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Dear Ms Kimmitt

ED3 BUSINESS COMBINATIONS
IAS 36, IMPAIRMENT
IAS 38, INTANGIBLE ASSETS

We are pleased to have the opportunity to respond to the above exposure drafts on behalf of BP.

As a major international oil company whose shares are listed on stock exchanges in the UK, USA and a number of other countries, BP is supportive of harmonisation between International Financial Reporting Standards (IFRS) and US GAAP. We therefore welcome the majority of the amendments made in the exposure drafts under review. There are, however, some points of particular concern to us which we would like to draw to your attention.

The scope of IAS 38 (paragraph 1(c)) specifically excludes expenditure on the exploration for, and the development and extraction of, oil and natural gas. Although this scope exclusion may therefore be implicit in IAS 36, we believe it should be stated explicitly in that standard, pending development of a standard or statement of recommended practice (SORP) for the Oil and Gas Industry. The industry does have certain inherent constraints and uncertainties which in our view render a requirement for an automatic annual impairment test inappropriate. In particular the costs of drilling exploratory wells are capitalized pending determination of whether the well has found proved reserves and whether the reserves found will be commercially exploitable within the near future. Such determination can take longer than a year and it is appropriate to develop specific rules to deal with this, such as those of the US's SFAS 19 or the UK's SORP.

We believe that the approach taken in the proposed IAS 36 to the allocation of goodwill to cash-generating units and to the impairment test in respect of goodwill is substantially similar to that taken in the FASB's standard on goodwill and other intangible assets. While we recognise the validity of the approaches adopted, we do not believe that there are sufficiently compelling arguments to justify maintaining the differences from the US approach. Maintaining such differences results in an increased burden for preparers who file financial statements in both US and IFRS jurisdictions, and is unlikely to provide useful information for users of those statements. In view of the fact that the US standard has been in force for almost two years, we believe that the impairment test in proposed IAS 36 should be aligned with that of SFAS No. 142.

We encourage the IASB to pursue its co-operation with the FASB to achieve convergence between International and US GAAP.

Our responses to the specific questions posed by the exposure drafts are set out in the attachment.

Yours sincerely

G D HODGKISS

Our responses to the specific questions are as follows:

Q1. **<u>Scope</u>**

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?

A1. We agree with the scope exclusions.

Q2. **<u>Method of accounting for business combinations</u>**

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?

A2. In the context of convergence between IFRS and US GAAP, we believe that elimination of the pooling method is appropriate at this time.

Q3. **<u>Reverse acquisitions</u>**

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?

A3. Yes, we agree that the description of a reverse acquisition is appropriate. The additional guidance on accounting for reverse acquisition is also appropriate.

Q4. **<u>Identifying the acquirer when a new entity is formed to effect a business Combination</u>**

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?

A4. We agree this is appropriate.

Q5. **<u>Provisions for terminating or reducing the activities of the acquiree</u>**

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?

A5. We agree with this proposal. In the interest of creating a level playing-field we would encourage the IASB to discuss this issue with the FASB with the aim of aligning SFAS 141 and EITF 95-3 with the IFRS approach.

Q6. **<u>Contingent liabilities</u>**

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?

A6. In our view, the recognition criteria applied to liabilities and contingent liabilities in the context of an acquisition should be those of IAS 37. Items which are identified as contingent liabilities as a result of the acquisition cost allocation process will therefore not be recognized.

In the absence of an adjustment to the acquisition price agreed by the contracting parties during the negotiations for a business combination, it is probably difficult to arrive at a reliable fair value for contingent liabilities acquired as part of the combination. It appears highly unlikely that there would be an amount for which such a liability could be settled between knowledgeable, willing parties in an arm's length transaction other than the amount agreed between the parties involved in the business combination transaction. In these circumstances we believe it is appropriate to apply the requirements of IAS 37 and recognise such a liability at the amount of a best estimate as part of the cost allocation only if the criteria of that standard are satisfied during the allocation period. After the end of that period, such liabilities would be recognised as a charge against profit or loss if the recognition criteria are satisfied.

Q7. **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?

A7. We agree with this approach pending the conclusions of the second phase of the IASB's Business Combinations project.

Q8. **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?

A8. We agree that goodwill acquired in a business combination should be recognised as an asset. We also agree with the non-amortisation and annual impairment testing of such goodwill on the grounds that this will assist with convergence with US GAAP.

Q9. **<u>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</u>**

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?**

A9. We agree with the requirement to reassess the purchase price allocation exercise, as stated in paragraph 55 (a) to ensure that all relevant assets and liabilities have been identified and measured. We also agree with the recognition of the remaining excess in profit or loss for the reason explained in paragraph BC120, i.e. that this is the working principle adopted by the IASB and the FASB for their joint project on the application of the purchase method, and we would therefore expected harmonisation of US GAAP and IFRS on this matter in the short term.

Q10. **<u>Completing the initial accounting for a business combination and subsequent adjustments to that accounting</u>**

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?

A10. We believe that a strict 12 month period for the completion of the accounting for a business combination is too restrictive. In the case of a company which makes an acquisition at the beginning of its second quarter, such a rule would in effect force it to complete its accounting for the business combination before the end of the fourth quarter for practical reasons i.e. the post-year end workload related to the publication of its annual financial statements may well prevent the entity from carrying out the work necessary to complete the accounting. We therefore think it is preferable to require that the accounting be completed by the end of the entity's financial year following that of the acquisition.

We agree that, with the exceptions noted in paragraph 62, only adjustments made to correct material errors should subsequently be allowed.

Other points on ED3

We believe that it would be difficult for most entities to provide the information required by paragraph 70, given the short timescale allowed for the preparation of annual financial statements.

IAS 36 QUESTIONS

Q1. 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?

A1. Generally we agree that annual testing is appropriate for material intangible assets with indefinite useful lives, including goodwill arising on an acquisition.

We believe that Oil and Gas licence acquisition and exploration appraisal costs should be specifically scoped out of this standard, as it is in the case of IAS 38, pending development of a specific Oil and Gas or extractive industries' Standard or Statement of Recommended Practice (SORP). Current accounting principles under the UK Oil and Gas SORP allow such costs to be capitalised for up to a maximum of three years, subject to satisfaction of certain conditions, pending evaluation as a commercial prospect. US GAAP (SFAS 19) has similar provisions allowing for the carrying-forward of such expenditure, subject to the satisfaction of specific conditions. Impairment testing as prescribed in the draft IFRS is not appropriate in such circumstances as cash inflows cannot be predicted.

Pending development of an international standard, such recognised existing requirements should be allowed to continue to be applied.

We believe there is an inconsistency between paragraph 8A, which requires testing for impairment of an intangible asset with indefinite useful life at "the end of each annual reporting period", and paragraph 93, which requires the annual impairment test for a cash generating unit to which goodwill has been allocated to be tested "at any time during the annual reporting period, provided the test is performed at the same time every year". The application of the timing requirement of paragraph 93 to intangible assets of indefinite useful life would lessen the burden on entities.

Q2. 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?

A2. We agree that this is appropriate.

Q3. 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?

A3. (a) We agree with the requirements of paragraph 25A. It is appropriate to provide the choice of adjustment to discount rate or to cash flow to reflect uncertainty.

(b) It is appropriate to take into account past actual cash flows. The requirement to take into account management's past success in forecasting future cash flows is superfluous, in our opinion. A poor record of success could be the result of unforeseeable factors outside management's control and is not necessarily indicative of management bias. Such a requirement might be a distraction from the important issue, which is to arrive at a realistic cash flow forecast which takes into account as many external, objective factors as possible. Past performance is matter for the consideration by auditors rather than a matter to be specified in an accounting standard.

(c) The guidance in Appendix B appears appropriate.

Q4. 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?**

A5. We consider that the proposed allocation method should be identical to that of US GAAP. Goodwill should be allocated to the segment or to one level below the segment.

Q5. 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?

A5. We believe that the US test for impairment should be adopted on the grounds of eliminating unnecessary differences between IFRS and existing US GAAP immediately.

However, laying aside our belief that convergence is the most important issue at present, we have the following comments:

(a) We agree with this method of identifying impairment but believe that it should also be used as the method of measuring the impairment loss for the goodwill. As the goodwill does not generate any separately identifiable cash inflows on its own, it may be assumed that any impairment loss can be allocated first to the goodwill, with any excess then to be allocated to other assets in the cash-generating unit. This would, in our opinion, be consistent with the definition of goodwill given in ED3, that goodwill is the excess of cost of the business combination over the net fair value of the identifiable assets, liabilities and contingent liabilities.

(b) The proposed allocation method gives rise to additional work and the resulting pro-rata allocation of impairment losses to other assets in the cash-generating unit does not have any greater theoretical validity than the assumption that the whole of the impairment loss relates to goodwill.

(c) Given the fact that under the principles of draft IFRS the impairment or otherwise of an asset is determined by the comparison of the recoverable amount with the carrying value of the same asset (definition in paragraph 5 of the draft IFRS), we are not convinced that the use of the implied value (i.e. fair value) of goodwill instead of recoverable amount is consistent.

Q6. **<u>Reversals of impairment losses for goodwill</u>**

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?

A6. We agree with the proposal, but believe that the prohibition against the reversal of impairment losses should be extended to all intangible assets in order to help avoid risk of arbitrage between goodwill and identifiable intangible assets in an acquisition.

Q7. **<u>Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives</u>**

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?

A7. We believe that the detailed disclosures required by paragraphs 134 (d) through to (f) inclusive and 137 are excessive. The information included here will generally be commercially sensitive and we see no over-riding need for the user of the financial statements to have access to this. The disclosures required by paragraphs 125 to 130 inclusive appear adequate to give the user an understanding of the impairment testing process.

<u>IAS 38 QUESTIONS</u>

Q1. **<u>Identifiability</u>**

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?

A1. We agree that the criteria are appropriate.

Q2. **<u>Criteria for recognising intangible assets acquired in a business combination separately from goodwill</u>**

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.

A2. We agree that in general, as a result of the "due diligence" process, an entity will have sufficient information to identify and measure reliably the fair value of intangible assets acquired in a business combination.

Q3. **<u>Indefinite useful life</u>**

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?

A3. We agree with this proposal.

Q4. **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)?

A4. We agree that this is appropriate.

Q5. **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?

A5. We agree with this proposal.