CL 113

28 March 2003

The Chairman
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear Sir David,

IASB ED 3 BUSINESS COMBINATIONS AND PROPOSED AMENDMENTS TO IAS 36 IMPAIRMENT OF ASSETS & IAS 38 INTANGIBLE ASSETS

The Malaysian Accounting Standards Board (MASB) is pleased to provide its comments on IASB Exposure Draft 3 Business Combinations and Proposed Amendments to IAS 36 Impairment of Assets & IAS 38 Intangible Assets, as set out in the accompanying pages.

The Board hopes that the IASB will find the comments useful in their deliberation to finalise the Standard.

We thank you for the opportunity to give our comments.

Yours sincerely,

Raja Arshad-Uda
Chairman

IASB ED 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?

The MASB has no objection to exclude from the scope of the Standard business combinations in which entities are brought together to form a joint venture and those involving entities under common control.

Whilst the MASB accepts the scope exclusions and notes that business combinations involving entities under common control will be dealt with in phase 2 of the project, the MASB suggests inclusion of the following provisions to deal with business combinations where entities or a group of entities undertake internal reorganisation or reconstruction exercises:

<u>Internal Group Reorganisations</u>

Internal group reorganisation includes any of the following arrangements:

(a) the transfer of a shareholding in a subsidiary from one group to another;

(b) the addition of a new parent to a group;

(c) the transfer of shares in one or more subsidiaries of a group to a new enterprise that is not a group enterprise but whose shareholders are the same as those of the group's parent; and

(d) the combination into a group of two or more enterprises that before the combination had the same shareholders.

Commercial reasons for a group to undertake internal reorganisation and reconstruction include economies of scale, efficiency in management and control of the group's activities, growth and expansion, tax planning, and forming of a new holding company for the purpose of gaining a listing on a stock exchange.

The majority of internal group reorganisations do not fall within the definition of a business combination. However, some of these reorganisations may be structured in such a manner that they do not change significantly the respective interests of the majority and the minority shareholders. The substance of such reorganisations is that there has been a continuity of the businesses insofar as the shareholders are concerned. Accordingly, the merger method is usually considered the most appropriate to account for such internal group reorganisations.

An internal group reorganisation should be accounted for under the merger method, even though there is no business combination meeting the definition of a merger, provided:

(a) the ultimate shareholders remain the same, and the rights of each such shareholder, relative to the others, are unchanged; and

(b) the minorities' share of net assets of the group is not altered by the transfer.

The substance of the merger method is that there has been no change in the shareholders' interests of the combining enterprises. Reorganisation within a group is basically an internal arrangement of enterprises in the group for whatever commercial reasons. If a reorganisation does not change the ultimate shareholders' interests, then in essence, there is no effect at the group level. Accordingly, the merger method should be used in such reorganisation to preserve the shareholders' interests so as to emphasise the continuity of the businesses in the group. However, any reorganisation which changes the interests of the ultimate shareholders, with a corresponding change in the minorities' interests, alters the group structure. In such circumstances, the merger method is not appropriate and accordingly, the acquisition method should be used.

(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. Since the scope exclusion will be addressed in Phase 2 of the project, the IASB may wish to consider that both Exposure Drafts (Phase 1 and Phase 2) on business combinations to have the same effective date to ensure that there would not be a gap in the interim period.

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?

Similar to our response to Question 1(a) above, the MASB believes that the pooling of interest method should be allowed in situations where, under rare circumstances, there could be no principal acquirer identified in a business combination. Our suggestion is as follows:

Apart from internal group reorganisations, the standard acknowledges that there could be rare circumstances where no principal acquirer can be identified in a business combination. In such a circumstance, a business combination may be accounted using the pooling of interest method.

The criteria for a business combination to be recognised as merger, are as follows:

Attributes of the combining enterprises:

(a) Prior to the combination, each of the combining enterprises must have been an autonomous and an independent business enterprise;

(b) The fair value of one enterprise is not significantly different from that of the other enterprise;

Manner of combining interests

(c) No party to the combination can be identified as the acquirer or as the acquiree, either by its own board or management or by that of the other party to the combination;

(d) All parties to the combination, as represented by the boards of directors or their appointees, participate equally in establishing the management structure for the combined enterprise and in selecting the management personnel, and such decisions are made on the basis of consensus between the parties to the combination rather than by virtue of exercise of voting rights;

(e) The combination is effected in a single transaction or completed within one year after its initiation and there are no further conditional provisions;

(f) The substantial majority, if not all, of the voting equity shares of the combining enterprises are exchanged or pooled;

(g) The shareholders of each enterprise maintain substantially the same voting rights and interest in the combined enterprise, relative to each other, after the combination as before and the voting rights are immediately exercisable;

Absence of planned transactions

(h) There have been no separate deals or plans by any of the combining enterprises to change the composition of the shareholdings or the voting or distribution rights, or to dispose of major assets within a period of two years after the date of the combination.

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?

Yes, the proposal is consistent with the control concept in IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries.

Notwithstanding the above, we wish to point out a practical issue arising from the above proposal. This issue arises in situation where an accounting standard requires entities to present separately both parent financial statements and consolidated financial statements. If the above proposal is put into place, the outcome would be that the parent financial statements would show an amount of share capital which is different from the amount of share capital of the consolidated financial statement.

In other word, although the equity structure reported in the consolidated financial statements (i.e. the number and type of equity instruments issued) is the same as that of the parent's financial statements, the amount of the share capital of the parent financial statements would be different from that reported in the consolidated financial statements.

This is because Paragraph B7(c) of Appendix B prescribes that the amount recognised as issued equity instruments in the consolidated financial statements shall be the total of the issued equity of the legal subsidiary before the business combinations and the cost of the combination, which is deemed to have been incurred by the legal subsidiary in the form of the equity instruments issued to the owners of the legal parent. However, the equity structure appearing in those consolidated financial statements (i.e. the number and type of equity instruments issued) shall reflect the equity

structure of the legal parent, including the equity instruments issued by the legal parent to effect the combination.

(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, the additional guidance provided is appropriate. However, the MASB wishes to suggest that the guidance be expanded to include both the presentation of parent separate financial statements and consolidated financial statements as well as other elements, such as the share premium reserves.

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?

See Response to Question 1 above.

Question 5 – Provisions for terminating or reducing the activities of the acquiree

Under IAS 22, an acquirer must recognise as part of allocating the cost of a business combination a provision for terminating or reducing the activities of the acquiree (a 'restructuring provision') that was not a liability of the acquiree at the acquisition date, provided the acquirer has satisfied specified criteria.

The Exposure Draft proposes that an acquirer should recognise a restructuring provision as part of allocating the cost of a business combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (see proposed paragraph 40 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?

Yes.

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?

While the MASB acknowledges that in theory, the proposal to require the acquirer to recognise the acquiree's contingent liabilities as part of the cost allocation of a business combination is appropriate and sound, it is very difficult to measure such contingent liabilities in practice, unless more guidance is provided.

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 acquiree, and why?

Yes.

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?

Yes, the MASB agrees that goodwill acquired in a business combination should be recognised as an asset.

However, the MASB believes that the issues raised by the alternative views of 2 board members, as indicated in Appendix D, should be given due consideration. There is shortcoming in the impairment approach to goodwill, in particular, due to the inability to eliminate internally generated goodwill accruing after a business combination from the measure of goodwill's implied value. This shortcoming would provide a "cushion" against the recognition of impairment losses of purchased goodwill by the "indirect" recognition of internally generated goodwill. In this case, it will be inconsistent with IAS 38, Intangible Assets that prohibits recognition of internally generated goodwill.

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?

Yes.

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-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?

(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.

ED of Proposed Amendments to IAS 36, Impairment of Assets

Question 1 Frequency of impairment tests

Are the proposals relating to the frequency of impairment testing intangible assets with indefinite useful lives and acquired goodwill appropriate (see proposed paragraphs 8 and 8A 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 MASB has no objection to the proposal.

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?

Yes.

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?

The MASB has no objection to the proposal.

(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?

Yes, the assumptions should take into account both past actual cash flows and management's past ability to forecast cash flows accurately.

(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?

Yes.

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?

Yes, the MASB agrees with the proposal.

(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?

Yes.

(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?

Yes.

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?

See Response to Question 8 to ED 3, Business Combinations.

(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, the MASB agrees with the proposal.

(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?

See Response to Question (a) above.

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?

Yes, the MASB agrees 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?

The MASB has no objection to the proposal.

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

The MASB has no objection to the proposal.

ED of Proposed Amendments to IAS 38, Intangible Assets

Question 1 – Identifiability

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

Yes, the separability and contractual / other legal rights criteria are appropriate for determining whether an asset meets the identifiability criterion.

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*, 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.

Yes, the MASB agrees that with the exception of an assembled workforce, sufficient information can reasonably be expected to exist to measure reliability the fair value of an intangible asset acquired in a business combination.

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?

Yes, the MASB has no objection to the proposal.

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)?

Yes, the MASB has no objection to the proposal.

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 for Conclusions).

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

Yes.