that goodwill should be measured as the excess of the goodwill's carrying amount over its implied value measured in accordance with proposed paragraph 86 (see proposed paragraphs 85 and 86 and paragraphs C28-C40 of the Basis for Conclusions).

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

**<u>Response</u>**
***We feel that all the above measures are appropriate.***

**Question 6 Reversals of impairment losses for goodwill**
The Exposure Draft proposes that reversals of impairment losses recognised for goodwill should be prohibited (see proposed paragraph 123 and paragraphs C62- C65 of the Basis for Conclusions).

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

**<u>Response</u>**
***We agree with the proposal***

***Question 7— Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives***
The Exposure Draft proposes requiring a variety of information to be disclosed for each segment, based on an entity's primary reporting format, that includes within its carrying amount goodwill or intangible assets with indefinite useful lives (see proposed paragraph 134 and paragraphs C69-C82 of the Basis for Conclusions).

(a) Should an entity be required to disclose each of the items in proposed paragraph 134? If not, which items should be removed from the disclosure requirements and why?

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

**<u>Respons e</u>**

*(a)* ***We feel the list of required items given in paragraph 134 should be reduced. Some of the required information seems burdensome and unwieldy adds little to understanding the financial statements. In particular we feel that disclosures (e) (iv) and (v) should be dropped.***

*(b)* ***We agree with the principle us proposed in paragraph 137 but would draw attention to our response to (a) regarding the extensive disclosure requirements in paragraph 134. We also feel guidance is needed on the definition of significant and "significantly in paragraphs 137(a) & 137(c) respectively***

**PROPOSED AMENDMNETS TO IAS 38 - INTANGIBLE ASSETS**

## Question 1 - Identifiably

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

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

**Response;**

***We agree 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 a contractual or legal right The seperability approach ensures that "conventional" intangible assets will be recognised, whilst the contractual/legal rights approach ensures that other intangibles (which may not be separable, but warrant recognition because of their nature and circumstance) are not omitted from financial statements.***

**Question 2 Criteria for recognising intangible assets acquired in a business combination separately from goodwill**

This Exposure Draft proposes clarifying that for an intangible asset acquired in a business combination, the probability recognition criterion will always be satisfied and, with the exception of an assembled workforce, sufficient information should always exist to measure its fair value reliably (see proposed paragraphs 29-32 and paragraphs B11-B15 of the Basis for Conclusions). Therefore, as proposed in ED 3, an Exposure Draft of a proposed International Financial Reporting Standard Business Combinations, art acquirer should recognise, at the acquisition date and separately from goodwill, all of the acquiree's intangible assets, excluding an assembled workforce, that meet the definition of an intangible asset (see proposed paragraphs 36, 43 and 44 of ED 3).

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

**Responses:**

***An intangible asset should only be recognised***

*a)* ***it is <u>probable</u> that the future economic benefits that are attributable to the asset will flow to the entity and***
*b)* ***the cost of the asset can be measured <u>reliably</u>***

***We agree that sufficient information should reasonably be expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination (with the exception of an assembled workforce). We support the IASB's perception that when an intangible asset is acquired as part of a business combination, then the fair value of that intangible asset reflects market expectations about the probability that the future economic benefits embodied in the asset will flow to the entity.***

***On this basis it should be reasonable to expect that sufficient information will be available to value an intangible asset acquired in a business combination (with the exception of an assembled work force).***

**Question 3 - Indefinite useful life**

The Exposure Draft proposes to remove from. IAS 38 the rebuttal 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 support the view of the L4SB in this respect Due to the nature of intangible assets, it is possible that some may have an indefinite useful life. As such, an accounting treatment should be available ,which reflects this period of us We therefore agree with the IASB's proposal to remove from IAS 38, the rebuttal presumption that an intangible assets useful life cannot exceed twenty years.***

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

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

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

**Response**

***We support, in principle, the useful life requirements proposed by the IASB However, we suggest that the condition of "without significant cost" should be Removed from Paragraph 91. It is possible that significant benefits in the future***

***period could far exceed, and be as a result of those significant costs and, this should not prevent the overall useful life from being extended***

***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 arnortised (see proposed paragraphs 103 and 104 and paragraphs B36-B38 of the Basis for Conclusions).

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

**Response**

**Because an asset is deemed to have an indefinite useful life it is not possible to apply a suitable rate of amortisation In this regard if the asset is subjected to regular impairment reviews the value of the asset will be accurate.**

**However, attention is drawn to our response to Q8 of ED 3 where we expressed our reservations on the use of annual impairment testing for Goodwill We felt that Goodwill has a finite useful economic life Other intangibles such as brands are a different type of asset and some are capable of having an indefinite useful life. However, the standard should set tests that limit the cases where intangible assets can have an indefinite useful life.**