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Mr A Teixeira
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International Accounting Standards Board
30 Canon Street
London
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Letter of Comment No: 238
File Reference: 1204-001

Dear Mr Teixeira

Exposure Draft of Proposed Amendments to IAS 27 Consolidated and Separate Financial Statements and IFRS 3 Business Combinations

We welcome the opportunity to respond on the above exposure drafts.

We support the move towards harmonisation of accounting standards worldwide and hence we can understand the IASB's desire to issue an accounting standard on the issues covered that is consistent with any standard that may be introduced in the USA.

We do not however support the increasingly theoretical nature of accounting developments and in particular the direction which is being initiated by the proposed amendments.

We believe that the key principles of relevance and reliability of financial statements will be eroded under these proposals when the financial statements are viewed from the perspective of the key user, namely the shareholder in the parent company.

We fully acknowledge the inconsistencies in accounting for key aspects of business combinations, and in particular the anomalous treatment of goodwill arising in such transactions. We do however believe that the proposals will introduce additional inconsistencies that will make the consolidated financial statements increasingly difficult to appraise.

The proposals place increasing reliance upon estimation techniques in valuing assets and liabilities arising on a business combination. In particular, we have concerns over the suggested methodologies for the valuation of goodwill in cases where there is a non-controlling interest. We believe there to be little benefit in placing any value on goodwill by a method other than that calculated by the grossing up the value derived from the purchase of the controlling interest.

Similarly, we find the treatment of changes in controlling participations, interesting but potentially detrimental to the users understanding of the underlying transactions.

We do not believe that the proposed treatment of the direct costs of acquiring a controlling interest is correct. In our view these costs are more correctly viewed as a legitimate cost of the investment in acquiring the interest. Such costs would be considered as such in any appraisal of the investment opportunity in the pre-acquisition process. It should be possible to demonstrate that the capital treatment is valid through the post acquisition impairment review of the goodwill acquired.

In summary, we concur with the views of the three members of the IASB offering alternative views on the proposals to amend IAS 27 and the five members offering alternative views to the proposals on goodwill within IFRS 3. We do not believe that the proposals will enhance financial reporting.

We attach responses to each of the questions in the exposure drafts to which the IASB invited responses.

We trust that you will find the responses helpful in your deliberations but if you have any queries on our response, please do not hesitate to contact us.

Yours sincerely

D.R. Logan
Director Group Technical Accounting

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Royal & Sun Alliance Responses to Amendments to IFRS 3 Business Combinations

Question 1—Objective, definition and scope

We do not believe that IFRSs deal adequately with true business mergers and indeed believe the abolition of merger accounting has been a retrograde step. We believe that the IASB should address this important aspect of business combinations in parallel with any other proposals for improvements to the existing standards.

Question 2—Definition of a business

We have no comments on the proposals.

Questions 3-7—Measuring the fair value of the acquiree

Question 3

We acknowledge that the accounting for goodwill will not be changed for the large number of business combinations in which the 100% of the control is acquired. However, for the remainder, to which this question is addressed, the proposed accounting treatment is revolutionary. We question whether such a change is really necessary to improve the reliability and the relevance of the results presented. We believe that the main users of the consolidated financial statements are the shareholders of the parent company and we believe that their understanding of the financial position of the Group will not be improved by these developments.

Further, we believe that if the participation in the acquiree is less than 100%, then there will be great difficulty in valuing the whole of the goodwill of the acquired business. We acknowledge that IASB have recognised this situation and used the acquirer's payment for his share of the goodwill as the proxy for the proportionate interest in the total goodwill. In most situations we believe that this will be used as basis for approximating the total goodwill since no reliable external measure will be available.

We see no reason to change the current basis for recognising goodwill, namely the residual asset acquired by the controlling equity interests (the parent company shareholders) on initial recognition of the controlling interest.

Question 4

As discussed in question 3 we disagree both with the principle of recognising 100% of the goodwill and with the basis of measurement. We believe that the guidance is over theoretical and may prove impossible to apply in practice.

Question 5

We agree that the consideration given should be determined at the date of acquisition, but as previously discussed, have reservations about the application of the purchase consideration and, more particularly, the concept of the residual valuation of the non controlling equity interest in the total goodwill.

Question 6

We acknowledge that the proposed treatment of contingent consideration is consistent with our response to question 5 and that it provides the best answer in theory. In practice, however we believe that the proposals will lead to adjustments being recognised in the income statement which more properly reflect the uncertainties prevailing at the date of acquisition. In addition we have concerns that the level of subjectivity used in initial valuation of the contingent consideration may lead to inconsistency when comparing similar transactions.

Question 7

We strongly disagree with the proposals for treatment of direct costs attributable to a business combination. We believe that such costs are included in the evaluation of a proposed business combination and hence should quite naturally be included in the calculation of any goodwill arising under a cost model.

We also believe that the treatment is inconsistent with the treatment of such costs when making other capital investments (for example the treatment under IAS16).

Questions 8 and 9—Measuring and recognising the assets acquired and the liabilities assumed

Question 8

In principle, we agree with the treatments proposed in the draft revision.

Question 9

We agree with the proposed exceptions.

Questions 10-12—Additional guidance for applying the acquisition method to particular types of business combinations

Question 10

We believe that this treatment is consistent although there may be a case for holding any such gains in equity rather than to recognise them immediately in the income statement.

Question 11

We do not object to this treatment

Question 12

We agree with the IASB on this point as we cannot envisage circumstances in which such a situation would knowingly arise.

Question 13—Measurement period

We agree with the proposed treatment that defines a period when the fair values of the assets and liabilities can be properly ascertained.

Question 14—Assessing what is part of the exchange for the acquiree

We have no comments to make on the proposed guidance.

Question 15—Disclosures

We believe that the proposed disclosures are appropriate.

Questions 16-18—The IASB's and the FASB's convergence decisions

Question 16

We are not convinced that intangible assets can always be separated and measured reliably. This again appears to be a highly theoretical concept that may not be applied consistently in practice.

Question 17

Conceptually, we agree that these assets should be accounted for outside the accounting for the business combination but we note that the emergence of such assets may influence the purchase consideration when making a financial appraisal of the business acquisition.

Question 18

We believe that differences are inevitable during a period of convergence as a consequence of impacted existing accounting practice that has not yet fully converged. There should be continuing effort to eliminate such differences as these other issues are re-examined.

Question 19—Style of the Exposure Draft

We have no issue concerning the style of preparation of the draft standard.

Other Issues

We note in the amendments to IAS 36 that it is proposed that where an impairment is recognised in respect of a partially owned subsidiary, then the impairment is allocated to the goodwill in proportion to the relative interests of the two classes of equity interest. We believe that it would be more appropriate to equalise any imbalance of the interest in the first instance and to allocate then, on the basis of the proportionate interests.