CONTROLLER and AUDITOR-GENERAL

KEVIN BRADY

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear Sir

SUBMISSION ON ED 3 BUSINESS COMBINATIONS

We comment below on two specific issues resulting from ED 3 *Business Combinations*

- The proposed accounting treatment of goodwill; and
- The proposed impairment test for goodwill.

We have been involved in the New Zealand submission process and generally support that submission. However, we feel strongly about the abovementioned issues and consider it important to provide additional comments directly to you.

The proposed accounting treatment of goodwill

We note the inconsistency in treatment between goodwill and discount on acquisition in a business combination.

Nevertheless, we acknowledge that aligning the treatment and thereby expensing acquired goodwill on acquisition would challenge well-established practice and would ignore the future economic benefits embodied in that goodwill. We therefore accept the proposal that goodwill acquired in a business combination be recognised as an asset.

However, we strongly disagree with the proposed subsequent accounting treatment of goodwill.

In our view goodwill should be amortised over a relative short period, as well as tested for impairment during the useful life i.e. goodwill should be accounted for at cost less accumulated amortisation and impairment losses.

The benefits arising from the goodwill acquired in a business combination will be consumed over time and replaced by internally generated goodwill. The Board acknowledges this in

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paragraph BC107 of ED 3. In our view it is therefore appropriate to write down the value of acquired goodwill over its useful life.

Further, if impairment testing is the only measure used to determine the write down of acquired goodwill, over time entities will effectively be recognising internally generated goodwill. This is inconsistent with IAS 38 *Intangible Assets* which prohibits the recognition of internally generated goodwill. We disagree with the inconsistent treatment of internally generated goodwill between entities involved in business combinations and other entities.

We acknowledge that it might be difficult in some circumstances to determine accurately the useful life of acquired goodwill, but we believe that acquired goodwill has a relatively short life. In our view, an average useful life could be determined through a limited review of how long goodwill lasted in business combinations where goodwill was recognised. An average could then be used as the period for writing-off all acquired goodwill.

The proposed impairment test for goodwill

We believe the proposed impairment test is complex and very costly to apply.

We are also concerned that the proposed two stage-test might not reveal the fact that the acquired goodwill is impaired. It is possible that the first stage might reveal no impairment of the unit to which goodwill is allocated. Therefore goodwill would not be tested for impairment even though calculations under the second stage would reveal that goodwill was impaired.

We note that internally generated goodwill would effectively be included in measuring the implied value of goodwill which provides a further "cushion" to the impairment of acquired goodwill.

We consider, in addition to amortisation, that acquired goodwill should be reviewed for impairment at each reporting date using the current one step impairment test in IAS 36 *Impairment of Assets*. That is, if the unit to which goodwill is allocated were considered to be impaired, the impairment amount would firstly be offset against the carrying amount of goodwill, and the remainder against the other assets in the unit.

If you have any questions concerning our comments, please contact Todd Beardsworth (+64 4 917 1590) or Sanel Tomlinson (+64 4 917 1601).

Yours faithfully

Kevin Brady