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Mr Alan Teixeira
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By email: commentletters@iasb.org

Dear Alan

Re: Exposure Draft of Proposed Amendments to IFRS 3 *Business Combinations*

We appreciate the opportunity to comment on the Exposure Draft of Proposed Amendments to IFRS 3 *Business Combinations*. Our comments have been prepared in consultation with members through our Asia-Pacific Financial Reporting Advisory Group (APFRAG) which is a board committee representing a regional perspective from South-East Asia, Oceania and Australasia.

Overall we are in agreement with the proposals. One major concern raised by our members is the reliance on fair value. Our members are concerned about the practical implications of relying on such a model, including the difficulties in reliable measurement and the increasing emphasis on the use of judgement required to determine appropriate values. However, our comments have been based on the assumption of consistent application of this fair value approach.

Our detailed comments are attached to this letter.

Should you have any queries on our comments, please contact Ms Sepi Roshan, CPA Australia's Financial Reporting and Governance Policy Adviser, at email: Sepi.Roshan@cpaaustralia.com.au.

Yours sincerely

Peter Lowe CPA
Chief Executive

cc: Sepi Roshan
David Boymal

CPA Australia comments on Exposure Draft of Proposed Amendments to IFRS 3 *Business Combinations*

Question 1 – Objective, definition and scope

Question 1 – Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

CPA Australia takes the view that all business combinations should be accounted for by applying the acquisition method regardless of the legal form of the combining businesses. We acknowledge that there may be difficulties in identifying the acquirer under some forms of business combination, but we do not take the view that these difficulties are insurmountable. We therefore support the increase in scope.

However, we are concerned that the continuing exclusion from the scope of the draft IFRS of businesses under common control has the potential to permit some entities to avoid applying the standard. For example, entities that wish to apply merger accounting could arrange for the controlling individuals to combine to form a single set of financial reports. Paragraph C8-9 notes that currently, this set of individuals may not be subject to the financial reporting requirements of IFRS, and, as a result, the entities they control could be brought together without applying the acquisition method.

Our members are curious as to why a review of accounting for businesses under common control has been deferred to future phases of the Business Combination project. In its equivalent exposure draft, the FASB continues to provide authoritative guidance for the treatment for the acquisition of entities under common control (see Proposed Statement of Financial Accounting Standards Business Combinations- a replacement of FASB Statement No. 141, Appendix C, paragraph C26). Guidance in the Draft IFRS 3 (Appendix C) only relates to identifying business combinations between entities under common control.

Question 2 – Definition of a business

Question 2 – Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

We consider the definition of a business and the additional guidance appropriate and sufficient. We support any additional guidance that provides clarity and encourages consistency in practice

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

Question 3 – In a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

We agree that, in a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, it is appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree – including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill (including the goodwill attributable to the non-controlling interest). The non-controlling interests must be clearly identified.

Question 4 – Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

We consider that the draft IFRS provides sufficient guidance for measuring the fair value of an acquiree. We support any additional guidance that provides clarity and encourages consistency in practice.

However, our members have expressed concerns about the increased emphasis on judgement required to sometimes determine fair value amounts.

Question 5 – Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer’s interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

We have encountered mixed views as to the whether acquisition date or another date such as the date a contract is signed is the appropriate date for measuring the fair value of the consideration transferred. Many argue that the agreement date is the more appropriate date as that is the date on which the values of the assets and liabilities exchanged are calculated for inclusion in the contract by the parties to the contract.

On balance, we take the view that the appropriate date for measuring the fair values associated with the acquisition is the date when control passes as it is at that date that any differences between the actual assets and liabilities transferred becomes apparent. We also believe that this is the date that the acquirer is able to start exerting its influence. Therefore, instead of identifying a specific date, we would prefer that reference be made to the “date control passes” rather than focussing on whether this will be the acquisition date or the date when the contract is signed.

Question 6 – Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

We consider that the accounting for contingent consideration is appropriate, but suggest that more cross-referencing is made to the requirements of the Draft IAS 37 to promote clarity of principles regarding the measurement of non-financial liabilities.

We would like clarification and the following wording change as it is implicit in IAS 37 that a non-financial liability contains contingencies (unconditional liability) and the change in terminology may confuse preparers and users of financial reports. Our members have raised concerns that changes in terminology can cause confusion and that standards must therefore use terms consistently.

To reduce confusion about terminology, as a result of the proposed changes to IAS 37, we suggest that following wording change to paragraph 26 (b)(2):

“are non-financial financial liabilities that ~~include a contingency~~ shall be accounting accounted for in accordance with [draft] IAS 37.....”

Question 7 – Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquiree? If not, why?

This approach being proposed embodies a principle, being that assets and liabilities acquired should be accounted for at fair value and that fair value does not include associated costs. As such, we agree that the costs incurred by the acquirer in connection with a business should be excluded from the measurement of the consideration transferred.

To ensure consistency, we urge the Board to ensure that these principles are embodied in all IFRSs.

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

Question 8 – Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

We consider that the changes proposed to the measurement of identifiable assets acquired and liabilities assumed in a business combination are appropriate in that they recognise these assets and liabilities at the fair value that would have been incorporated into the decision to make the acquisition.

Question 9 – Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

In our overarching view, to apply the principles being proposed consistently, all identifiable assets acquired and liabilities assumed should be recognised at fair value. However, we recognise difficulties in measuring certain assets and liabilities at fair value because other IFRSs require a measurement basis other than fair value immediately after acquisition or assumption. To ensure a consistent approach, we urge the Board to revisit the standards under which the exception assets and liabilities are measured to ensure that, in due course, it is practicable to measure these assets and liabilities at fair value.

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

Question 10 – Is it appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

We consider that it is appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree.

However, some of our members have raised concerns that such an approach could be used to artificially inflate an entity's profits, as it is essentially buying or selling shares from itself. Based on our understanding, CPA Australia suggests that the Board clarify that it sees each circumstance that results in the loss or gain of control as an in substance change in relationship, that will require remeasurement of assets and liabilities to fair value.

We suggest the following wording for paragraph 56:

“.....In a business combination achieved in stages, the acquirer shall remeasure its non-controlling equity investment in the acquiree.....and recognise any gain or loss in profit or loss **as the realisation of these gains and losses reflects the in substance change of relationship previously in existence. Therefore, [if] before the business combination**

Question 11 – Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer’s interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

We agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer’s interest in the acquiree is less than the fair value of that interest. We agree with the Board that a bargain purchase will be rare, but that other provisions of the draft IFRS may lead to an apparent bargain purchase. However, we believe that the requirement should be clarified.

Generally “in the absence of evidence to the contrary, the exchange price (referred to in this [draft] IFRS as the consideration transferred) paid by the acquirer.....is presumed to be the best evidence of the acquisition-date fair value.....” (paragraph 20). Fair value is defined as the “price at which an asset or liability could be exchanged in a current transaction *between knowledgeable, unrelated and willing parties*” (emphasis added) (paragraph 3(i)). It is accepted that sometimes “the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer’s interest in the acquiree” (Basis of Conclusion, paragraph BC59) even though it is agreed between the parties. With this acknowledgement and the example in Appendix A paragraph A64, we believe that the requirements in paragraph 61 need clarification. That is, that the goodwill that would otherwise be recognised is based on a fair value other than that determined by the willing parties involved in the acquisition (eg determined by a third party valuer).

Therefore, in order to clarify the requirements of paragraph 61, we suggest the following wording changes:

“If, after performing any remeasurements by the entity.....the acquirer shall account for that excess by reducing the amount of *any nominal* goodwill that *would have* otherwise ~~would be~~ *been* recognised *based on other available valuation techniques undertaken by a party, other than a willing party*, in accordance with paragraph 49.....”

Question 12 – Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

We consider it unlikely that the amount of an overpayment could be measured reliably at the acquisition date.

Question 13 – Measurement period

Question 13 – Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

We agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments. This approach is in accordance with the similar provisions of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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

Question 14 – Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

We consider that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree.

Question 15 – Disclosures

Question 15 – Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

We agree with the disclosure objectives and the minimum disclosure requirements.

Questions 16-18 – The IASB’s and the FASB’s convergence decisions

Question 16 – Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics:

- (a) the intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability; and**
- (b) cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?**

We have no reason to consider that an intangible asset that is found to be identifiable can not always be measured with sufficient reliability to be recognised separately from goodwill. However, our members are concerned about the increasing emphasis on the use of judgement required to determine appropriate values.

Question 17 – Do you agree that any changes in an acquirer’s deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

We agree that any changes in an acquirer’s deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination.

Question 18 – Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

The differences in disclosure between the IASB’s draft and the FASB’s draft appear to arise from differences outside the ambit of this draft IFRS. In our view, the aim should be for all differences between IFRSs and US GAAP to be eliminated so as to produce a single set of high quality global accounting standards. However, we expect such elimination to be achieved over a number of iterations rather than in a single change to a standard. As such, we are conscious that in the interim and for practical reason, the IASB and the FASB will have those disclosure differences.

Question 19 – Style of the Exposure Draft

Question 19 – Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

We find the style of the Exposure Draft generally consistent with the format of recent IFRSs. We appreciate the changed location of the definitions to the front of the draft IFRS rather than being lost in an Appendix.