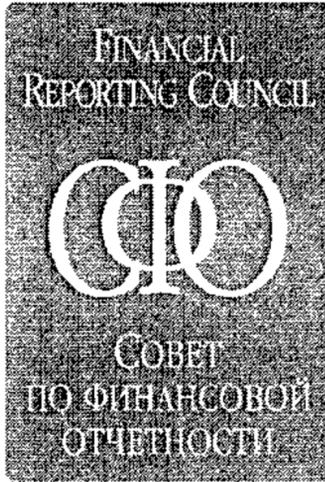


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22 b, build. 3,

Tverskaya ul.
? ?scow, 125009
Russia

Phone: (095) 975 7200

Ext. 037

E-mail: info@frcouncil.ru
gorbatovalv@polyusgold.com

Joint Comments of the Financial Reporting Council (FRC) and the IFRS Issues Committee at the Institute of Professional Accountants of Russia (IFRS Committee) on Exposure Draft of proposed Amendments to IFRS 3, Business Combinations, and Exposure Draft of proposed Amendments to IAS 27, Consolidated and Separate Financial Statements

Financial Reporting Council (FRC) and the IFRS Issues Committee at the Institute of Professional Accountants of Russia (IFRS Committee) are pleased to submit the comments on Exposure Draft of proposed Amendments to IFRS 3, Business Combinations, and Exposure Draft of proposed Amendments to IAS 27, Consolidated and Separate Financial Statements

With best regards,

Larissa Gorbatova,
Chair

Comments on Exposure Draft of proposed Amendments to IFRS 3, Business Combinations

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?

The existing definition of a business combination embraces all the types of combinations. Although existing IFRS 3 provides for an acquirer to be determined in every business combination, it does not consider obtaining **control** to be a necessary feature of a combination. Presumably there are business combinations in which no one party obtains control of the other (so called 'true mergers'). The proposed definition leaves such transactions out of the scope of IFRS 3, thus raising a question with regard to the method of accounting to be chosen for them.

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?

The definition of a business does not encompass sets of activities and assets which are purchased for the purposes of future return on investments, but are not capable to provide such a

return as of the acquisition date, e.g. a plant under construction, a company performing exploration without any revenue-generated activities, etc. It would be appropriate to include in the definition those sets of activities and assets which are presumed by the acquirer to be capable to provide a return on investments in the future.

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 can not support the proposed approach as a whole since we believe that it introduces too much subjectivity into measurement and recognition principles.

Goodwill initially appeared, and was treated, as a reconciling item justifying the amount paid over the fair value of identifiable net assets of the acquiree. The main idea about goodwill is that it is not identifiable, thus it can not be recognized as a separate asset. At the same time goodwill is not necessarily an asset, or a group of assets, which existed prior to the acquisition, i.e. existed as an asset, or a group of assets, of an acquiree, which could not be identified. Goodwill also can include a synergy which arises only as a result of a business combination (the Boards call it a second component of ‘core goodwill’ – BC 130-131) and may become visible for the combined entity after a while – after the synergy is realized. This means that were such a combination not take place, this part of goodwill would not be recognized. But the proposed approach is based on an assumption that fair value of the business **as of the acquisition date** includes the ‘synergy’ part of goodwill, which often is not the case. As a result of this assumption, there could be cases when the amount of ‘full goodwill’ is less than the amount of goodwill attributable to the parent company, in which the proposed accounting treatment does not look reasonable (BC 62).

We believe that this ‘synergy’ part of goodwill can be measured reliably only via reference to the consideration paid for the acquiree. We also believe that the whole issue of goodwill arises only in a case when an acquirer paid more than the fair value of net assets acquired, so goodwill as such is not necessarily a part of the business prior to its acquisition. Thus **we question the idea to recognize goodwill as an asset inherent in business, which exists separately from a business combination, and we question the reliability** of the measure of goodwill as of the difference between fair value of the business and fair value of its net assets. Thus we do not support the allocation of a part of goodwill to the non-controlling interest (NCI).

We consider the existing approach as a reasonable alternative, which is balanced with regard to costs and benefits, meets the prudence principle since does not allow to overstate assets, and provides a reliable measure of goodwill based on the best evidence of its fair value i.e.the consideration transferred for the acquiree.

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?

First, we would like to make a reference to our response to the question 3 where we indicate our disagreement with the proposed approach as a whole.

Second, the ED introduces the measurement of the non-controlling interest held prior to the business combinations at fair value with recognition of gains/losses from changes in fair value in profit and loss account. This approach contradicts with the provision in the existing IAS 39, which prohibits fair valuing of unquoted equity instruments IAS 39.46(c) and for those quoted which are available for sale requires recognition of changes in fair value in equity IAS 39.55(b).

We suggest not to consider non-controlling interests in the acquiree owned prior to the acquisition as a part of the consideration transferred for the acquiree and, instead, to retain the existing approach.

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 agree that from the point of the proposed approach – full fair value approach - the costs incurred in connection with business combination should not be recognized as assets but expensed. But since we do not support this approach as a whole (see above our comment on the Question 3) we believe that there should be criteria set for recognition those costs as assets or as an expense.

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 agree that the proposed changes are in line with the approach in the ED.

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?

We believe that the proposed exceptions are reasonable.

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?

Please see the response to the question 3.

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?

First, we would like to make a reference to our response to the question 3 where we indicate our disagreement with the proposed approach as a whole.

Second, the practical implications of this approach are not clear. E.g. if the acquirer finds out that the fair value of the net assets acquired exceeds the fair value of the consideration paid, is it possible not to go the all way around with fair valuing the acquiree as a whole, determining full goodwill (difference between the fair value of the business acquired and fair value of its net assets), but instead to recognize the difference between the fair value of the net assets acquired and the fair value of the consideration paid as a gain – i.e. to go short-cut. Example A65 allows this way of calculations, but paragraphs 60-61 of ED require the full set of procedures. If it is not allowed, we believe that the requirements in the ED will be too costly for preparers with no additional benefits for users.

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?

First, we would like to make a reference to our response to the question 3 where we indicate our disagreement with the proposed approach as a whole.

However, since the proposed approach is based on the assumption that all the items necessary for goodwill calculation & allocation can be measured at fair value at the acquisition date, namely: consideration transferred to the seller, purchased interest in the acquiree, net assets of the

acquiree, acquired business, - impossibility to measure the overpayment does not seem to be in line with the whole concept of full fair value accounting for business combinations. At the same time it is not clear what exactly is meant by 'overpayment': under the proposed approach this 'overpayment' may in fact represent synergy, which is not included in the fair value of the business acquired because it was not inherent in this business as of the acquisition date, but is only a result of the combination. Thus we think that it could be a problem to measure the amount of overpayment due to the fact that there could be not really an overpayment, but a synergy part of goodwill arisen on acquisition which can be measured reliably only **after the acquisition date**, when this synergy is realized.

So we believe that the problem to measure the overpayment at the acquisition date is a result of the proposed approach, which presumes that goodwill is an unrecognized asset inherent in the acquiree at the acquisition date. The existing approach to recognition and measurement of goodwill provides the reasonable basis for goodwill accounting, which is consistent with the substance of goodwill.

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 do not agree with the requirement to restate the comparative information for prior periods if the combining entity changes its provisional accounting values during the measurement period. We believe that such changes should be accounted for as changes in accounting estimates and, accordingly, no restatement of prior period should be required.

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 do not support the requirement in ED 74(b)1) to disclose the revenue and profit or loss of the combined entity for current reporting period as though the acquisition date for business combinations that occurred during the year been as of the beginning of the annual reporting period. In practice many questions arise with regard to application of this requirement, e.g. what if the acquiree did not compile financial statements at all, what if all, or the most part of, the acquiree's revenue came from the related parties, etc. We believe also that such a requirement results in an unjustified extra costs for the preparer while the benefits are questionable. We suggest to exclude 74(b)1), or, at least, to provide more guidance on its application in the situations mentioned above.

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 believe that all licenses have the characteristics specified. Thus it is usually impracticable to measure them with sufficient reliability to recognize separately from goodwill.

Comments on Exposure Draft of proposed Amendments to IAS 27, Consolidated and Separate Financial Statements

Question 1

Draft paragraph 30A proposes that changes in the parent's ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes would be recognised in profit or loss (see paragraph BC4 of the Basis for Conclusions).

Do you agree? If not, why not and what alternative would you propose?

We agree with the proposed approach from the practical point of view. The existing standard is silent on those issues, while such transactions are often the case. And this proposal is also in line with the treatment of minority interest as of a part of equity.

Question 2

Paragraph 30D proposes that on loss of control of a subsidiary any non-controlling equity investment remaining in the former subsidiary should be remeasured to its fair value in the consolidated financial statements at the date control is lost. Paragraph 30C proposes that the gain or loss on such remeasurement be included in the determination of the gain or loss arising on loss of control (see paragraph BC7 of the Basis for Conclusions).

Do you agree that the remaining non-controlling equity investment should be remeasured to fair value in these circumstances? If not, why not and what alternative would you propose?

There could be two different scenarios for the investor:

- 1) loss of control, but retaining significant influence
- 2) loss of control and loss of significant

Under the first scenario the remaining interest in the investee is to be accounted using the equity method in accordance with IAS 28, Investments in Associates. Thus the proposed treatment is supposed to change IAS 28 provisions regarding the equity method, which requires investments in associates to be initially measured at cost, not at fair value, but the ED is silent about such changes.

Under the second scenario the remaining interest in the investee is to be accounted as an equity instrument under the IAS 39, which prohibits fair valuing of unquoted equity instruments IAS 39.46(c) and for those quoted which are available for sale requires recognition of changes in fair value in equity IAS 39.55(b) (please see also our response to the question 5 on proposed changes to IFRS 3 above).

Accordingly, we would like to draw attention of the Boards to the inconsistencies, which the proposed treatment will cause, if adopted, and suggest a different approach to measurement of the remaining interest in the investee at corresponding share in carrying amount of net assets of the investee, if significant influence is retained, and in accordance with IAS 39, if no significant influence is retained.