**CL 64**

Sir David Tweedie
Chairman, IASB
30 Cannon Street
London EC4M 6XH
United Kingdom

Paris, 4 April 2003

Dear Sir,

The French Society of Financial Analysts, SFAF, (*Société Française des Analystes Financiers*) wishes to play an active role in the preparation of international accounting regulation. SFAF represents 1,700 members in France and is itself a member of the European Federation of Financial Analysts Societies (EFFAS), which brings together the main European financial analysts societies.

Financial analysts are among the principal users of corporate financial statements and therefore wish to express their opinion on the development of the international standards.

For this reason, our association, through its Accounting and Financial Analysis Commission, was keen to respond to Exposure Draft ED 3, Business Combinations, and to the proposed amendments to IAS 36 and IAS 38, and would like to thank you for the opportunity to make its position known.

The draft standard on business combinations proposes the elimination of the pooling of interests method and the generalisation of the purchase method. The pooling of interests method seems to us to have no acceptable foundation. SFAF, being favourable to the application of a single method for accounting for business combinations, supports the IASB's proposals on this subject.

SFAF is very favourable to a convergence of international standards. However, aligning the treatment of goodwill impairment with that adopted by the FASB in 2001, as proposed by the IASB, does not seem desirable in current market environment. A search for convergence cannot be used to justify the acceptance of standards whose foundations are incorrect. Although favourable to the recognition of acquired goodwill as an asset, the French financial analysts we represent do not wish for:

- the replacement of goodwill amortisation by an impairment test which, by considering both acquired and internally generated goodwill together, would, in practice, lead to no impairment

being recognised. This implicit recognition of internally generated goodwill is in contradiction with current IAS practice in this regard.

- the allocation of goodwill to cash-generating units; coming in addition to the previous problem, the absence of any distinction between allocated goodwill and that included in the cash-generating unit but not recognised, would make monitoring goodwill over the medium and long term particularly complex and illusory.

Furthermore, regarding intangible assets, it seems important to point out that SFAF is doubtful as to the existence of assets with indefinite useful lives, and is convinced that a time limit should be set for the determination of the economic benefits expected to flow to an enterprise. We also consider that the valuation of these intangible assets is, in most cases, particularly subjective.

Moreover, the use of the cash flow methods proposed for the determining of these future benefits by accounting professionals will raise a certain number of issues. From experience, we consider that these methods are particularly sensitive to the assumptions made, in particular as regards discount and perpetual growth rates. The recent use of these methods for impairment testing by certain companies, even though they included the publication of reasonable assumptions for discounting and growth rates, has shown that the valuations obtained were still not very realistic.

In that respect, allowing enterprises to choose these assumptions does not guarantee the reliability of measurements of assets, and on the contrary seems to go against the policy followed by the IASB – of which, as financial analysts, we support the principle – consisting in adopting a benchmark treatment and progressively eliminating allowed alternative treatments in order to improve the comparability of corporate financial statements.

We would like to thank you for having involved SFAF in consideration of this draft and the proposed amendments and remain,

Yours faithfully,

Franck Ceddaha
Chairman, SFAF Accounting and Financial Analysis Commission

Bernard Coupez
Chairman of SFAF

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?

**Response:**
SFAF agrees with the Board's proposals.

**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?

**Response:**
SFAF agrees with the Board's proposal to eliminate the pooling of interests method. The pooling of interests method seems to us to have no acceptable foundation. We wish that one method only, the purchase method, should be used in all business combinations and that an acquirer should be identified for all such transactions.

**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?

**Response:**
SFAF agrees with the Exposure Draft's proposals on reverse acquisitions.

**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 ?

**Response:**
SFAF agrees with this proposal. In this particular situation, it is logical to consider that one of the combining entities forming part of a new entity is the acquirer.

**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?

**Response:**
SFAF agrees with the Board's proposal that no recognition criteria other than those in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* should be used in respect of restructuring provisions in a business combination.

However, the conditions proposed by the Board seem too restrictive. On this point, SFAF supports the US GAAP position under which provisions for restructuring the acquiree are identifiable liabilities if the plan, on which development work commences as from the date of acquisition, is drawn up in detail and announced at the latest at the end of the 12-month period for allocating costs.

### 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?

**Response:**
SFAF agrees with the Board's proposal.

### 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 remeasurement 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?

**Response:**
SFAF agrees with the Board's proposal to eliminate the partial remeasurement method, which generally tends to underestimate minority interest in consolidated financial statements.

However, with regard to the date at which assets and liabilities should be measured, we consider that in certain cases values at the acquisition date do not reflect the terms of the transaction stated when the parties come to an agreement.

For quoted equity based transactions, the IASB proposal would result in business combinations being measured at the date of exchange (which might be far from the date of the agreement), which would not reflect the value of the acquiree or of the combining entities taken into account in the terms of the transaction (e.g. the offer price or the parity of exchange agreed by the shareholders).

**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?

**Response:**
SFAF agrees with the Board's proposal to recognise goodwill arising in a business combination as an asset in the consolidated financial statements. However, we do not agree with the Board's proposals with regard to the impairment test, as the proposed test does not measure the goodwill acquired. The goodwill measured when the impairment test is made includes both the goodwill acquired and the internal goodwill generated after acquisition. It is therefore not very realistic to expect this test to provide evidence of a loss of value.

Furthermore, allocation of goodwill to cash-generating units also raises a certain number of problems with respect to monitoring. For example, how will goodwill be monitored in the case of the reorganisation or restructuring of a group that is itself the result of a business combination? How will that part of the goodwill that is sold after several reorganisations be measured?

For all these reasons, we consider that the Board is proposing techniques that in practice will justify the value given to goodwill and will not lead to recognition of impairment losses. We

therefore favour retaining goodwill amortisation and recognising an impairment of goodwill whenever there is an unfavourable change in the assumptions made at the time of acquisition.

**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?

**Response:**
SFAF agrees with the Board's proposals.

**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?

**Response:**
SFAF agrees with the Board's proposals.

## 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?

**Response:**
SFAF is doubtful as to the existence of tangible or intangible assets with indefinite useful lives. However, as regards the frequency of impairment testing of intangible assets, whether their useful lives are definite or not, we consider that an enterprise should remeasure its assets at each balance sheet date.

**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 ?

**Response:**
As we are doubtful as to the existence of intangible assets with indefinite useful lives, SFAF does not wish the treatment of these assets to be different from that of other assets.

**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:

(b) 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 ?

**Response:**
SFAF considers that cash flow methods are always based on arbitrary variables and that the application of these methods by an enterprise's accounts staff – with no training on these calculations and their sensitivity – provides no guarantee as to the reliability of the measurements produced, and therefore no guarantee as to the reliability of enterprises' financial statements.

**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.

(b) 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 ?

**Response:**
We would repeat our answer to Question 8 on the "Business Combinations" Exposure Draft: we do not agree with the proposal to abolish goodwill amortisation and replace it with an impairment test that in practice will not lead to goodwill impairment losses being recognised.

Moreover, we are not in favour of the allocation of goodwill to cash-generating units. This will make the medium and long-term monitoring of goodwill extremely complex because of disposals, reorganisations and restructuring operations.

**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 ?

**Response:**
SFAF does not agree with the Board's proposal and is convinced that the proposed impairment test covers not only the goodwill acquired but also the internally generated goodwill.

For this reason, SFAF is convinced that this impairment test would not in practice lead to the impairment of enterprises' goodwill being recognised and therefore considers that it does not fulfil the objective of an impairment test.

**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 ?

**Response:**
SFAF agrees with the Board's proposal.

**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?

**Response:**
For the reasons given in our answer to Question 4, SFAF is not in favour of the allocation of goodwill to cash-generating units. However, given the Board's proposals regarding disclosures, we consider the list given in paragraph 134 to be scarcely sufficient.

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 ?

**Response:**
SFAF agrees with the criteria proposed by the Board.

## 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.

**Response:**

SFAF does not agree with the Board's proposal and supports EFRAG's answer to this question.

**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 ?

**Response:**
SFAF is doubtful as to the existence of intangible assets with indefinite useful lives, and is therefore not in favour of the Board's proposal

**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) ?

**Response:**
SFAF supports EFRAG's answer to this question.

**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 ?

**Response:**

SFAF is doubtful as to the existence of intangible assets with indefinite useful lives, and therefore does not agree with this proposal and considers the amortisation of these assets appropriate.