April 4, 2003

Ms. Annette Kimmitt
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Ms. Kimmitt:

The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants is pleased to offer comments on the IASB's December 2002 exposure drafts of the proposed International Financial Reporting Standards, *ED 3 Business Combinations* (ED) and *Proposed Amendments to IAS 36 Impairment of Assets* (IAS 36) *and IAS 38 Intangible Assets* (IAS 38).

AcSEC supports the issuance of the proposed standard on business combinations and the proposed amendments to IAS 36 and IAS 38.

Although AcSEC supports international convergence among standard setters, AcSEC's comments are based on achieving high quality standards. We believe convergence is secondary to the quality of the accounting standards. In that regard, we recognize that certain of AcSEC's major comments do not support convergence. However, if there is agreement on the fundamental principles among various standard setters, we support building on the existing work of other standard setters.

Additionally, AcSEC observes that the ED proposes guidance on several issues, including restructuring costs, contingent liabilities, and certain consolidation procedures, that will be deliberated in the IASB and FASB joint project Business Combinations, *Application of the Purchase Method* (joint project). Although we commend the efforts of the standard setters to address certain of the purchase procedures issues, we are not in favor of altering current standards when some of the same issues are currently being addressed in another forum. Therefore we suggest that those issues would be best addressed as part of the joint project. With the above as background, we offer the following major comments:

- AcSEC believes the definition of a business combination should more clearly articulate what constitutes a business for which business combination accounting is appropriate. Additionally, the standards should articulate that goodwill should not be recognized in transactions that do not qualify for business combination accounting.

- AcSEC believes that acquired goodwill is an asset that results from the allocation of the purchase price and declines in value over time. Accordingly, we believe that the accounting and reporting should recognize that diminution in value through amortization.

- AcSEC does not believe that gain recognition is appropriate for the excess of fair value of acquired net assets over its cost ("negative goodwill"). Although it is difficult to characterize the nature of negative goodwill, we do not believe that a negotiated transaction for a business is an income-producing event.

- AcSEC believes that all intangible assets should be amortized, similar to our view of goodwill amortization.

- If the IASB continues to support a nonamortization model for goodwill, AcSEC believes that goodwill should be tested at a level that provides consistency among entities. We have concerns that the testing the goodwill at the lowest level at which management monitors the return on the investment may lead to variability in practice.

The attachment to this letter contains a more comprehensive response to the IASB's specific questions. Representatives of AcSEC would be pleased to discuss our comments with the Board or its representatives.

Sincerely,

Mark V. Sever, Chair Accounting Standards Executive Committee	Jan Hauser, Chair Business Combinations Task Force

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?

(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?

AcSEC agrees with the IASB's proposal to exclude from the scope of any final standard those 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. AcSEC supports the IASB's goal of addressing those transactions in the joint project.

Additionally, AcSEC believes that the definition of business combinations involving entities under common control and the additional guidance provided on identifying such transactions are helpful.

The ED defines a business combination as "the bringing together of separate entities or operations of entities into one reporting entity." That definition would appear to encompass certain kinds of transactions that have not typically been regarded as business combinations, such as the acquisition of a nonoperating entity or the acquisition of an entity that may have some productive assets, but that does not represent or constitute a business. Additionally, that definition differs from the one contained in FASB Statement No. 141, *Business Combinations*. We believe defining what constitutes or qualifies as a business combination is an important issue, because goodwill is not recognized other than in a business combination. Accordingly, we recommend that the proposed standard more clearly define the term business combination and require that the acquired entity qualify as a *business* before business combination accounting is applied.

Our experience in applying the guidance of EITF Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,* as provided by FASB Statement No. 141, has raised a number of implementation issues, particularly as it relates to development stage enterprises, acquisitions of product lines, acquisitions of various subsets of businesses, and so forth. EITF Issue No. 98-3 was not designed to address the scope of business combination accounting and therefore was not evaluated in that light when debated by the Emerging Issues Task Force. Although it has been helpful in evaluating whether a collection of assets should be viewed as a business, its guidance creates a presumption that a development stage enterprise is not eligible for business combination accounting, a conclusion that some have questioned. Thus, we believe that the IASB should take this opportunity to examine this issue further. At a minimum, the proposed standard should state that business combination accounting is applicable only when a business is acquired, thereby making it clear that goodwill would not result from the purchase of a nonoperating entity or the purchase of certain productive assets that do not constitute a business.

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?

AcSEC agrees with the ED's proposal to eliminate the pooling of interests method of accounting for business combinations. Additionally, we agree that business combinations should be accounted for under the purchase method.

Our experience with FASB Statement No. 141 has been that we generally are able to make a reasonable determination of the accounting acquirer in a two-party transaction or select the dominant or largest participant in a multi-entity transaction. However, we also believe that the IASB should consider how purchase accounting should be applied in a multi-entity transaction when it addresses new basis issues in a future project.

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?

(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?

AcSEC agrees with the description of the circumstances in which a business combination should be regarded as a reverse acquisition and the additional guidance on accounting for reverse acquisitions. However, AcSEC believes that the reverse acquisition example provided in paragraph 21 of the ED is not a business combination. AcSEC suggests that the proposed standard should instead use an example of a reverse acquisition that involves a business combination of two operating companies. Additionally, as a general comment we believe that examples should not be included in the body of the standard. Rather, the examples should be included in the appendices.

Additionally, AcSEC agrees with the example of a reverse acquisition included in pages 9–13 of the ED's illustrative examples and believes that such guidance is appropriate and sufficient.

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?

AcSEC agrees with the guidance proposed in paragraph 22 of the ED. It is consistent with FASB Statement No. 141 and recognizes the substance of the transaction.

We note, however, that the criteria in the ED for determining the accounting acquirer differ from those set forth in FASB Statement No. 141. The ED contains a presumption that the combining entity with the greater portion of the voting rights should be deemed the accounting acquirer, unless it can be demonstrated that such ownership does not determine control. FASB Statement No. 141 indicates that a number of factors should be considered and that all pertinent facts surrounding the transaction must be evaluated in determining the accounting acquirer. It has also been our experience with FASB Statement No. 141 that the guidance is operational and generally has recognized the substance of the arrangement. An example might include the combination of two entities in which one entity, with a widely-held shareholder group, obtains 51% of the voting shares of the combined enterprise while another entity, with very concentrated ownership or a single shareholder, obtains 49% of the voting shares of the combined enterprise. Under the ED, although it is not clear, it would appear that the entity with the 51% shareholder group would be the presumed acquirer. However, in this situation it may be likely that the entity with the 49% shareholder has greater control in the combined enterprise even though the 49% shareholder does not have the majority of the voting rights.

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?

As indicated in our cover letter, AcSEC suggests that this issue would be best if addressed in the IASB and FASB joint project. If the IASB continues to address this issue in the proposed ED, AcSEC believes that, if certain circumstances and criteria are met, an acquirer should be able to recognize as part of allocating the cost of a business combination the cost resulting from a plan to exit (restructuring provision), even if that was not a liability of the acquiree. The criteria would be similar to those set forth in EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Business Combination,* except that AcSEC believes that the period of time allowed for a business to develop an exit plan should be significantly reduced. AcSEC believes that a timeframe similar to that allowed under FASB Statement No.144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, for newly acquired assets that will be sold would be reasonable. Paragraph 32 of FASB Statement No. 144 indicates that newly acquired assets that will be sold may be classified as held-for-sale at the acquisition if the criteria for held-for-sale are probable of being met within a short period following the acquisition (usually within three months).

AcSEC is also concerned with the guidance set forth in paragraph 41 of the ED that allows the recognition of a liability for contractual payments once the business combination becomes *probable*.

We believe the word *probable* could introduce opportunities for creating liabilities in purchase accounting that were not pre-existing obligations of the target. That is, we are concerned about the ability to formulate contingent contractual obligations in anticipation of the business combination. Although we do not believe this is the kind of obligation the IASB intended to address, we believe recognition of such contingent future obligations should be explicitly prohibited. Liabilities result from past transactions or events, not from probable future transactions or events. Thus, we believe that the probability of a business combination should not be a triggering event for the recording of a liability on a target's books. AcSEC suggests that the proposed guidance be modified to eliminate the word *probable* and require liability recognition at the acquisition date for those circumstances described previously.

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?

AcSEC suggests that this issue would be best addressed as part of the of the IASB and FASB joint project.

However, AcSEC believes that contingent liabilities should be recognized when the occurrence of an event or future events is within a likelihood level well above 50 percent and if the amount of the contingent liability can be reasonably estimated. Therefore, AcSEC believes that contingent liabilities, as defined in IFRS No. 37, *Provisions, Contingent Liabilities and Contingent Assets*, should not be recognized as part of allocating the cost of a business combination, even if the contingent liabilities can be measured reliably.

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?

As indicated in our cover letter, AcSEC suggests that the IASB should reconsider whether the incremental benefit of adopting these new procedures at the present time is advisable particularly given that the issue is currently being addressed by the IASB and FASB joint project.

AcSEC generally agrees that measuring the acquiree's identifiable assets, liabilities and contingent liabilities at their fair values at the acquisition date may provide more meaningful information regarding the value of the net assets of the acquired entity. However, AcSEC believes that it is necessary to address the implications of such an approach on the consolidated enterprise if there are subsequent increases or decreases in the parent's interest. AcSEC does not believe that such increases or decreases in ownership are capital transactions. We believe that any increases in ownership interest should be accounted for as an additional purchase and decreases as a disposition, with the potential for gain or loss recognition. The disposition of subsidiary shares by a parent generally represents the culmination of the earnings process; therefore, the result should be recognized in income.

The ED also proposes recognizing only the acquirer's portion of the computed goodwill in the transaction. Under this approach, goodwill is measured as the difference between the consideration paid and the acquirer's proportionate interest in the fair value of the acquired entity's identifiable assets, liabilities, and contingent liabilities—goodwill is not recognized for the noncontrolling interest. That methodology is consistent with the allowed alternative under IAS 22, *Business Combinations*, it conflicts with the current direction of the joint project on Purchase Method Procedures. The joint project currently is recommending the use of the full goodwill method, which recognizes all of the goodwill of the acquired entity, not just the acquirer's portion at the date control is obtained. Further, AcSEC believes that the issues surrounding the consolidation procedures that may result from this approach should be more fully articulated in order to allow commentators to focus on the related consolidation issues.

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?

AcSEC believes that goodwill is an asset that results from the allocation of the purchase price and declines in value over time. The majority of AcSEC members believe that the accounting and financial reporting should recognize that diminution in value through amortization. Those AcSEC members believe that if an entity is able to maintain the value of acquired goodwill, it is because the acquired goodwill is being replenished by internally generated goodwill or by unrecognized intangible assets. We acknowledge that a systematic method of amortizing goodwill may not be entirely representative of the actual decline in the economic value of acquired goodwill, but we consider the result to be an appropriate balance between conceptual soundness and operationality at an acceptable cost. Further, amortization reduces the stress in subsequent years of impairment measurements, especially in years well after the acquisition date when the acquired goodwill has lost its original value without internal replenishment. However, other AcSEC members believe that goodwill should not be amortized. Rather, they believe goodwill should be tested for impairment on an annual or more frequent basis if certain impairment indicators are present. Although those members acknowledge that acquired goodwill does diminish in value over time, they believe that the best measure of that diminution in value is through an impairment model that is operational rather than an amortization model. The minority members would acknowledge, however, that it is still too early to tell whether the model developed under FASB Statement No. 142 is robust enough to address the issues that stem from impairment testing. They believe this model, in theory, is appropriate.

AcSEC notes that its majority view is consistent with that expressed in our March 2001 comment letter to the FASB on the ED for FASB Statements No. 141 and 142 and that it is a view the FASB rejected; therefore, our position would not contribute to international convergence. Conceptually, however, AcSEC has concerns about a model that effectively allows the capitalization of a certain portion of internally generated goodwill or other unrecognized intangible assets.

Question 9 – Excess over the cost of a business combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities

In some business combinations, the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of the combination exceeds that cost. The Exposure Draft proposes that when such an excess exists, the acquirer should:

(a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and

(b) recognise immediately in profit or loss any excess remaining after that reassessment.

(See proposed paragraphs 55 and 56 and paragraphs BC109-BC120 of the Basis for Conclusions.)

Is this treatment appropriate? If not, how should any such excess be accounted for, and why?

AcSEC does not support gain recognition at the date of acquisition for the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities, and contingent liabilities (net assets) over its cost. AcSEC believes that a negotiated transaction for a business is not an income-producing event. Rather, such excesses generally result from an acquiring entity's inability to determine the fair value of the acquired assets and the liabilities assumed, as well as from the existence of uncertainties or other detrimental factors at the acquiree that do not meet the criteria for recognition. Therefore, the majority of AcSEC believes that after reassessing the identification and measurement of the acquiree's identifiable assets and liabilities and the measurement of the cost of the combination, the excess should be allocated as a pro rata reduction of the amounts that otherwise would have been assigned to all of the acquired assets except (a) financial assets other than investments accounted for by the equity method, (b) assets to be disposed of by sale, (c) deferred tax assets, (d) prepaid assets relating to pension or other postretirement benefit plans, and (e) any other current assets. The remaining excess, if any, should be accounted for as a deferred credit and amortized. The buyer should amortize the excess over a period based upon the expected term of those factors that gave rise to the deferred credit. However, some AcSEC members believe that the fair value of the acquiree's identifiable assets and liabilities (net assets) over its cost (the excess) should not be allocated as a reduction to the acquiree's assets. Rather the entire excess should be accounted for as a deferred credit and amortized.

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?

AcSEC agrees that, if the cost of a business combination can be determined only provisionally by the end of the reporting period in which the combination occurs, the business combination should be accounted for using those provisional values. We also agree that any adjustment to those values as a result of completing the initial accounting should be recognized within twelve months of the acquisition date. However, AcSEC suggests that the proposed guidance in paragraphs 62 and 63 of the ED be enhanced to provide guidance on situations in which adjustments should be made to the initial values versus those situations in which adjustments are more appropriately recognized as a charge or credit to income. We believe recognizing such adjustments to income is appropriate when the changes in value result from events or circumstances arising subsequent to the acquisition date. The twelve month period to complete the initial accounting should be characterized as the time available to obtain information on the fair values of assets and liabilities acquired. The twelve month period is not an open invitation to have events subsequent to the acquisition date influence fair values determined at the acquisition date. The effect of changes in fair value of amounts subsequent to the acquisition date should not be embedded in the purchase price allocation as adjustments to goodwill.

We generally agree with the guidance proposed in paragraphs 62 and 63; that is, that adjustments to purchase accounting after the initial accounting is complete are generally considered changes in estimates that should be recognized in the income statement. However, certain adjustments relating to purchase price or consideration given may occur after the initial accounting is complete. That is, purchase price may be returned or otherwise adjusted as a result of subsequent negotiations between the buyer and seller (rather than as a result of agreed-to adjustments as described in paragraphs 31 through 34). The IASB may wish to provide guidance on whether, and how, such subsequent changes in consideration affect the initial purchase accounting.

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?

As indicated in our response to Question No. 8 of *ED 3 Business Combinations*, we believe that goodwill should continue to be amortized. Under an amortization model, AcSEC believes goodwill should be tested for impairment when there are events or changes in circumstances that suggest an impairment test of goodwill may be required. However, if the IASB continues to support the proposed nonamortization model for goodwill and indefinite-lived intangibles, AcSEC agrees with the proposed frequency of impairment testing for intangible assets with indefinite useful lives and acquired goodwill.

However, we do not agree with the provisions of paragraph 93 of IAS 36 that require that if some or all of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current annual reporting period, that unit should be tested for impairment, because the goodwill that arises from a current business combination has been recently measured and recorded at fair valued. Therefore we do not support a requirement to test goodwill in the year of acquisition other than as part of the normal annual testing procedures, unless circumstances change or other factors indicate an impairment.

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?

As indicated in our response to Question No. 3 of IAS 38, AcSEC generally believes that intangible assets should be amortized. The majority of AcSEC members also believe that all intangible assets should be amortized. However, some AcSEC members would support assigning an indefinite useful life to a limited group of intangible assets as proposed by the ED. Those AcSEC members believe that if an intangible is assigned an indefinite life, the intangible should be tested for impairment, similar to the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, as interpreted by EITF Issue No. 02-7, *Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets.* That is, other than the aggregation permitted by EITF 02-7, the fair value of the intangible must be determined directly, not by reference to a larger asset grouping.

Finally, AcSEC does not agree with the reversal of an impairment loss for either indefinite-lived intangibles or amortizing intangibles. We believe that once an intangible or goodwill is impaired, the subsequent reversal of such impairment is tantamount to capitalization of internally generated goodwill. We believe that, similar to goodwill, it would be difficult, if not impossible, for an entity to determine the fair value of the acquired intangible asset separate from the value of any internally generated value.

Question 3 – Measuring value in use

The Exposure Draft proposes additional guidance on measuring the value in use of an asset. Is this additional guidance appropriate? In particular:

a) should an asset's value in use reflect the elements listed in proposed paragraph 25A? If not, which elements should be excluded or should any additional elements be included? Also, should an entity be permitted to reflect those elements either as adjustments to the future cash flows or adjustments to the discount rate (see proposed paragraph 26A and paragraphs C66 and C67 of the Basis for Conclusions)? If not, which approach should be required?

(b) should the assumptions on which cash flow projections are based take into account both past actual cash flows and management's past ability to forecast cash flows accurately (see proposed paragraph 27(a)(ii) and paragraphs C66 and C67 of the Basis for Conclusions)? If not, why not?

(c) is the additional guidance in proposed Appendix B to [draft] IAS 36 on using present value techniques in measuring an asset's value in use appropriate? If not, why not? Is it sufficient? If not, what should be added?

AcSEC is pleased that the IASB is providing guidance relative to the considerations that enter into the determination of fair value. We support the ED's proposal that the calculation of an asset's value in use should reflect the elements listed in paragraph 25A. We note that those elements currently are used in practice and are important considerations in the calculation of an asset's value in use. We also support the concept of adjusting future cash flows or discount rates on the various items enumerated in the standard in order to achieve a better measure of fair value.

We also agree that the assumptions on which cash flow projections are based should take into account both past cash flows and management's past ability to accurately forecast cash flows.

We further believe the additional guidance proposed in Appendix B on using present value techniques in measuring an asset's value in use is appropriate and helpful.

Finally, on all matters referencing the determination of fair value or other present value techniques, AcSEC believes that the IASB should also solicit the views of valuation experts who might not usually provide comments on financial reporting exposure drafts.

Question 4 – Allocating goodwill to cash-generating units

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

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

(b) If an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, should the goodwill associated with that operation be included in the carrying amount of the operation when determining the gain or loss on

disposal (see proposed paragraph 81 and paragraphs C21-C23 of the Basis for Conclusions)? If not, why not? If so, should the amount of the goodwill be measured on the basis of the relative values of the operation disposed of and the portion of the unit retained or on some other basis?

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

If the IASB continues to support an impairment-based model, AcSEC believes that goodwill should be tested at a level that provides for consistency among enterprises similar to that set forth in FASB Statement No. 142. We observe that the ED's allocation provisions could result in inconsistent application because of the subjectivity involved in determining the lowest level at which management monitors the return on the investment. Although this allocation process attempts to achieve a goodwill impairment test closer to the source of the acquired goodwill, AcSEC has concerns about the operationality of testing at the level proposed. Given our experience with the methodology set forth in FASB Statement No. 142, we suggest that the IASB consider an approach that tests goodwill at the operating segment level or one level below. Additionally, we believe the term *management* needs to be defined.

AcSEC believes that if an entity disposes of an operation within a cash-generating unit to which goodwill has been allocated, goodwill associated with that operation should be included in the carrying amount of the operation when determining the gain or loss on disposal. Similar to our response to Question 1 to *ED 3 Business Combinations*, however, we believe that the operation being disposed of should constitute a *business* for goodwill to be allocated to it. We believe, however, that the standard should require that when a business being disposed of has not been integrated in the reporting unit or has been operated as a stand-alone entity, the associated goodwill, if any, should be part of the carrying amount of the operation.

Additionally, except in those circumstances where the business being disposed of has not been integrated into the reporting entity, we agree that the amount of the goodwill associated with the operation being disposed of should be measured on the basis of the relative values of the operation to be disposed of and the portion of the operation that will be retained.

We also agree that if an entity reorganizes its reporting structure in a manner that changes the composition of one or more cash-generating units to which goodwill has been allocated, goodwill should be reallocated to the units affected using a relative fair value approach.

Question 5 – Determining whether goodwill is impaired

The Exposure Draft proposes:

(a) that the recoverable amount of a cash-generating unit to which goodwill has been allocated should be measured as the higher of the unit's value in use and net selling price (see proposed paragraphs 5 (definition of recoverable amount) and 85 and paragraph C17 of the Basis for Conclusions).

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

(b) the use of a screening mechanism for identifying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as

potentially impaired only when the carrying amount of the unit exceeds its recoverable amount (see proposed paragraph 85 and paragraphs C42-C51 of the Basis for Conclusions).

Is this an appropriate method for identifying potential goodwill impairments? If not, what other method should be used?

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

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

If the IASB continues to support an impairment-based model, AcSEC agrees with the approach in which the recoverable amount of the cash-generating unit to which goodwill has been allocated is measured as the higher of the unit's value in use or net selling price, given that the proposed goodwill impairment test is designed to determine the recoverable amount of goodwill rather than to determine the fair value of goodwill.

AcSEC also agrees with 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. We would note, however, that our experience with this screening test has revealed a problem with entities with negative book value and positive fair value (by reference to the public share price). Often there could be significant goodwill remaining in such a situation where an entity is in financial difficulty, particularly when the reporting unit is highly leveraged. We believe that it is inappropriate to allow a screening mechanism to by-pass a situation in which an impairment of goodwill is otherwise obvious.

AcSEC further believes that 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.

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?

AcSEC agrees with the proposed guidance that reversals of goodwill impairment should be prohibited.

Question 7 – Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

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

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

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

AcSEC believes that the required information as proposed by paragraphs 134 and 137 of IAS 36 is excessive and will be difficult and costly to prepare. Additionally, we question whether it would provide significant incremental benefit for financial statement users. We suggest that the list include disclosures that provide general descriptions, rather than the proposed detailed information.

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?

We agree that if an intangible asset is separable or arises from contractual or other legal rights, it meets the criterion of identifiability in the definition of an intangible asset. However, our experience to date with FASB Statement No. 141 suggests that, without further guidance, significant differences in interpretation may emerge. EITF Issue No. 02-17, *Recognition of Customer Relationship Assets Acquired in a Business Combination*, attempted to bridge some of the interpretive issues surrounding the conflicting views that were emerging from the initial application of FASB Statements No. 141 and 142. Although the issues surrounding the identification and measurement of contractual and customer related intangibles continue, we observe that the range of outcomes has been narrowed by the EITF.

Thus, we believe that if the proposed guidance is implemented as currently drafted, it will also result in similar operational problems. Therefore, AcSEC suggests that the IASB consider the issues raised in EITF Issue No. 02-17 and clearly articulate the principle associated with recognition of customer intangibles. Our experience has indicated that the recognition and measurement issues associated with customer intangibles are particularly difficult, even in light of the guidance provided in EITF Issue No. 02-17. We expect that this difficulty may moderate over time as practitioners and valuation experts gain experience with the standard.

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.

AcSEC agrees, as a general principle, that fair value can be determined for most intangibles that meet the recognition criteria. However, we have observed that certain types of intangible assets are more reliably measurable than others. Intangible assets that are exchangeable or that are traded regularly in the marketplace are more reliably measurable than intangible assets without those characteristics. In contrast, customer related intangibles have proven particularly difficult to identify and value. Also, based on our experience implementing FASB Statements No. 141 and 142, we observe that fair values may differ depending on the valuation methodologies used. Furthermore, at the present time, there is not a defined body of principles for assessing the propriety of each of those methodologies. Thus, we recommend that both the IASB and other standard setters address valuation issues, particularly given the difference in accounting afforded the various categories of intangibles and goodwill.

We would also comment that as a part of the valuation process for many assets, valuation experts continue to use workforce as a contributory asset. Thus, this appears to be an inconsistency. That is, workforce is considered an important contributory asset in determining the value of other assets, yet is not recognized as an asset.

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?

AcSEC believes that the value of an acquired intangible declines over time, absent subsequent expenditures to maintain their value.

Therefore, AcSEC believes that an intangible asset should be regarded as having an indefinite useful life only when no subsequent expenditures or only nominal subsequent expenditures are required to maintain its value.

However, if the IASB continues to accept indefinite useful lives for a broader category of intangible assets, we would recommend a more robust description of the factors that may allow an enterprise to categorize an intangible as having an indefinite life. Currently, IAS 38 defines an indefinite-lived intangible asset and states "there is no foreseeable limit on the period over which the asset is expected to generate net cash inflows for the entity." That definition does not provide criteria that would assist preparers in making a thorough assessment. The additional interpretative guidance for indefinite-life classification in paragraphs 87–89 and Appendix A of IAS 38 are more descriptive of the factors that might lead to an indefinite useful life. Thus, we recommend that that guidance be included within the standard.

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)?

AcSEC agrees 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 should include the renewal period(s) if there is evidence to support renewal by the entity without significant cost. However, we believe it is important to articulate the principle that the Board intends with the recognition of such contractual intangibles. For example, concerning the value of customer-related contracts, is the intent to capture the fair value of the customer relationship or is the intent to capture the value of defined portions of the customer relationship? Similar to the issues identified in EITF Issue No. 02-17, there are practice issues relative to not only the definition of a contract, but also the definition of a renewal. For example, if the vendor must engage in a competitive reproposal effort, but history shows that the contract has been awarded consistently over the last ten years, how should such renewals be considered? Another example could include contracts for consulting services, with historical experience showing a continuous contractual relationship with a customer, but for different types and levels of services. These are practical examples encountered in trying to determine what intangible should be identified and valued.

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?

See our responses to Question No. 3 to IAS 36.