Investment Management Association
ima

2 April 2003

Ms A Kimmitt
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Dear Ms Kimmitt

Exposure Draft 3, Business Combinations and consequential proposals to revise IAS 36, Impairment of Assets, and IAS 38, Intangible Assets.

The IMA is the trade body representing the UK asset management industry. IMA Members include independent fund managers, the asset management arms of banks, life insurers and investment banks, and occupational pension scheme managers. They are responsible for the management of over £2 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK authorised investment funds.

In managing assets for both retail and institutional investors, IMA Members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the requirements governing how such companies prepare their accounts and the information disclosed to our Members as users.

On the project overall we welcome the fact that it will be split into two phases and that issues relating to fresh starts, joint ventures and entities under common control will be covered in Phase II This is a pragmatic approach to limit initially the project's scale.

The proposals in ED 3 on Business Combinations eliminate the pooling method of acquisition accounting leaving simply the purchase method. We consider that, in the interests of consistency, this is long overdue and only in exceptional circumstances it would not be possible to identify the acquirer. A choice of accounting methods for business combinations results in some combinations having very different figures both at the date of the acquisition and for many years thereafter.

However, we have reservations about certain of the proposals and these are reflected in our answers to the attached questions. In summary, ED 3 proposes that goodwill arising on a business combination should be recognised as an asset and not amortised but tested annually for impairment.

65 Kingsway London WC2B 6TD
Tel: +44 (0)20 7831 0898 Fax: +44 (0)20 7831 9975
www.investmentuk.org

The main objection to amortisation is that the period over which goodwill is amortised is arbitrary. However if amortisation is banned, acquirers will not be able to use the simplest and cheapest way of accounting for goodwill, which will not help small companies. Impairment requires a "robust yet practical" test. We are concerned about the robustness of the proposed test and the conditions that trigger Ft. In addition, the test is complex.

The ASB's concerns about the IASB's proposals are well known in that it believes the test is less robust than that in the UK's FRS11. We agree with the ASB and consider its concerns should be addressed (especially those about the cash flow tests).

We also consider it strange that in the future negative goodwill would be treated as an immediate profit. If markets work, we do not believe there are bargain purchases and instant profits. If positive goodwill (when the price paid exceeds the fair value of the assets) is an asset why is negative goodwill not a liability? Alternatively if negative goodwill is a credit to equity why is "positive" goodwill not a debit to equity? This goes to the heart of the debate about the nature of goodwill.

As regards the proposed IAS 38, we are concerned about the boundary between goodwill and other intangibles and that different requirements would apply to each. We are also concerned that impairment testing in IAS 36 would be over-complex and potentially not rigorous; and that the new approach may not necessarily provide better financial reporting than the simpler amortisation-with possible- rebuttal regime.

Please do contact me if you require any clarification of the points in this letter or the attached or if you would like to discuss any issues further.

Yours sincerely

Liz Murrall
Senior Adviser – Regulation

Cc Mary Keegan, Chairman, Accounting Standards Board

THE IMA'S ANSWERS TO THE QUESTIONS IN EXPOSURE DRAFT 3, BUSINESS COMBINATIONS AND THE CONSEQUENTIAL PROPOSALS TO REVISE IAS 36, IMPAIRMENT OF ASSETS, AND IAS 38, INTANGIBLE ASSETS.

Business Combinations

IASB question 1. Should the standard exclude 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. Are these scope exclusions appropriate? If not why not?

We agree that these types of combinations should be excluded from the scope of the new requirements on the basis that the transaction has no economic substance to the ultimate shareholders. However, there needs to be guidance on how to account for a group reconstruction at intermediate levels.

Would it be helpful to include a definition of business combinations involving entities under common control and additional guidance on identifying such transactions? If not, what additional guidance would you suggest and why?

We agree that, in the interests of ensuring accounts are comparable, definitions and guidance on business combinations involving entities under common control would be helpful, particularly if these are to be excluded from the scope of the new standard.

IASB question 2. Do you agree that it is appropriate to eliminate the pooling of interests method and require all business combinations within its scope to be accounted for by applying the purchase method? If not why not?

We consider that in the interests of consistency the elimination of the pooling method of accounting is long overdue. A choice of accounting methods for business combinations results in some combinations having very different figures both at the date of the acquisition and for many years thereafter.

If 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?

This question is outside the IMA's remit.

IASB question 3. Is this an appropriate description of the circumstances in which a business combination could be regarded as a reverse takeover. If not under what circumstances, if any, should a business combination be accounted for as a reverse acquisition.

We agree with this description and consider that the substance of the transaction should be considered as opposed to its legal form. That having been said, we have some sympathy with the arguments raised in paragraph BC41 in that although the legal parent has acquired a subsidiary, preparing accounts as if the subsidiary acquired the parent could be difficult for users to understand and may provide less relevant information than if the legal parent was treated as the acquirer. (Moreover, the Draft Illustrative Example on page 9 on Reverse Acquisitions appears unrealistic and raises questions in that Co B has a market value of 2400 (60X40) but is accepting an offer that values its shares at only 1800 (30X60 i.e. 2.5 shares in A at 12 for each B or 150 shares in A).

Is the additional guidance in paragraphs B.t-B14 appropriate? If not why not? Should additional guidance be included? If so, what specific guidance should be added?

This question is outside the IMA’s remit

IASB question 4. Do you consider it appropriate 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? If not why not?

We do not agree with this. In our experience the identity of the acquirer is generally apparent. However, in the exceptional circumstances when it is not, we consider fresh start accounting should be adopted.

IASB question 5. Do you consider it appropriate that an acquirer should recognise a restructuring provision as part of allocating the cost of a business combination only when the acquiree has an existing liability for restructuring?

This question is outside the IMA's remit.

IASB question 6. Do you consider it appropriate 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 fair values can be measured reliably?

We agree with this and consider that negative goodwill can often arise from a failure to reflect adequately contingent liabilities.

IASB question 7. Do you consider it appropriate that the acquiree's identifiable assets, flab/I/ties and contingent liabilities should be measured at their fair values at the acquisition date so that minority interests in the acquiree will be stated at the minority’s proportion of the net fair values of those items?

This question is outside the IMA’s remit.

IASB question 8. Do you agree that goodwill acquired in a business combination should be recognised as an asset? If not, how should it be accounted for/nit/ally 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?*

We agree that goodwill acquired in a business combination should be recognised as an asset. That having been said, we consider it strange that in the future negative goodwill would be treated as an immediate profit. If markets work, we do not believe that there are bargain purchases and instant profit. If goodwill (when the price paid exceeds the fair value of the assets) is an asset why is negative goodwill not a liability? Alternatively if negative goodwill is a credit to equity why is not "positive" goodwill a debit to equity? This again goes to the heart of the debate about the nature of goodwill.

The main objection to impairment is that it requires a "robust yet practical" test. We are concerned about the robustness of the proposed test and the conditions that trigger it. In addition, the proposed basis for impairment is complex. The ASB's concerns about what is proposed are well known in that it believes the test is less robust than that in the UK's FRS11. We agree with the ASB and consider its concerns should be addressed (especially the cash flow tests).

IASB question 9. Do you consider it appropriate that when an acquirer's interest in the fair value of the acquiree's assets, liabilities and contingent liabilities exceeds cost, the identification of and measurement of the identifiable assets, liabilities and contingent liabilities and cost should be reassessed and recognised immediately in the profit and loss after reassessment? If not, how should any excess be accounted for?

This question is outside the IMA's remit.

IASB question 10. If/nit/ally provisional values are used when business combinations are accounted for, do you think that any adjustment to those provisional values could be made within 12 months of the acquisition date? If not what period would be sufficient and why? Do you consider it appropriate that adjustment to the initial accounting for a business combination should be recognised only to correct an error? If not, under what other circumstances should the initial accounting be amended?

This question is outside the IMA's remit

Impairment testing and amendments to IAS 36

IASB question 1. Are the proposals relating to the frequency of impairment testing intangible assets and acquired goodwill appropriate? If not, how often should such assets be tested for impairment and why?

We consider that if impairment testing is to be adopted then it should be done at regular intervals and that annually, when the accounts are prepared, would seem a suitable interval.

IASB question 2. Is it appropriate that the recoverable amount of an intangible asset with an indefinite useful life should be measured and impairment losses for such assets accounted for in accordance with the requirements in IAS 36 for assets other *than goodwill? If not, how should the recoverable amount be measured and impairment losses be accounted for?*

We agree that it is appropriate that the recoverable amount of an intangible asset with an indefinite useful life should be measured and impairment losses for such assets accounted for in accordance with the requirements in IAS 36 for assets other than goodwill.

IASB question 3. Is the additional guidance on measuring the value in use of an asset valuable?

We believe that in the interest of ensuring accounts are comparable, this guidance is helpful.

IASB question 4. This question relates to acquired goodwill and whether it should be allocated to one or more cash generating units for the purposes of impairment testing.

This question is outside the IMA's remit.

IASB question 5. This question relates to the appropriateness of the method of calculating impairment losses.

We are concerned that the impairment testing in IAS 36 would be over-complex and potentially not rigorous; and that the new approach may not necessarily provide better financial reporting than the simpler amortisation-with possible- rebuttal regime.

IASB question 6. This quest/on relates to the appropriateness of prohibiting reversing impairment losses for goodwill.

This question is outside the IMA’s remit.

IASB question 7. This question relates to various disclosure requirements in paragraph 134 and C69 to 82.

We agree that, in the interests of ensuring accounts are comparable, these disclosures should be given.

Intangible assets and amendments to IAS 38

IASB question 1. Are the separability and contractual/other legal rights criteria appropriate for determining whether an asset meets the identifiability criteria? If not, what criteria are appropriate and why?

This question is outside the IMA’s remit.

IASB question 2. 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?

This question is outside the IMA's remit.

IASB question 3. Is this appropriate? If not, under what circumstances, if any, should an intangible assets be regarded as having and indefinite useful fife?

Although we agree that twenty years is an arbitrary measure, we consider that a default period of some kind is needed.

IASB question 4. Is this an appropriate basis for determining the useful life of an intangible asset conveyed for a limited term that can be renewed? If not, under what circumstances should the useful life include the renewal period?

This question is outside the IMA's remit.

IASB question 5. Is it appropriate that an intangible asset with an indefinite useful fife should not be amortised? If not, how should such assets be accounted for after their initial recognition?

We are concerned about the boundary between goodwill and other intangibles and that different requirements would apply depending on which they were.