

Letter of Comment No: 248
File Reference: 1204-001

October 25, 2005

Alan Texeira
Senior Project Manager
International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH,
United Kingdom

Dear Mr. Texeira:

Proposed Amendments to:

- **IFRS 3 - Business Combinations**
 - **IAS 27 Consolidated and Separate Financial Statements**
-

The Canadian Accounting Standards Board (AcSB) is strongly in favour of having single high quality, globally accepted accounting standards for business combinations and non-controlling interests. As a consequence, the AcSB issued an exposure draft on business combinations that is fully converged with the IASB and FASB exposure drafts. Similar to the IASB's exposure drafts, the comment period for the Canadian exposure draft on business combinations ends on October 28, 2005.

AcSB's approach

The AcSB's approach to date on this project has been to maintain a watching brief on the work done by the IASB and the FASB, and to make pertinent suggestions and observations on an exception basis, as it did in the case of the proposed treatment of negative goodwill, when it appeared to the AcSB that the analysis of the issues was incomplete. It now appears to the AcSB, however, that the full implications of some of the proposals may not have been fully evaluated. The AcSB's purpose in submitting this response is to urge the IASB to reconsider its approach to the completion of this project.

Fair value measurement

While the AcSB strongly supports the use of fair value as the basis of initial measurement, the proposals will create inconsistencies between the accounting for assets acquired as part of a business acquisition, and the accounting for similar assets acquired outside a business acquisition

(for example, the treatment of acquisition costs will differ depending on whether an asset is acquired as part of, or outside, a business acquisition). Such inconsistencies are undesirable and should be avoided where possible. The issuance of a stand-alone standard for fair value measurement guidance, applicable to all transactions requiring such measurement, would provide an important safeguard against inconsistent fair value measurements. The AcSB urges the IASB to reconfirm its intention to issue such stand-alone guidance before the new standard for business combinations accounting becomes effective. Moreover, you will recall that the AcSB wrote to the IASB and the FASB on March 1, 2005 expressing concerns that all issues relating to fair value measurement had not been appropriately addressed, either in the business combinations project or the fair value measurement project.

A number and variety of pervasive and fundamental issues are addressed in the exposure drafts, certain of which also have important ramifications for other areas of accounting outside business combinations. These include the proposed treatment for contingent assets and liabilities, and contingent consideration. The change to have the probability of cash inflows and outflows of assets and liabilities affect measurement rather than recognition is a fundamental and far-reaching change. While there is considerable merit in the concept of measuring all contingencies, there can be practical difficulties in measuring the associated assets and liabilities due to the significant uncertainty that sometimes surrounds these items (for example, a law suit that has just been filed for a seemingly quite unrealistic amount of damages, and that will take some time to determine if there is any liability, let alone the amount that might be paid). In addition, the benefit of fair valuing items with a low fair value relative to the cost of doing so requires careful consideration.

Non-controlling interests

The proposed changes for the treatment of non-controlling interests, including the following, are also significant:

- The use of the entity view for the reporting entity, as opposed to a version of the parent entity view.
- The treatment of non-controlling interests as equity and the consequential treatment of step-acquisitions and partial dispositions that do not lead to a loss of control (the AcSB recognizes that the IASB's conceptual framework leads to non-controlling interests being treated as equity).
- The proposal to measure and recognize 100 per cent of the fair value of the goodwill of an acquiree when the acquirer holds less than 100 per cent of the equity of the acquiree.

The AcSB realizes that the current version of IFRS 3 classifies non-controlling interests as part of equity of the consolidated entity. It might be argued that the proposals merely provide detailed implementation guidance to support the principle. However, it is not apparent that the implications have been researched and subjected to due process. In particular, the case must be made why the entity view of the reporting entity, on which the proposed model is based, provides superior information for investors and creditors of the parent company. This proposal alters the view of the reporting entity fundamentally, with consequential implications for debt and equity categorization, and performance measurement. There are many who believe that

performance should be reported from the perspective of the controlling shareholder and that the present model is superior in this regard.

The proposals in the exposure drafts appear to be based on the contention that non-controlling interests do not qualify as a liability under basic financial statement concepts, and therefore must be considered to be a form of equity in the consolidated financial statements of the parent entity. However, this argument presumes that the definition of a liability should not be re-examined as the result of the business combinations project. If it were to be determined that the parent entity view of the reporting entity is appropriate, it would seem logical that any interest in the entity that does not comprise an interest in the parent should not be considered to be part of the equity of the entity. Adopting this view would create a conflict between two basic financial statement concepts – anything that does not qualify as a liability must be equity and anything that is not the parent’s interest in a reporting entity cannot be equity. This potential contradiction should not be ignored in establishing basic consolidation principles. Rather, further study may be required (a) to determine whether a contradiction in fact exists (i.e. whether the parent entity view is appropriate) and (b) if so, resolve the contradiction in an appropriate way (either by defining liabilities to include non-controlling interest, or creating a separate “credit” balance in the balance sheet that is neither a liability or equity).

Additional research

The AcSB stands ready to assist the project team in whatever way it can, but questions the feasibility of dealing with all of the issues as part of the current project in light of the apparent widespread divergence of views. More research and debate on some issues may be required. It would be preferable to focus on a few issues that are of critical importance in applying the purchase method. Changes, particularly those that may require broader application to transactions and in circumstances other than business combinations, such as the proposed treatment of contingencies and non-controlling interests, might be better understood and accepted if proposed separately for consideration and subsequent application at a later date.

We would be pleased to discuss these comments with you at your convenience. If you have any questions please contact either me by e-mail at paul.cherry@cica.ca or by phone at 416 204 3456, or Harry Klompas (Principal, Accounting Standards) by e-mail at harry.klompas@cica.ca or by phone at 416 204 3236.

Yours sincerely



Paul G. Cherry
Chair
Accounting Standards Board