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30 Cannon Street
London
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Letter of Comment No: 225
File Reference: 1204-001

By email to: commentletters@iasb.org

Dear Mr Texeira,

**EDs of Proposed Amendments to IFRS 3 Business Combinations, IAS 37 Provisions,
Contingent Liabilities and Contingent Assets and IAS 27 Consolidated and Separate
Financial Statements**

Further to our recent telephone conversation, I am writing on behalf of LIBA (the London Investment Banking Association) to comment on the Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations, which was published on 12 July, and on the related EDs on Proposed Amendments to IAS 37 and IAS 27; I am most grateful to you for allowing us to submit this letter a few days beyond the official 28 October deadline. LIBA is, as you know, the principal UK trade association for investment banks and securities houses; a list of our members is attached.

We have followed with considerable interest the discussions over the past few years on how best to account for Business Combinations, and we commented (in our letter of 3 April 2003) on a number of points in the previous (December 2002) ED on this topic. We therefore welcome the opportunity to comment on these latest EDs. We continue to support the Board's approach towards convergence, but we do have a number of comments on the current proposals.

Our principal concern with these proposals is the extended application of fair value accounting to non-financial assets and liabilities. As financial institutions, our members have generally supported the use of fair value measurement for financial instruments; its relevance and reliability are however crucial to our investors, and its use should therefore be subject to clear policies, governance, controls and disclosure.

We are concerned that the proposals, particularly the proposed amendments to IFRS 3 and IAS 37, appear to extend the application of fair value measurement to non-financial instruments without sufficient regard for the key concepts of relevance and reliability. We consider that the proposals not only contradict important parts of the IASB's Framework for the Preparation and Presentation of Financial Statements ("the Framework") but that they could potentially undermine the credibility of fair value measurement.

We also have significant concerns over the practical benefits of the “economic entity approach” which underlies the proposed amendments to IFRS 3 and IAS 27. Although we appreciate the conceptual basis for the amendments, namely that minority interests do not meet the definition of a liability under the Framework, we question the need for, and the timing of, the proposed changes to a model which preparers and users currently have little problem in applying, and which they clearly understand. Many of our members have either just completed, or are still involved in, the transition to IFRS and consider that amendments on the basis of conceptual purity that involve significant implementation issues for little practical benefit are ill-timed.

Given the significance of these proposals, we urge the Board to reconsider their timeframe in order to sponsor a wider and more transparent debate regarding what we consider to be fundamental changes in the application of fair value measurement, accounting for business combinations and the Framework.

In addition to these general comments, we have a number of specific comments on the current proposals. These are set out below, and (in the case of the proposed changes to IFRS 3) follow the structure of the questions in the “Invitation to Comment” section of the ED. Please note that we have not responded to all of these questions.

Proposed Amendments to IFRS 3

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, when would you make an exception, and what alternative do you suggest?

In our (3 April 2003) letter on ED 3 we stated that:

“We agree in principle that there are advantages to the adoption of a single method of accounting for business combinations. In particular, a single method helps to create a level playing field, both within and across accounting jurisdictions, and should enable the financial statements to provide greater transparency on the effects of business combinations.”

With regard to the current proposals, we continue to support the use of the purchase method of accounting for business combinations, based on its stronger conceptual merit and broader applicability. We welcome, however, the Board's commitment to explore a “fresh start” methodology, which we see as the right way to investigate the best means of reflecting the realities of those business combinations for which acquisition accounting does not provide the best representation of the economic substance of the transaction.

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 of additional guidance?

We have concerns that the definition is too wide. In particular, we are unclear how the definition would apply to managed portfolios of financial assets, such as those held by special purpose entities (“SPEs”) or segregated funds. Many SPEs consist of assets (i.e. inputs) the management of which is governed by a set of rules (i.e. processes) which produce increases in

value, correlation of risk etc (i.e. outputs). As a result we are unsure whether IFRS 3 should apply to the consolidation of SPEs.

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 goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

As stated in our general comments above, our members have significant concerns regarding the practical benefits of the “the economic entity approach” underlying the amendments to IFRS 3 and question the timing of these proposals.

We also indicated above that we are concerned about how the proposals will be applied in practice. With respect to the proposals in IFRS 3 regarding the “full goodwill method” we are unsure how an entity might differentiate between the fair value of the company as a whole and the fair value of the consideration paid for the interest acquired, especially when the acquiree’s shares are not publicly traded. As a result, the reliability of the value reported as goodwill may be compromised. Even if the values could be reliably determined, the costs (which are required to be expensed immediately) would be significant compared to the extra information the new methodology may convey. We consider that the practical difficulty of measuring goodwill and the reliability of any such measure may outweigh the perceived conceptual purity of this approach.

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 the guidance on measuring fair value contained in the definition (paragraphs 3(i)) and in the application guidance (paragraphs A8-A26) is sufficient at the present time. We note that guidance already exists in other IFRS (for example the fair value hierarchy in IAS 39) and we are concerned that providing further detail in IFRS 3 could lead to inconsistencies with those other standards.

As a result we do not support the inclusion of Appendix E at this time. We consider that Appendix E (or more precisely the FASB’s fair value measurement hierarchy which it represents) should only be incorporated into IFRS 3 after the IASB has been able to issue it as its own standard, after appropriate exposure and debate in a wider IFRS context. Potential inconsistencies and the wider application of fair value measurement to non-financial instruments can be considered as part of that debate. We therefore support the IASB’s decision at its September 2005 meeting to issue an exposure draft soon after the FASB finalises its fair value measurement proposals. Given the lack of reference to the Appendix in the body of the proposed standard, we consider that its removal should not have adverse consequential impact on the remainder of the proposals.

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

On the basis that fair value on acquisition date is an appropriate measure, we consider that fair valuing contingent consideration is necessary in order to be consistent with that model.

However, consistent with the general concern raised above, we consider that a value should be attributed to contingent consideration only where it can be reliably measured, which in practice we believe would be relatively rare. (The same argument would apply to the measurement of litigation-related contingencies - see our comments below on the proposed changes to 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?

We do not agree that costs should be excluded from the measurement of the consideration transferred for the acquiree. As noted in the alternative view expressed by two Board members (see paragraph AV18), analysts and acquirers alike regard acquisition costs as an intrinsic part of the investment against the return should be measured. We therefore believe that including acquirer costs in the fair value of the consideration transferred gives a more accurate reflection of the economics of the transaction.

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 have no particular comment on the proposed treatment of receivables, but we do have a major concern over the proposed measurement of contingent (or conditional) liabilities: this concern is set out in our comments below on the proposed amendments to IAS 37.

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?

In principle we support the concept of an acquirer recognising a gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree. It is consistent with the manner in which gains/losses are recognised in the rare circumstance that financial instruments are moved between classifications (e.g. from held-to-maturity to available-for-sale), and recognises the fact there has been a significant change in the nature of the investment held. However, we appreciate that there has been no sale or other exchange of the pre-existing interest in the subsidiary from which a gain or loss could have occurred. Accordingly, a possible way forward might be to record a revaluation of previously acquired interests (which were not included in the latest transaction giving control) in valuation reserves, and to reverse these into P&L on disposal.

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 consider that it may be appropriate to “expense” negative goodwill. However we are not certain that such treatment is consistent with the manner in which Day One P&L is recognised for financial instruments in IAS 39. In particular, the IFRS 3 proposals would require the recognition of profit immediately on a write-off of negative goodwill, irrespective of the liquidity/observability of the underlying assets and liabilities of the acquiree. For example, would the Board consider it appropriate to recognise negative goodwill immediately in the income statement when a significant portion of an acquiree’s assets were financial

instruments, the fair value of which relied on valuation techniques whose variables include data primarily from unobservable inputs?

Question 13- Do you agree that the 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 consider that measurement period adjustments are accounting estimates, and should therefore be treated in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. As a result, we believe that such adjustments should be made in the period of change or prospectively only.

Proposed Amendments to IAS 37

We share the concern expressed by UNICE (in their 29 July letter to Sir David Tweedie) that the proposed deletion of the probability recognition criterion in paragraph 14(b) of the current Standard implies a material change to the Framework, for which proper due process requires separate exposure and consultation. We believe, furthermore, that the much greater use of subjective probabilities in financial accounts which the proposed change would bring about has potentially significant adverse consequences for both preparers and users:

- The requirement to provide for the expected cost of a major adverse event (such as loss of a lawsuit) could result in critically sensitive information becoming available to opposing litigants and/or competitors.
- More generally, there is extensive evidence that the estimation of subjective probabilities of one-off events is extremely difficult, and that probabilistic estimates prepared by managers and their advisors are at best very unreliable, and at worst can be (consciously or unconsciously) distorted by factors such as a perceived need for consistency with budgets or other projected figures, and/or by a reluctance to disclose a commercially sensitive position.
- In the case of potentially significant one-off events, any estimation may need to consider a wide range of probabilities and possible settlement amounts. The leverage created by the variability in these two factors means that the value attributed to the non-financial liability may bear little resemblance to the amount for which the obligation will eventually be settled.

We therefore believe there is a serious risk that the proposed changes would result in the publication of figures which are less reliable, and less useful, than those that result from the disclosures required by the existing standard. For these reasons we strongly recommend that this change be excluded from the present exercise and be considered instead as a part of the Concepts project.

Proposed Amendments to IAS 27

We acknowledge the conceptual basis for the proposed amendments to IAS 27, namely that a non-controlling interest does not meet the Framework definition of a liability. However we are not convinced that the Board's decision to adopt an "economic entity approach" represents such a significant improvement to the reporting of business combinations to warrant exposure of the amendments so soon after transition to IFRS. In addition, many of our members

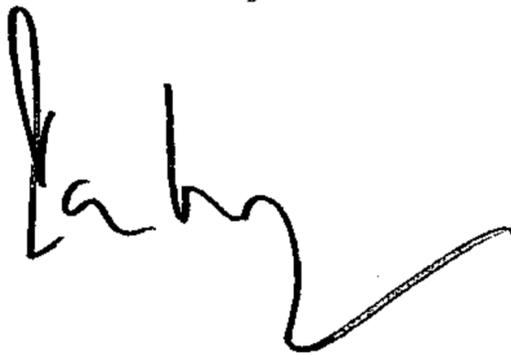
believe that although minority interests do meet the definition of equity, they should be differentiated from controlling interests, either as a separate or mezzanine component of equity, and therefore gains/losses attributable to transactions in those interests should also be differentiated from treasury share transactions and treated as transactions with third parties.

We also have the following practical concerns with these proposals:

- We consider that it may not always be appropriate to allocate losses to a non-controlling interest where the amount exceeds the investment made. This would be the case where there is an implicit understanding that the parent entity will guarantee the losses of the subsidiary. Since the guarantee is an understanding rather than a right, it is unlikely that the subsidiary would be able to recognise the impact of the protection under IAS 37, but conversely it does not seem appropriate to allocate losses to a non-controlling interest that may never need to provide for those losses. This could potentially underestimate the loss attributable to the parent entity.
- As significant users of financial statements, our members have not historically viewed minority interests as equity; we have instead preferred to exclude them when assessing the financial position of an entity, as inclusion could potentially overstate the portion of net income available to the parent entity. As a result we question whether the proposals result in more useful and relevant information for users than the existing “parent entity model”.
- Given that many of our members have recently made the transition to IFRS, we ask the Board to ensure that the transitional provisions in the proposed amendments to IAS 27 are consistent with the application of IFRS 1 to IFRS 3 and IAS 27.

I hope that the above comments are helpful. We would of course be very pleased to expand on any particular points if there are aspects which you find unclear, or where you would like further details of our views.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Harrison', with a long, sweeping underline.

Ian Harrison
Director

Copy: Michelle Crisp, ASB

LONDON INVESTMENT BANKING ASSOCIATION

LIST OF MEMBERS

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Arbuthnot Latham & Co., Limited
Arbuthnot Securities Limited
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Banc of America Securities Limited
Barclays Capital
Bear, Stearns International Limited
Brewin Dolphin Securities
Bridgewell Group Limited
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