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**Letter of Comment No: 274**  
**File Reference: 1204-001**

Dear Mr Teixeira

### **IFRS 3 Business Combinations**

I am writing in response to the IASB's exposure draft on proposed amendments to its financial reporting standard on business combinations. The Association of British Insurers is the largest single grouping of UK institutional investors, our Members having some £1,200 billion of assets under management. As fund managers using accounts for investment decisions and as shareholders with the ownership interest in the shares and other securities of entities responsible for the preparation of financial statements, they have an important interest in high quality financial reporting.

We support the endeavours of the IASB to improve accounting for business combinations. We believe that the acquisition method of accounting for business combinations will be appropriate in most cases and we do not support the pooling method. However, we do believe there is merit in the "fresh-start" approach to combinations that fall into the category of "genuine mergers of equals" and we therefore encourage the IASB to take forward examination of this concept.

Our specific reason for making this response which we recognise reaches you some time after the end of the formal consultation period is to highlight our concerns on a matter which is closely connected to the wider and on-going review of the IASB's conceptual framework.

In so far as it relates to the consultation on business combinations we strongly disagree with the proposal that is the subject to question 3 of the Exposure Draft. The Board's proposal would, amongst other things, involve recognition of goodwill upon acquisition relating to 100% of the acquired entity even where less than 100% of the entity has in fact been acquired. Future changes in the proportion of the acquired entity owned by the parent would be recognised as changes in equity.

The IASB has put forward this proposal in accordance with the "entity concept" of accounting treatment. This is an essentially inward-looking concept the adoption of which we do not consider accords with the fundamental objective of financial

reporting by the preparing entity for the benefit of those with, or seeking to take, a financial interest in it. In the case of goodwill it has led to the Board proposing a manifestly unsound treatment which will have the effect of weakening management and board accountability to shareholders.

The concept of goodwill does not have meaningful existence other than in the context of the proprietary relationship of the company to its owners. The management is responsible for any decision to purchase businesses, in whole or in part, for more than the identifiable net asset value and should be accountable for its stewardship in this regard. There is no equivalent goodwill created in respect of that part of a subsidiary not acquired.

The interests of neither shareholders nor investors making decisions as to the merit of investing in the securities of the company preparing accounts on this basis would be served by such accounting treatment. These concerns highlight the significance of the current review by the Board of its conceptual framework on which insufficient debate has taken place so far.

More generally, the high profile cases of accounting irregularities in the earlier part of this decade have highlighted the difficulties that arise when accounts do not reflect the substance of shareholders' interests in the assets and liabilities of the reporting entity. We believe that greater attention to the stewardship and parent entity concepts would be a more productive route to achieving an accounting framework that better reflects substance over form. We would welcome the opportunity for dialogue with the IASB as it takes its conceptual framework project forward.

Yours sincerely

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