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OLD MUTUAL | plc

Exposure draft 3 - Business Combinations and the proposed amendments to IAS 36 and 38 (together, The Exposure Drafts)

Old Mutual response

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1. Overall comments

1.1 *Introduction*

We generally welcome the convergence with other international standards that many of the changes contained in the Exposure Drafts will bring about. It should increase comparability of financial statements across countries and should help to level the playing field internationally. We consider most of the changes contained in the Exposure Drafts to be very useful to both users and preparers of financial statements.

However, we do have significant concerns with a couple of the proposed amendments to IAS 36 related to impairment, specifically the disclosure requirements and the requirement to allocate goodwill to the lowest level of cash Generating Unit. We have summarised our concerns below, followed with our responses to a limited number of specific questions in the Exposure Drafts on which you have sought feedback.

1.2 *Allocating goodwill to cash generating units*

The requirement to allocate goodwill to the lowest cash-generating unit will create an undue burden on our financial reporting. We are an international financial services group with many retail banking branches and insurance portfolios. We have made a number of acquisitions and have recorded a significant amount of goodwill related to those acquisitions. As part of managing our operations, we monitor the return on assets for many operating units, including our retail branches.

The requirements to allocate goodwill (and then test for impairment) at the lowest CGU level, appears to require an additional level of financial reporting. We understand that paragraphs 73 and 74 of The Proposed Amendments to IAS 36 would (except when certain conditions are met) require us to allocate goodwill to many of our retail branches. This exercise will be very time-consuming and could require us to allocate goodwill to hundreds of our retail banking branches and many of our insurance product portfolios. This is in addition to the fair value exercise that will be required to arrive at the implied value of goodwill for each of these operating units. This will require a massive effort on our part upon initial application of IAS and will produce significant extra reporting requirements each year.

We believe that the costs imposed by such requirements cannot outweigh the benefits that are intended by the Proposed Amendments to IAS 36.

We believe that a better approach for testing impairment of goodwill would be at the segment level. The segment reporting level is one with which users of financial statements are already familiar and it is also a level that would encourage consistency of application among preparers of financial information. Using the segment level for allocation of goodwill would alleviate our concerns and still provide meaningful information to users of financial statements on bow well an acquisition has performed compared to its cost.

We note that the U.S. FASB had originally proposed allocating goodwill to the lowest level of reporting unit (similar to a CGU) in its Exposure Draft of FASU 142 in 2001. Based on the feedback received, the FASB abandoned this level in favour of a level at, or one level below the segment level. Respondents pointed out that the original requirement to allocate goodwill to the lowest level of reporting would potentially create hundreds or even thousands of reporting units. This would have made the impairment testing unnecessarily cumbersome and it is doubtful whether the information presented in the financial statements would have been understandable or relevant to users.

We are unclear why the IASB is proposing a different approach to that recently adopted under US GAAP as we endorse convergence with US GAAP in this respect.

1.3 ***Disclosure of estimates used to measure the recoverable amount of CGUs***

We also have concerns relating to the proposed disclosure requirements. In particular, we believe the requirements in paragraphs 134 to 137 of the proposed amendments to IAS 36 to disclose estimates used in calculating the implied value of goodwill are unduly onerous.

While we welcome the requirement to disclose key assumptions, the proposed disclosure requirements are very detailed and require a level of disclosure not required by other IAS Standards. This may result in undue prominence being accorded to any impairment of goodwill.

For example, while the proposed amendments to IAS 36 and IAS 32 both seek to disclose information on fair value, IAS 32 does not require similar information about "the long end of the curve". We believe that this level of detail is inconsistent and that the Board should consider a similar approach to the proposed amendments to IAS 32 for requiring fair value disclosures of CGUs.

We are concerned that because of the detailed disclosure requirements, entities will default to using "low growth assumptions" to avoid the disclosure requirements in the ED. This could also have the unintended effect of attributing lower values to CGUs, which could result in unrealistically large impairment charges on initial application of this standard.

1.4 ***Summary***

To summarise our concerns about the proposed amendments to IAS 36, we believe that:

- Allocation of goodwill should be done at the segment level, not at the lowest level of CGU as proposed;
- Consistent with the above, the disclosure requirements of estimates used in calculating the values of CGUs should be made at the segment level; and
- The proposed disclosures of estimates used in calculating values of CGUs are considerably more detailed and are thus inconsistent than other Standards dealing with fair value.

[1] By "long end of the curve" we mean: that period that follows an initial few years, when assumptions become necessarily more subjective and a particular valuation becomes far more sensitive to changes in assumptions.

2 Responses to specific questions

2.1 ***ED 3 Question 2—Method of accounting for business combinations***

We fully support the elimination of the pooling of interests method and the requirement to use the purchase method for all business combinations. This should result in more comparable financial statements between different entities.

2.2 ***ED 3 Question 5—Restructuring provisions***

We do not agree with the proposal. We agree with the existing criteria in IAS 22 that permits entities to record restructuring provisions when certain conditions are met.

2.3 ***ED 3 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***

We believe that the proposed treatment is appropriate, as we do not believe that negative goodwill should be recognised in the balance sheet. However, we believe that the requirement of Question 9 (a) amounts to an instruction to revisit the fair value calculations and to come back with the "right" answer and as such is unnecessary.

2.4 ***IAS 36 Question 1 – Frequency of impairment tests***

Our initial response is that the impairment frequency is high given the complexity of the calculation. However, the Exposure Draft introduces in paragraph 96 the concept that detailed calculations may be carried forward from period to period subject to certain restrictions. We view this accommodation as very important and necessary.

2.5 ***IAS 36 Question 4(a) – Allocating goodwill to cash-generating units***

As set out in Section 1 of this letter, we do not agree with the proposed approach to use the "*lowest level at which management monitors the return on the investment in that goodwill*" to allocate goodwill to CGUs.

2.6 ***IAS 36 Question 6—Reversals of impairment losses for goodwill***

We do not agree with the proposal. We believe that any impairment loss on goodwill represents an estimate and, consistent with other Standards, estimates are continuously evaluated for their reasonableness against expectations. Revisions to estimates are generally accounted for prospectively through the income statement. We believe that changes to estimates related to goodwill impairment charges should be permitted to be reversed consistent with the above principles.

2.7 ***IAS 36 Question 7— Estimates used to measure recoverable amounts of cash generating units containing goodwill or intangible assets with indefinite useful lives***

As stated in Section 1 of this letter, while we support disclosure of key assumptions and their sensitivities, we do not agree with the level of disclosure proposed in paragraphs 134-13 7. We believe the requirements to be inconsistent with other Standards and very onerous. We propose simplifying the requirements and applying them at the segment level only.