CL 96

21 March 2003

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
UNITED KINGDOM

Dear Sir David

IASB ED 3 'Business Combinations'
IASB ED of Proposed Amendments to IAS 36 'Impairment of Assets'
IAS 38 'Intangible Assets'

The Group of 100 (G100) is pleased to comment on the proposals in ED 3. Our comments are developed in the context that the G100 is a strong supporter of international convergence and harmonisation. While the G100 generally supports the proposals in ED 3 we have particular concerns about the extent and nature of the disclosure requirements and the implications of application of IAS 38 'Intangible Assets' for some Australian companies.

Our comments, particularly those in respect of accounting for intangible assets, are prepared in the context of the G100's Statement of Principles on Intangible Assets (SOP) which was first prepared in 1995 (refer attached). While the proposals in ED 3 are not as comprehensive as the G100's SOP we believe their adoption as part of the international convergence process will lead to a significant improvement in the quality of financial reporting in Australia.

We are, however, concerned about the implications of adopting IAS 38 'Intangible Assets' for some entities that have recognised internally generated identifiable intangible assets and which, in some cases, have been revalued. For some companies these assets represent a significant proportion of total assets which under IAS 38 would be derecognised. Derecognition would have a severe impact on a number of Australian companies particularly when taken in conjunction with thin capitalisation rules for taxation purposes. We are also concerned that some companies will be required to derecognise assets when IAS 38 is adopted and that some of these assets would, depending on the outcome of the IASB/AASB longer-term project on intangible assets, be re-recognised in a future period.

The G100 also has serious concerns about the level of detail and scope of the disclosure requirements in respect of intangible assets. It is not clear from the proposals what objective is being served by such detailed and comprehensive disclosures other than to provide information to replicate the measurements and processes of management.

Yours sincerely

John V Stanhope
National President

Att:

14 March 2003

Mr Keith Alfredson
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Dear Keith

ED 109 "Request for Comment on:
IASB ED 3 'Business Combinations'
IASB ED of Proposed Amendments to IAS 36 'Impairment of Assets'
IAS 38 'Intangible Assets' and
AASB added material"

The Group of 100 (G100) is pleased to comment on the proposals in ED 109. Our comments are developed in the context that the G100 is a strong supporter of international convergence and harmonisation. The G100 generally supports the proposals in ED 109 and believes that the AASB should adopt the resulting IASB standards at approximately the same time as the IASB. We believe that the early adoption of IASB standards is necessary to enable companies to prepare for their implementation and, where appropriate to their circumstances, early-adopt the standards.

Our comments, particularly those in respect of accounting for intangible assets, are prepared in the context of the G100's Statement of Principles on Intangible Assets (SOP) which was first prepared in 1995 (refer attached). While the proposals in ED 109 are not as comprehensive as the G100's SOP we believe that they will lead to a significant improvement in the quality of financial reporting in Australia.

We are, however, concerned about the implications of adopting IAS 38 'Intangible Assets' for some entities that have recognised internally generated identifiable intangible assets and which, in some cases, have been revalued. For some companies these assets which represent a significant proportion of total assets which under IAS 38 would be derecognised. This would have a severe impact on these entities particularly when taken in conjunction with thin capitalisation rules for taxation purposes. We are also concerned that some companies will be required to derecognise assets when IAS 38 is adopted and that some of these assets would, depending on the outcome of the IASB/AASB longer-term project on intangible assets, be re-recognised in a future period.

The G100 also has serious concerns about the level of detail and scope of the disclosure requirements in respect of intangible assets. It is not clear from the proposals what objective is being served by such detailed and comprehensive disclosures other than to provide information to replicate the measurements and processes of management.

Yours sincerely

John V Stanhope
National President

Att:

Group of 100 comments

ED 3 “Business Combinations”

IASB SPECIFIC QUESTIONS

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?

The G100 agrees with the scope of the standard. However, we anticipate that the Board will deal with the creation of dual listed entities and similar structures in Phase 2 of this project.

(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).

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

Yes.

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?

In view of recent international developments, particularly in the USA, the G100 supports the use of the purchase method as in the vast majority of cases one entity obtains control of another.

However, we do not consider that the purchase method is appropriate where an acquirer is not identifiable as, for example, occurs in dual listed arrangements. Where a new reporting entity is created under contractual arrangements as occurs for dual listed entities it is unlikely that the pooling of interests method, which combines two sets of book values, generates relevant, useful information for users. On the other hand the purchase method has the impediment that the resulting financial reports reflect a mixture of book and fair values.

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?

Yes.

(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?

Yes.

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?

There may be a rebuttable presumption that one of the entities is the acquirer. We consider that the formation of a non-operating holding company without the recognition of goodwill is possible under these arrangements and, as such, reflects the economic substance of the arrangements. However, the identification of an acquirer should not be forced in those cases where a new entity is formed. Whether one entity or the other is an acquirer should depend on the facts and economic substance of the transactions.

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 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?

While the G100 believes that the treatment of restructuring costs, whether relating to a business combination or otherwise should be determined by a consistent application of the principles in IAS 37 we believe that the existing requirements of IAS 37 should be amended to better reflect the circumstances of corporate restructurings. In this respect, we believe that the approach in UIG 8 'Accounting for Acquisitions- Recognition of Restructuring Costs as Liabilities' better reflects the variety of circumstances which arise in acquisitions, whether friendly or contested, and the processes adopted in respect of internal restructurings. We do not believe there is a case for special/different accounting for restructurings occurring as part of a business combination. However, we note that this proposal is inconsistent with those made in respect of contingent liabilities.

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?

No. The requirements of IAS 37 should apply otherwise there is different accounting for similar items. For example, if an entity acquires a fellow venturer's interest in a jointly controlled operation its share of the contingent liabilites would be disclosed in accordance with IAS 37 but those assumed as part of the acquisition would be recognised in the financial statements.

We believe that inconsistent treatments of this nature should not be fostered by an accounting standard and that the recognition of acquired contingent liabilities would facilitate "gaming" similar to that where there was excessive provisioning for acquisitions. This is amplified if changes in fair value are recognised in the profit and loss statement. The existence of contingent assets and contingent liabilities would be taken into account by the acquirer in determining the amount of the

purchase consideration and, if crystallised subsequent to the acquisition would impact on the amount of goodwill recognised.

The proposals are also internally inconsistent in the sense that contingent liabilities are required to be recognised but not contingent assets. We believe that if the proposal relating to contingent liabilities is retained the principle should be applied consistently to include contingent assets.

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 acquiree, and why?

The G100 agrees with the proposals (but see above re contingent liabilities). The initial recognition of an acquisition is at the cost of acquisition and fair values are used to allocate the cost to the identifiable assets and liabilities acquired. For recognition in the financial statements an item must satisfy the relevant definition and recognition criteria.

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?

The G100 agrees that goodwill should be recognised as an asset in that it represents future economic benefits expected to flow to the entity from unidentifiable assets. To the extent that goodwill on initial recognition as part of the acquisition transaction does not represent future economic benefits the amount should be written down. As set out in its Statement of Principles the G100 believes that goodwill should not be amortised and strongly supports an approach where the carrying

amount of the asset is tested for impairment on a regular basis so that any reductions in its value are recognised as an expense in the periods in which those reductions in value occur.

The G100 believes that this approach is consistent with the increasing use of fair values and best reflects the way in which management assesses the operations and performance of a business.

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?

No. The G100 believes that in a cost-based system the purchase price is the maximum amount at which the net assets of the acquired entity should be recognised. Where an excess over cost arises the excess should be allocated to non-monetary assets acquired. In the event that excess still remains after this allocation process it should be recognised in the profit and loss as a revenue item in the period of acquisition.

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-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?

Yes. We believe that in the vast majority of cases it is reasonable to expect adjustments to be made within one year of the date of acquisition. However, while this may ordinarily be the case, twelve months from the date of acquisition may not be adequate in certain circumstances including resolution of requirements of regulators such

as competition authorities, environmental obligations, legal proceedings and tax disputes. Where an entity has not completed the acquisition entries and process in the 12 months from acquisition it should be required to disclose why it has not done so.

(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-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?

Yes.

Group of 100 Comments

IAS 36 "Impairment of Assets"

IASB SPECIFIC QUESTIONS

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 and paragraphs C6, C7 and C41 of the Basis for Conclusions)? If not, how often should such assets be tested for impairment, and why?

The G100 supports the impairment testing of assets to coincide with reporting dates, at least annually. However, we believe that, in general, for consistency and comparability purposes the testing should occur as of the same date for all assets. While this is the general case testing should be undertaken more frequently in respect of specific assets where the indicators of impairment are triggered. We note that review of the triggers of impairment would occur on a regular basis in order for companies to meet their continuous disclosure obligations.

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?

The G100 agrees with these proposals.

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?

© 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?

The G100 suggests that further guidance on the use of present value techniques would be useful to facilitate implementation, for example on the use and significance of terminal values and the use of post-tax discount rates.

While companies would normally take previous experience into account in preparing forecasts/making estimates we do not consider that the points in (b) warrant this emphasis. We are also concerned about the use of the word "accurate" in this context and how it would be interpreted in practice.

The G100 believes that the standard should set down the objectives of the valuation process and establish the principles to be applied.

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?

The G100 supports the use of the cash generating unit, being the lowest level to which goodwill is allocated, as being the basis of the impairment test in most circumstances. However, the requirement should have sufficient flexibility to enable commercial factors to be taken into account in determining the level at which impairment testing is undertaken. For example, an entity may be engaged in retailing and have a chain of retail outlets such as shops, service stations etc. which it regards as a cash generating unit. As part of its ongoing activities the entity may expand by purchasing additional outlets, either singly or in groups. Where an entity purchases an entity having a single shop and goodwill arises on the transaction we consider it would be

inappropriate to mandate that this shop be regarded as a cash generating unit for the purposes of impairment testing, particularly where the retail chain is managed on a unified basis.

In other cases, an entity may have acquired a business entity and arbitrarily allocated goodwill to geographic segments as the business is operated on that basis. However, the commercial and management assessment may be undertaken on a whole of business basis. In these circumstances it would be appropriate for the impairment testing to be undertaken on a business rather than a geographic segment basis.

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?

Yes

(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?

Yes. While we recognise that the impairment test is imperfect and imprecise (e.g. not distinguishing pre-existing goodwill, whether recognised or not, and purchased goodwill) its application is viewing the cash generating unit on an integrated basis which, in most cases, the way in which it will be viewed by management.

(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?

Yes. While the screening mechanism admits the inclusion of pre-existing goodwill (which serves as a buffer or cushion) it reflects more accurately the way in which the business is assessed by management and provides a reasonable practical compromise where purchased goodwill becomes part of the total goodwill of the business.

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?

The G100 agrees that goodwill impairments should not be reversed because the separation of the various components of the goodwill of a cash generating unit is unlikely to be achievable on a consistent and reliable basis. This is because of the range of factors having on impact on the value of the goodwill.

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?

No. It is not clear what objective is being served by requiring such detailed and comprehensive disclosures. Our impression from the proposed requirements is that they are seeking to provide information that would enable users to replicate the measurements and processes of management. In this regard we strongly oppose proposals to require disclosure of the difference between recoverable and carrying amounts as required by paragraph 134(d).

The G100 has serious concerns about the level of detail and scope of the disclosure requirements. The proposals do not set out the case for, or the purpose of, such comprehensive disclosures. Our concerns relate to the commercial sensitivity of the information and the potential impact on the competitive environment of the company. For example, the requirements are selective and take no account of how a company has grown with the result that a company that has grown through acquisition makes disclosures while another with similar, but internally-generated, intangibles does not. In some cases the disclosure is tantamount to valuing the company and is likely to expose directors to challenge where the margin between the carrying amount and the fair value is disclosed and differs from market estimates. In these circumstances the directors may be challenged on the grounds that they have allowed a false/uninformed market in the company's shares to occur, particularly where their estimates of fair values are different from those of the market. In addition, we believe that the costs of collecting the information and the audit costs if disclosures are required for each cash generating unit would not be justified.

(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?*

No. The G100 is concerned about the level of detail required and the intrusive nature of the matters to be disclosed. The G100 believes that although impairment is tested at the cash generating unit level disclosure would be more appropriate at the segment level. There is a presumption that management in identifying reportable segments takes account of the source and nature of the entity's risks and returns.

Group of 100 Comments

ED 3 Business Combinations

AASB SPECIFIC QUESTIONS

1. ***Scope***

The Exposure Draft proposes to include revalued assets within the scope of the revised IAS 36. (In contrast, ED 104 proposed that it would not apply to non-current assets measured at fair value in accordance with AASB 1041.)

Is the inclusion of revalued assets within the scope of the revised IAS 38 appropriate? If not, why not?

Yes. The AASB standard should reflect the requirements of the IASB standard.

2. ***Measurement of recoverable amount***

The Exposure Draft proposes that if, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss. (See proposed paragraph 52). The recoverable amount of an asset is defined as the higher of its net selling price and value in use (see proposed paragraph 5 and 15).

Is this appropriate? If not, how should recoverable amount be measured?

Yes. The AASB should adopt IAS 36 as amended.

3. ***Value in use calculation***

The Exposure Draft proposes that value in use calculations only include the future benefits of capital expenditure that has been incurred rather than committed to (as is the case for restructuring) (see proposed paragraphs 37 – 42).

Is this appropriate? In particular, should the value in use calculation of an asset that is voluntarily scaled down to undergo a multi-period capital expenditure program exclude the future net benefits of capital expenditure that the entity is committed to but yet to incur? If not, why not?

The G100 believes that ongoing maintenance and enhancement programs and expenditure on existing business should be distinguished from expansion activities such as new acquisitions. The future benefits of maintenance and enhancement programs should be taken into account.

4. ***Community service obligations***

The Exposure Draft proposes that, where there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual *asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (see proposed paragraph 59).*

Community service obligations are not specifically addressed in this Exposure Draft, but guidance is provided in the current AASB 1010/AAS 10 (paragraphs 5.3 and 5.3.2).
Does the concept of cash-generating units remove the need to explicitly provide guidance on calculating the recoverable amount of assets subject to community service obligations?

We believe that the guidance included in AASB 1010 and AAS 10 "Recoverable Amount of Non-Current Assets", paragraphs 5.3 - 5.3.2 should be included in the proposed standard.

5. Definition of a not-for-profit entity

A not-for-profit entity is currently defined within existing Australian pronouncements as follows:

"an entity whose financial objectives do not include the generation of profit".

The Exposure Draft proposes the following definition:
"A not-for-profit entity is an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls." (See IAS 36 AASB Material in Preface section 6.).

Is this definition appropriate? If not, how should a not-for-profit entity be defined?

No comment.

6. Assets of Not-for-Profit Entities that are Not Primarily Dependent on Net Cash Inflows

The Exposure Draft proposes that an asset's value in use, where a not-for-profit entity has an asset that is not primarily dependent on net cash inflows and whose future economic benefits the entity would replace if it were deprived of the asset, is the written-down current cost (depreciated replacement cost). (See Preface section 6 IAS 36 AASB Material.).

Is this appropriate? If not, how should the value in use of such an asset be measured?

No comment.

7. AASB transitional provisions

As discussed in the Preface section 2.2.2(b), the AASB has considered a number of approaches with regard to transitional provisions to be included within the Australian converged Standard on impairment of assets.

The AASB considers a modified retrospective application of the Australian converged Standard as at the beginning of the reporting period to which it is first applied to be the most appropriate approach. Where this gives rise to initial adjustments which would otherwise be recognised in net profit or loss/result, the net amount of those adjustments, including any adjustments to *deferred income tax balances, would be adjusted against retained profits (surplus) or accumulated losses (deficiencies) as at the beginning of the reporting period to which these proposals are first applied. (See Preface section 4.2.3).*

Are these transitional provisions appropriate? If not, why not?

Yes, provided that this does not lead to subsequent adjustments and restatements in accordance with the forthcoming IASB standard dealing with first-time application of IFRSs.

Group of 100 comments

Proposed Amendments to IAS 38 "Intangible Assets"

IASB SPECIFIC QUESTIONS

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).

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?

As stated in the G100's Statement of Principles the G100 believes that where an item satisfies the definition of an asset and recognition criteria it should be recognised as an asset (that is future economic benefits and a cost or value that can be measured reliably). We do not see any grounds for treating intangible assets any differently than tangible assets in this respect.

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, 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).

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.

No. We consider that other examples of intangibles where reliable measurement is unlikely to be satisfied as, for example, occurs in respect of customer lists and non-contractual customer relationships. The G100 believes that if the definition and recognition criteria are satisfied the entity should recognise an asset. We believe that this principle should be applied consistently to all assets. Accordingly, the principles should apply whether items are purchased or internally developed.

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?

The G100 supports these proposals.

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)?

The G100 supports these proposals.

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 for Conclusions).

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

The G100 supports these proposals.

Group of 100 comments

Proposed Amendments to IAS 38 "Intangible Assets"

AASB SPECIFIC QUESTIONS

1. Research expenditure

The Exposure Draft proposes that no intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred (see proposed paragraph 46). The Exposure Draft takes the view that, in the research phase of an internal project, the entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.

Is the proposed treatment of research expenditure appropriate? If not, why not?

While, in general, this may be the case an entity that can demonstrate the existence of future economic benefits should not be precluded from recognising an asset. On balance, the G100 believes that the AASB should harmonise with the IASB requirements.

2. Development expenditure

The Exposure Draft proposes recognition of an intangible asset arising from development (or from the development phase of an internal project) if the entity can demonstrate the following:

- *it is technically feasible to complete the intangible asset so that it will be available for use or sale;*
- *the entity intends to complete the intangible asset and use or sell it;*
- *the entity is able to use or sell the intangible asset;*
- *the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset or, if it is to be used internally, the usefulness of the intangible asset;*
- *adequate technical, financial and other resources are available to complete the development and to use or sell the intangible asset; and*
- *the expenditure attributable to the intangible asset during its development can be measured reliably (see proposed paragraph 49).*

Are the proposed requirements appropriate for determining whether an intangible asset arising from development should be recognised? If not, what criteria are appropriate, and why? (Note not-for-profit specific questions in section Preface5.2.2(b)(i.)

Yes, on the basis that these are the types of factors taken into account in determining the existence of future economic benefits.

3. ***Prohibition on the recognition of certain items as intangible assets.***
The Exposure Draft proposes that internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets (see proposed paragraph 55). The Exposure Draft takes the view that expenditure on these particular items cannot be distinguished from the cost of developing the business as a whole and therefore should not be recognised as intangible assets.
Is the proposed prohibition appropriate? If not, why not?

No. If the definition and recognition criteria for assets are met an asset should be recognised. In addition, it is incongruous for these items to be recognised only when purchased.

4. ***Revaluation of intangible assets***
The Exposure Draft proposes that an intangible asset can only be revalued where there is an active market for that asset (see proposed paragraph 70). The Exposure Draft comments that active markets (as defined in the Exposure Draft) cannot exist for brands, newspaper mastheads, music and film publishing rights, patents or trademarks, because each such asset is unique. Furthermore, it is uncommon for an active market to exist for any intangible asset.

Is the proposed restriction on the revaluation of intangible assets appropriate? If not, why not?

No. As stated in the G100 Statement of Principles, if the criteria for a revaluation are satisfied intangible assets should be able to be revalued. We do not believe that there are any grounds for applying requirements differentially to different types of non-current assets.

5. ***Development expenditure in a not-for-profit entity.***
The Exposure Draft proposes recognition of an intangible asset arising from development (or from the development phase of an internal project) if the entity can demonstrate that certain criteria are satisfied (see Preface 5.2.2(a)(ii) for list of criteria).

Are the proposed requirements suitable for determining whether an intangible asset arising from development should be recognised by not-for-profit entities? If not, what criteria would be appropriate, and why?

No comment.

6. ***AASB transitional provisions.***
Assuming the proposals within the IASB's ED 1 are incorporated into an Australian converged Standard, upon first-time application of Australian Standards converged with IFRSs, Australian entities would be required to derecognise, as at the beginning of the annual reporting period to which it is first applied, the following:

- *all intangible assets that are not permitted to be recognised by the proposed Australian converged Standard;*

- *Where an internally generated intangible asset is recognised at cost, the portion of the cost of the internally generated intangible asset that represents costs which are not permitted to be included in the cost of an internally generated intangible asset under the proposed Australian converged Standard; and*

- *all revaluations of intangible assets that are not permitted to be recognised by the proposed Australian converged Standard.*

Where this gives rise to initial adjustments which would otherwise be recognised in profit or loss/result, the net amount of those adjustments, including any adjustments to deferred tax balances, would be adjusted against retained profits (surplus) or accumulated losses (deficiencies) as at the beginning of the annual reporting period to which the proposed Australian converged Standard is first applied. In respect of revaluations of intangible assets that are not permitted to be recognised by the proposed Australian converged Standard, in the first instance, any initial adjustments would be made against the asset revaluation reserve to the extent, and only to the extent, that a credit balance exists in the asset revaluation reserve in respect of those assets. (See Preface section 4.3.3).

Is this appropriate, particularly in relation to previously revalued intangible assets carried at deemed cost? If not, why not?

The G100 supports these proposals. However, derecognition of assets which do not qualify under IASB Standards and/or write back of revalued amounts would have a significant impact on the reported net assets of some companies. These impacts are likely to be exacerbated where thin capitalisation rules for taxation purposes rely on amounts reported in financial reports.

In addition, we have serious concerns that quite significant changes to Australian requirements and practice in respect of accounting for internally generated identifiable intangible assets and the revaluation of identifiable intangibles assets are foreshadowed as part of this project while, at the same time, the IASB/AASB are undertaking a more comprehensive project on accounting for intangible assets. It is likely that the outcome of the IASB/AASB project will modify the existing requirements of IAS 38 in respect of internally generated identifiable intangible assets. It would be unsatisfactory both from the point of view of preparers and users of financial statements if entities were required to derecognise some assets and, in some cases, write back revaluations in respect of meeting the Year 2005 timetable and shortly thereafter be required to reinstate some of those assets.

The G100 believes that in view of these circumstances there is a strong case for providing some relief to those entities most likely to be impacted by these changes and potential changes. For example, the existing practices of these entities could be grandfathered pending the outcome of the IASB/AASB project.

OTHER ISSUES

- **IASB PROPOSALS**

1. **There is a presumption that purchased goodwill has an indefinite life. However, in some circumstances purchased goodwill may have a finite life. For example, in the extractive industries the useful life of purchased goodwill may be tied to the life of a mine. We suggest that there should be some acknowledgment in the proposals that in some limited circumstances goodwill has a finite life.**

2. **Further guidance on the assessment of goodwill where there is a minority interest in the acquiree would aid implementation, ie whether it is the parent entity share only or whether it is 100%.**

- **AASB PROPOSALS**

The interface of any new standard arising from these Eds and AASB 1038 'Life Insurance Benefits' raises some concerns. These concerns are amplified because the outcome of the IASB's project on insurance is uncertain.

ED 109 contemplates the treatment of intangibles other than goodwill that have not previously been recognised. However, it does not seem to contemplate goodwill that has not previously been recognised (e.g. if a local accounting standard, such as AASB 1038, required something other than goodwill to be recognised on acquisition but which is essentially akin to goodwill).

Issues that arise in this context are whether the new IASB and AASB standards on goodwill should establish requirements on the recognition of goodwill that has not previously been recognised, and if so, how the goodwill is to be calculated and the basis of measurement.