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4 April 2003

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David,

Exposure Draft 3, *Business Combinations* and Amendments to IAS 36 and IAS 38

Deloitte Touche Tohmatsu is pleased to comment on the International Accounting Standards Board's (the Board's or IASB's) Exposure Draft—ED 3 *Business Combinations* and the consequential amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets* (collectively, the Exposure Draft). Our objective in developing this letter is to provide constructive feedback to assist the IASB in developing standards of the highest possible quality. Our responses to the questions raised in the Exposure Draft are set out in the Appendices to this letter.

We commend the Board for paying particular attention to the need for a new International Financial Reporting Standard (IFRS) dealing with business combinations. We believe there is an urgent need for global harmonisation of accounting standards on business combinations given the impact these transactions have on the reported results of entities.

Overall, we are supportive of the proposals in this document based on our desire for global harmonisation of accounting standards to the greatest extent possible. However, we are concerned with the application of some of the proposals, such as the subsequent accounting for contingent liabilities, the prohibition on amortisation of goodwill in all circumstances, the proposed treatment for 'negative goodwill', and the determination of cash-generating units. Our concerns are documented in detail in the Appendices to this letter.

We are also concerned with the timing of the various projects on business combinations. We understand the Phase II project on the application of the purchase method has been developed in co-ordination with the FASB in order to promote convergence. Our understanding is that an exposure draft on the Phase II project is expected in the second quarter of 2003 with a final IFRS to be issued in 2004. Based on the IASB's tentative decisions in the Phase II project, certain principles may contradict or significantly alter the decisions in the Exposure Draft. Therefore, we suggest the Board carefully assess its process on this project. It may be advantageous to delay the issuance of a final standard until the completion of the Phase II project on the application of the purchase method to minimise any confusion with the issuance of two standards on business combinations within a short period of time. Our comments on the Phase II project may cause us to change our recommendations that are set forth in this letter.

We thank you for the opportunity to provide our comments. If you have any questions concerning our comments, please contact Ken Wild in London at (020) 74382511.

Sincerely,

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

Appendix A
Comments of Deloitte Touche Tohmatsu on
Exposure Draft 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?

We agree with the scope exclusions set out in the Exposure Draft provided the IASB addresses these issues as part of the Phase II business combinations project. Guidance on these transactions is needed and we encourage the IASB to provide such guidance.

We support the inclusion of a definition for business combinations under common control in the Exposure Draft, and believe that the additional guidance is helpful in identifying transactions within the scope exclusion.

We are in general agreement with the proposed definition of a business combination in the Exposure Draft, however, we have a concern as to the application of the current definition in distinguishing a purchase of assets from a business combination. For example, it is unclear if a purchase of a factory and its employees would represent a business combination under the proposed standard. We also note the importance of this distinction to IAS 12.15, 12.24 and IAS 39.19.

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?

We agree with the decision that one method of accounting for a business combination is preferable to two or more methods and that the purchase method is the best, and most widely used, method available at this time.

We suggest that paragraph 14 should be removed from the final standard as it adds little to the document. In addition, the phrase "nearly all business combinations" in paragraph 14 may be interpreted as less definitive than the statement in paragraph 13 that the purchase method is the only available method for business combinations.

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?

We are in general agreement with the additional guidance provided on the accounting for reverse acquisitions as set out in paragraphs B1 to B14 in Appendix B to the Exposure Draft. However, we do not agree that the proposed paragraph 21 provides an appropriate description of the circumstances in which a business combination should be accounted for as a reverse acquisition. In contrast to the equivalent guidance currently in IAS 22, the description refers to the fact that the legal subsidiary has the power to control the financial and operating policies of the legal parent. The legal subsidiary generally has no power to control the legal parent. Rather, it is the former shareholders of the legal subsidiary that achieve such control. Therefore, we propose that the penultimate sentence of paragraph 21 be reworded as follows:

> Although legally the issuing ~~non-operating public~~ entity is regarded as the parent and the ~~operating~~legally acquired entity is regarded as the subsidiary, the ~~legal subsidiary is the acquirer with~~ <u>previous owners of the legal subsidiary have</u> the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities.

We also believe the example would be more effective if it discussed a situation with two operating companies in which the issuing entity is the target company. As discussed in our response to question 1, it should be clarified whether the purchase of a shell company represents a business combination transaction.

Question 4—Identifying the acquirer when a new entity is formed to effect a business combination

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?

We agree.

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?

We agree with the conclusion that the recognition of a provision should be accounted for in accordance with IAS 37 regardless of whether the provision arises out of a business combination. We believe the final standard could be improved if it provided an example reflecting the difference in accounting treatment between restructuring costs considered to be post-acquisition events and restructuring costs that are considered liabilities of the acquiree.

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?

We support the Board's conclusion 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 that the fair values can be measured reliably. However, we are concerned with the Board's decision to defer consideration of the appropriate treatment of contingent assets to the Phase II project, as we believe that there should be symmetrical treatment between contingent liabilities and contingent assets. Therefore, we believe that the final standard should require that the contingent assets of the acquiree be recognised separately as part of the cost allocation exercise, on the same basis as contingent liabilities.

We do not, however, agree with the proposal in paragraph 46 of the Exposure Draft that such contingent liabilities should be measured on an ongoing basis at fair value. Since the estimation of fair value of those items at the date of acquisition has established their cost, we propose that they be maintained at cost, adjusted only for known events. That is, contingent liabilities would be increased based on the probability criteria in IAS 37 or released to income when events occur that cause their probability of occurrence to be remote. As noted above, we believe that contingent assets of the acquiree should be recognised separately as part of the cost allocation exercise. Consistent with our view of the subsequent accounting for contingent liabilities, we believe that the estimation of fair value at the date of acquisition has established a cost basis. We would disagree with remeasurement of contingent assets at fair value. Subsequently, contingent assets would be reduced in value as a result of any identified impairment loss.

We believe there is an urgent need to address the conceptual merits of fair value measurements in accounting as part of a project on the Framework. While we do not believe a contradiction with the Framework should prevent what is determined to be the "right" answer in this case (as noted in the paragraph above), we are concerned that the IASB is setting a dangerous precedent by departing from the principles of the Framework. Therefore, if the IASB intends to increase the use of fair value measurements in this and other projects, we suggest the Framework be revisited. Such a change and the resultant due process should enable the necessary debate around fair value measurement, in general, in the light of the various difficulties such measurement creates in terms of reliability and auditability of information.

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?

We agree.

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?

We agree with the conclusion that goodwill acquired in a business combination should be recognised as an asset. With regard to the accounting for goodwill after initial recognition, we generally agree with the Board's proposal. However, we note that there may be circumstances where goodwill has a finite life. For example, this may be the case when an entity has a specified life. In certain jurisdictions such as the Peoples Republic of China (the PRC), foreign investment is made by means of certain legal structures that expire after a specified number of years. At the end of the agreed period, the assets will revert to the PRC partner. In such circumstances, any goodwill will have an implied value of zero at the end of the entity's life.

Consequently, we believe that, in accounting for goodwill after initial recognition, there should be a rebuttable presumption that goodwill has an indefinite life and, therefore, accounted for at cost less any accumulated impairment losses. However, in those cases where that presumption is rebutted and sufficient persuasive evidence exists indicating that goodwill has a finite life, we believe that a method of systematic amortisation is preferable to "impairment only" accounting. In such cases, we believe that goodwill, consistently with other intangible assets that have a finite life, should be amortised and tested for impairment when an indicator exists. The impairment test applied to goodwill with a definite life should be the same test as goodwill with an indefinite life.

We would emphasise that we do not believe entities should have a choice as to which method to use in accounting for goodwill, but that the method required to be used in each case should reflect the economic substance of the goodwill recorded. A significant advantage of our proposed treatment is that there is symmetry of treatment between goodwill and other intangible assets, thus removing some arbitrage opportunities.

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?

We do not agree with the approach in the Exposure Draft. We believe that the recognition of contingent liabilities at fair value significantly reduces the likelihood of an 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 recognise that there are a number of views on how such an excess may arise. However, we believe it is inappropriate for an enterprise to recognise a gain on the acquisition of assets.

The cost of individual assets and liabilites is generally determined by reference to their fair value. Where the cost of acquisition exceeds the aggregate fair value of such assets and liabilities, then it is logically assumed that an additional asset (goodwill) has been acquired, which is also recorded at its cost. Where the aggregate of the fair values exceeds the cost of acquisition, and assuming the fair value measurements have been re-examined to ensure that they are complete and accurate, then the logical conclusion is that the assets have been acquired for less than their fair values. Therefore, we consider that the excess should be set off against the non-monetary assets acquired.

We do not agree with the Board's conclusion in BC 114 that it is not possible to make a meaningful allocation, nor that the resulting reduced cost is not 'representationally faithful'. It is not representationally faithful of fair value – but that is not a necessary condition. The resulting accounting is far more representationally faithful than recognising a profit on acquisition.

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?

We agree that 12 months is an appropriate period in which to finalise purchase accounting adjustments. However, we would suggest final purchase accounting adjustments be recorded in the financial statements if these adjustments are finalised after the balance sheet date, but before issuance of the financial statements. Therefore, we would suggest an appropriate change to paragraph 61, which appears to state that such an adjustment would be a non-adjusting event after the balance sheet date under IAS 10.

Other Comments

The guidance in paragraphs 32 and 34, we believe is attempting to distinguish the accounting for contingent consideration that is, in substance, a guarantee of the purchase price and contingent consideration that is, in substance, additional cost of the net assets acquired. Without clarifying this delineation clearly, the current drafting appears to provide conflicting guidance for securities issued based "on the market price of the securities issued being maintained."

The Exposure Draft proposes a definition of "probable" as more likely than not. We note that there is currently no pervasive definition of "probable" in IFRS, except for the definition restricted to IAS 37. The definition of "probable" is pervasive to much of IFRS, notably IAS 11, 12, 17, 18, 19, 27, 31, 32, 36, 38 and 39. We strongly encourage the Board to consider the effects of this definition.

We note that the phrase "and its fair value can be measured reliably" is included in paragraph 36(a), (b), and (d), but not in (c). We believe the fair value of intangible assets acquired in a business combination should also be measured reliably in order to be recognised separately from goodwill.

We have a general concern with the current drafting of the transitional provisions. Specifically, the encouragement for early adoption appears to contradict the guidance in BC144 that would prevent application of the guidance prior to finalisation of the IFRS. We suggest the Board clarify its intentions with regard to transition. We also encourage the Board to ensure consistency between the transitional provisions in ED 3 and the exemption for business combinations in the final Standard on First-time Adoption of IFRS.

We believe the phrase "…before the date the IFRS is issued" in the first sentence of BC159 should actually be "…after the date the IFRS is issued" in order to be consistent with the Board's conclusions.

Appendix B
Comments of Deloitte Touche Tohmatsu on
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?

We agree with the proposal that indefinite life intangible assets are tested for impairment at least annually or when certain indicators exist that call into question the recoverability of the carrying amounts of the intangible assets. As noted in our response to Question 8 of ED 3, we believe there may be situations where goodwill has a finite life and therefore amortisation may be more appropriate. In those situations we would recommend an impairment test be conducted only when certain indicators exist call into question the recoverability of the carrying amounts of the goodwill.

We disagree with the requirement in paragraph 93 that where goodwill has been allocated to a cash-generating unit during the current period, that unit must be assessed for impairment after the acquisition and before the end of the year. If goodwill has been established in an arm's length transaction subsequent to the impairment test for the current year, we do not believe that an impairment test should be required in the current year unless there has been an indicator of impairment. For example, if an enterprise with a calendar year-end acquires a business on November 30, the proposed amendment would require an additional goodwill impairment test in December, which we believe would be onerous and unnecessary.

Additionally, in many instances, the amounts recorded by the entity will be provisional and may change within 12 months of the acquisition date (which may be after the current reporting period). Therefore, in the absence of any indicator of impairment, a goodwill impairment test at the end of the current period may be premature, as it would be based on provisional amounts.

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?

We agree with the IASB's proposal, however, we request additional guidance be provided on how to project cash flows for assets with an indefinite life. For example, we would encourage additional guidance on the determination of net selling price for indefinite life intangible assets that relate to the operations of the enterprise (e.g., broadcasting rights for a radio station, radio frequency rights for wireless telephone businesses, etc.).

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?**

We agree with the guidance presented in paragraphs 25A, 26A, and 27(a)(ii).

In view of the sensitivity of the calculations to the discount rate used, and the subjectivity involved, we would welcome additional practical guidance and possibly examples which may help readers to understand how the principles expressed in Appendix B can be applied. Specifically we request additional guidance on converting a post-tax interest rate to a pre-tax discount rate and guidance on how cash flows should be projected for a group of assets that have different useful lives.

We notice an inconsistency in the drafting between paragraphs 25(e) and B1(e). We encourage the deletion of the phrase "sometimes identifiable" from paragraph B1(e) to conform to paragraph 25(e).

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?

We believe it is generally not possible to use a cash flow model to estimate the fair value of a business with sufficient precision and objectivity to determine that such estimate represents the amount that a willing buyer and seller would exchange for the business. There are many intangible factors involved in negotiating a business acquisition and cash flow estimates typically provide only a foundation for the start of the negotiation.

We believe an impairment test based on determination of a cash-generating unit to which goodwill is allocated is appropriate if a cash flow model is used. However, we believe the guidance in paragraphs 73-78 is vague and open to a wide range of interpretation. In particular, the criteria for the aggregation of cash generating units in order to test goodwill for impairment is based on the level at which management monitors its return on investments in assets that include the goodwill. However, 'management' is not defined. Is the definition of management to be interpreted similar to IAS 14 as the Board of Directors or CEO (as IAS 14 is identified in paragraph 74 of the Exposure Draft), or is it the intention of the Board to not restrict the definition of management to chief decision-makers (by specific reference to an indirect monitoring of a unit in paragraph 77)? How does management (however defined) monitor performance indirectly?

In addition, paragraph 73 requires allocation of goodwill to cash-generating units only when a reasonable and consistent basis can be determined. This would seem to require certain cash generating units to be aggregated to test some goodwill amounts, but disaggregated to test other goodwill amounts. We are not sure the benefits of such an approach outweigh the cost of implementing, performing and auditing these tests annually.

We generally believe that goodwill should be tested for impairment at the lowest practicable level taking account of the costs and benefits of such a test. We request that the Board provide guidance on the appropriate level of aggregation of cash generating units to achieve a balance between the costs and benefits of the impairment approach.

We are aware that many entities may already have cash flow information at the cash-generating unit level in order to analyse performance. However, entities have generally not in the past determined a fair value (basis for net selling price) for these cash-generating units as this would generally require an appraisal or other outside assistance that is not useful for assets or businesses not held for sale. Since the determination of recoverable amount would require the calculation of both the net selling price and value in use, we believe this requirement to be extremely burdensome without much benefit over a method that aggregates cash-generating units at a practicable level.

We agree with the guidance provided in paragraph 81 for the disposal of an operation within a cash-generating unit that contains goodwill. We also agree with the proposal in paragraph 82 on the reallocation of goodwill as a result of a restructuring of cash-generating units.

However, we request clarification of whether "value" in these paragraphs shall mean carrying amount, fair value or both.

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?

We agree with the Board's proposal 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.

If the Board concludes in the final standard that the implied fair value approach should be used to measure goodwill impairment, we believe that a screening mechanism is necessary, based on practical considerations. While the 'first step' in the approach proposed in the Exposure Draft is already a demanding assessment, we believe that approach provides an acceptable balance between the costs to preparers and the benefits to users.

We believe a conceptual case can be made both for the implied fair value approach and for the recoverable amount approach, and that each method has both its merits and its difficulties. We are willing to support the implied fair value approach proposed in the Exposure Draft, as it is a consistent method of estimating of the value of goodwill from the measurement of goodwill at initial recognition. This approach also will avoid the "double-expensing" of a contingent liability that subsequently becomes a liability under the current IAS 37 approach.

However, we are concerned with the reliability of a goodwill amount based on what may be subjective estimates of the fair value of recorded and unrecorded items. As noted in our response to Question 6 of the Exposure Draft on business combinations, there is an urgent need to address the conceptual merits of fair value measurements in accounting as part of a project on the Framework.

Additionally, we note the inconsistency that will be created in the determination of an impairment loss for goodwill and that for all other assets. As such, we suggest that the definition of 'impairment loss' be amended to incorporate this change.

From the guidance provided in paragraphs 103-107, we are uncertain as to whether the IASB intends the first step in the goodwill impairment test to be a screening mechanism or a calculation of a minimum impairment charge. We believe that the first step of the test should not be used as a minimum impairment charge.

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?

We generally agree with the prohibition of the reversal of impairment on goodwill in all cases. While we believe there may be a conceptual argument to allow the reversal of an impairment of goodwill based on the reversal of specific external events that caused the impairment, the guidance necessary for such a proposal would need to be extensive. We do not believe such situations would be pervasive enough to warrant the cost of developing such additional guidance.

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?

We are in general agreement with many of the disclosures required in paragraphs 125-137. We do, however, consider many of the proposals to be onerous and potentially misleading for users of the financial statements. We are concerned with certain disclosures that attempt to quantify variations in assumptions from actual results (for example, paragraph 134(e)(i, ii, iv, and v) and paragraph 134(f)(i, and ii). Using a cash flow model requires assumptions that will rarely, if ever, be the same as actual results given the unlimited possibilities for change in market conditions, etc. The requirement to make these disclosures may imply to the reader that the expectation is that assumptions and estimates will rarely differ from actual results. This is an inappropriate message to convey to the readers of financial statements and such requirements should be deleted.

We also believe that the inclusion of sensitivity analysis with respect to assumptions in the footnotes to the financial statements may be misleading to the user in view of the obvious interdependencies associated with the assumptions and the exercise of flexing only one variable. We believe these disclosures may be more appropriate in a management discussion and analysis (MD&A) document and should be considered when the Board addresses that project.

Other Comments

We are concerned that the Exposure Draft does not carryforward much of the Basis for Conclusions in IAS 36—even related to issues that have not been amended. Much of the guidance in the basis is quite helpful and should be retained. Specifically, the Basis for Conclusions of IAS 36 (paragraphs B43-B48) gave useful information about the definition of net selling price and should be retained. We also believe it would be useful to give guidance on the hierarchy of fair value determination similar to or by reference to the guidance in the amendments to IAS 32/39.

Appendix C
Comments of Deloitte Touche Tohmatsu on 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.

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.

We generally agree that an asset acquired as part of a business combination will always meet the probability recognition criterion in the Framework.

We underscore the fact that measuring intangible assets acquired in a business combination reliably at fair value may be difficult and subjective depending on the facts and circumstances relating to the combined entities and the industries in which they participate. We agree with the Board that sufficient information should be reasonably expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination. However, as noted in our comment on paragraph 36(c) in the Exposure Draft on business combinations, we believe intangible assets whose fair value can not be measured reliably should not be recognised separately from goodwill. We suggest the Board explicitly state that an entity should not attribute a fair value to intangible assets acquired (including those in the draft Illustrative Examples) where fair value cannot be determined reliably.

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?

We agree.

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)?

We agree.

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?

We agree.