

Tech4/SC/SC0009

Alan Teixeira
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

28 October 2005

Letter of Comment No: 214
File Reference: 1204-001

Dear Alan

Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations, IAS 27 Consolidated and Separate Financial Statements and IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits

We are pleased to present our comments on the above exposure drafts, which have been considered by the CIPFA Accounting and Auditing Standards Panel.

CIPFA has a number of concerns over the 'Business Combinations' package, many of which are shared by the Accounting Standards Board (ASB) and are signposted in the explanatory material attached to the ASB's parallel exposures reflecting Phases I and II of the Business Combinations project. The ASB has discussed the emerging results of the UK consultation with the UK CCAB institutes, and has explained the basis of the response the Board will be making to the IASB consultation.

Given the above, this response reflects only matters of particular relevance or concern to the public benefit sector.

Proposed Amendments to IFRS 3 Business Combinations
Question 1 Objective, definition and scope/ The Acquisition Method of Accounting
Question 4/ Fair Value generally

The Acquisition Method of Accounting

Our first concern is over the deliberate and exclusive focus of the proposed draft on the acquisition method of accounting. We share the view expressed by other commentators that in practice there are true mergers and that in such cases, the application of the acquisition method, specifying an acquirer in all cases, will not reflect economic reality. This is particularly true for many combinations in the public benefit sector, even those which do not involve entities under common control.

Furthermore, we note that proposed draft is silent on accounting for entities under common control. We consider that this is a very significant class of entities for which guidance is needed. In your Basis for Conclusions you indicate that the IASB will be undertaking research into 'fresh start' accounting, and we look forward to seeing development of this

alternative to the acquisition method; we also suggest that it would be sensible to consider whether this might usefully be extended to carefully defined categories of true merger.

Fair Value Generally

The guidance focuses on fair values as 'exit values' that are observable market prices. In the public benefit sector there are many circumstances where 'exit values' give a much less useful indicator of the service potential and future benefits arising from the use of assets, particularly in cases where 'exit' is an unlikely or remote prospect. As the use of fair value is extended in line with convergence between UK and international standards, we are concerned that fair value should, where appropriate, encompass the use of 'entry value'.

Furthermore, we are concerned that the Business Combinations package is being exposed in advance of further IASB work on Measurement. We understand that the IASB intends to redeliberate any issues that emerge from FASB work on fair value measurement, which might result in amendments to the guidance without further consultation. This would raise issues as to whether such amendments properly reflected due process, and would be of particular concern if this resulted in an increased requirement to use 'exit values' that are observable prices.

Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Question 2 – Contingent liabilities

Question 5 – Probability recognition criterion

Question 6 – Measurement

The proposed amendment includes proposals to:

- eliminate the use of the term contingent liabilities
- reclassify former contingent liabilities as liabilities and
- to value these on the basis of 'exit values', assessed as probability weighted point estimates.

While these proposals represent a radical and new approach, we can see that they might provide more useful information to readers of accounts under certain circumstances, notably where the potential liability:

- could be assessed with reasonable accuracy, both in terms of likelihood and amount or
- could be wholly or substantially avoided by transfer to a third party for monetary consideration, particularly where there is an active market.

However, our own consideration of these issues is particularly influenced by the position of governments, although we would expect similar arguments to apply to some private sector organisations. Governments often find themselves in the position of default guarantor for potentially very large liabilities. The nature of such liabilities tends to preclude 'exit' by an

effective transfer to a third party. More tellingly, while the likelihood of such liabilities being incurred is frequently low, they also tend to be difficult to estimate. The resulting combination of an unreliable estimated probability with a very large guaranteed amount would in many cases introduce material uncertainty into the entity balance sheet.

Yours sincerely

Liz Cannon
Assistant Director: Technical & International
liz.cannon@cipfa.org