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Grant Thornton International and its U.S. member firm, Grant Thornton LLP, appreciate the opportunity to jointly comment on the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) Exposure Drafts on business combinations.

We support the issuance of a common standard on business combinations and believe the standard proposed would be a significant step toward achieving the Boards' objective of developing a set of accounting standards that can be used for both international and U.S. financial reporting. We believe the Boards have succeeded in developing an objective-based standard that will improve financial reporting. We also believe that the proposed accounting objective for business combinations and scope of the standard are appropriate. In addition, we believe that the proposed guidance on the application of the accounting objective is generally consistent with that objective and appropriate.

Although we support the issuance of a common standard on business combinations, we have significant concerns about the following provisions of the proposed standard:

- the definition of a business. We believe that the proposed definition of a business and related guidance is not sufficient to appropriately distinguish between a business and an asset or asset group. It is too broad and could be applied in practice to identify an asset or asset group as a business. (Question 2)

- noncontrolling equity interests in the acquiree held by the acquirer immediately before the acquisition date. We support the proposal to remeasure those interests as of the acquisition date, because we agree that change of control is an economic event and remeasurement is consistent with the
accounting objective for recognition of the acquiree. However, there is no acquisition-date transaction with an outside party for those interests. Therefore, we believe that:

1. those noncontrolling interests should not be characterized as consideration transferred (Questions 5 and 15)

2. the remeasurement gains or losses are analogous to unrealized gains or losses on available-for-sale securities. Accordingly, we believe that such acquisition-date remeasurement gains or losses should be recognized in equity (other comprehensive income (FASB)) and recycled to profit or loss (IASB) (reclassified to income (FASB)) upon impairment or disposal of the related interests. (Question 10)

- acquisition-related costs. We believe that direct acquisition-related costs represent a component of the measure of the fair value of the acquirer's interest in the acquiree and should be included in the accounting for a business combination. (Question 7)

- recognition of intangible assets separately from goodwill. We support full convergence with the FASB recognition criteria. However, we believe that it is not clear whether the proposed amendments to IFRS 3 achieve or are intended to achieve full convergence. The examples in the application guidance appear to reflect the FASB’s presumption that an intangible that meets the identifiable criteria has also met the definition of an asset, of which control is an essential characteristic. In contrast, the definition of an intangible asset in IAS 38, Intangible Assets, is the recognition threshold in the proposed amendments to IFRS 3. That definition requires the presence of both identifiability and control. Therefore, we believe the proposed amendments to IFRS 3 should explain how the control element of the definition should be considered in the context of a business combination. (Question 16)

- effective date. We recommend that the effective date of the standard be at least six months from the issue date of the final standards on business combinations and noncontrolling interests.

- guidance in the Basis for Conclusions. We suggest that the Boards consider whether any discussion in the Basis provides guidance that should be authoritative for the consistent application of the standard in accordance with their intentions.

The areas of concern outlined above are described more fully in the following detailed responses to the Boards’ questions on the Exposure Drafts and specific recommendations that we believe will help preparers and auditors better understand and apply the standard.
Question 1: Objective, Definition of a Business Combination, and Scope

We support the proposed financial accounting objective, definition of a business combination and scope. We believe the objective is appropriate and provides a good foundation for the proposed standard.

We believe the discussion of the definition of a business combination in paragraph BC32 of the IASB’s Basis for Conclusions on the proposed standard is not consistent with the proposed standard itself. The proposed definition of a business combination is “a transaction or other event in which an acquirer obtains control of one or more businesses.” The IASB’s existing definition in IFRS 3 is “the bringing together of separate entities or businesses into one reporting entity.” Paragraph BC32 states:

Even though the new definition [of a business combination] focuses on control, all business combinations included in the scope of IFRS 3 are within the scope of the draft revised IFRS 3. Like IFRS 3 and SFAS 141, the proposed IFRS will continue to require the acquisition method to be applied to those rare combinations, if any, for which one of the combining entities does not obtain control of the other combining entity. However, the Board noted that it is committed to exploring in a future phase of its Business Combinations project whether the “fresh start” method might be applied to these combinations. (Emphasis added)

We think that a preparer may not understand that the Board intends that the proposed definition of a business combination apply to transactions that do not convey control. Thus the basis, which is not authoritative and, we understand, will be available only in English, explains that the definition of a business combination should be applied in circumstances that are outside the explicit scope of the proposed definition, that is, when control does not exist. To avoid confusion and inconsistent application of the proposed standard, we recommend that the IASB:

- include all guidance essential to the understanding of the definition of a business combination in the authoritative standard or application guidance
- express such guidance in a manner that does not explicitly contradict provisions of the definition itself, identify the guidance as an exception to the definition, or change the definition to be consistent with its intended application.

The FASB’s Basis for Conclusions also provides interpretive guidance on the definition of a business combination that we think the Board should consider including in the authoritative implementation guidance. For example, in paragraph B30 of its proposed Basis for Conclusions, the FASB observed that the existing Statement 141 definition of a business combination would not include a combination in which no party obtained control of another, but that the existing and
proposed definitions would apply to transactions in which an acquirer cannot be identified. We suggest that the Boards use the similar wording in paragraphs BC32 (IASB) and B30 (FASB) to describe the transactions to which the proposed (and existing Statement 141) definition of a business combination would apply so that constituents do not perceive that the Boards have adopted different definitions.

**Question 2: Definition of a Business**

We believe that the proposed definition of a business and related guidance is not sufficient to appropriately distinguish between a business and an asset or asset group. Although we agree with the Boards' decision not to expand the scope of the proposed standard to include asset acquisitions until the necessary research and deliberations are complete, we believe the proposed measurement and recognition differences between the two acquisition models will increase the financial statement impact of applying business combinations accounting, inappropriately, to an asset acquisition. Accordingly, we believe the definition of a business must be robust enough to appropriately distinguish a business from an asset group. We also encourage both Boards to add a project on asset acquisitions to their agendas.

We understand that the Boards based the proposed definition of a business on the existing definition in EITF Issue 98-3, “Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets of a Business.” The proposed definition would modify and clarify the existing EITF guidance that the Boards decided is too narrow and leads to unnecessarily restrictive interpretations of whether an integrated group of assets and activities constitutes a business. Therefore, the Boards incorporated modifications to the original EITF guidance in the proposed definition.

We believe the following proposed changes to the existing definition of a business would improve that definition:

- elimination of the “self-sustaining” requirement (FASB only, IFRS 3 does not include that requirement)
- clarification that inputs and processes but not outputs are essential elements
- clarification that administrative systems typically are not processes that are used to create outputs
- inclusion of the guidance in paragraph A5 on development stage companies.

We are concerned that the proposed definition could be applied so broadly as to inappropriately identify an asset or asset group as a business. Paragraph 3d defines a *business* as “…an integrated set
of activities and assets that is capable of being conducted and managed for the purpose….” We are particularly concerned about the phrase *is capable of being* in the definition. Paragraph B37a (FASB) indicates the phrase *is capable of being* is part of the replacement for the self-sustaining condition in the existing definition. Paragraph BC 37 (IASB) explains the IASB’s reason for adding this phrase as follows:

...the acquired set is assessed as it exists at the acquisition date rather than how it was used by the seller or how it will be used by the buyer. *This change is intended to clarify that a business need not include all of the inputs or processes that the seller used in operating that business if a willing acquirer is capable of operating the business, for example, by integrating the business with its own inputs and processes.* (Emphasis added)

The intended clarification described in paragraph BC 37 (IASB) is included in application guidance in the second sentence of paragraph A3, as follows:

However, a business need not include all of the inputs or processes that the seller used in operating the business if a willing party is capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with its own inputs and processes.

We do not believe that this guidance achieves its goal of distinguishing a business from an asset or asset group. The proposed guidance does not address how to determine the extent to which the inputs and processes of the seller’s business could be excluded from the transaction without changing the nature of what was purchased from a business to an asset group. A market participant’s ability to continue to produce outputs by acquiring something less than all of the seller’s inputs and processes is not dependent on whether the acquired part is determined to be a business. Therefore that ability is not sufficient to identify the acquired part as a business. We are concerned that paragraph A3 could be interpreted as effectively eliminating any distinction between a business and an asset or asset group and could result in the inappropriate identification of an asset or asset group as a business.

Furthermore, under paragraph A3, different parties could reach different conclusions about the nature of the same set of inputs and processes. We think that the reference to “a willing party” in paragraph A3 could be understood to mean a single market participant or, more generically, any market participant, or all market participants. Therefore, it appears that conclusions about the nature of a set could be based on a consideration of how the acquired set could be used by a specific acquirer (a willing party), notwithstanding the IASB’s expectation that the nature of an acquired set be assessed without consideration of how it will be used by the buyer. For example, a market participant with sufficient existing inputs and processes might be capable of continuing to
produce outputs by acquiring a small part of the seller’s business. That potential buyer could identify the acquired part as a business under the proposed guidance because of its ability to integrate that part to produce outputs. At the same time, other market participants (other willing parties) that would not be capable of producing outputs by acquiring such a small part of the seller's operations might determine that part to be a group of assets, rather than a business.

To reduce the likelihood of diverse and inappropriate interpretations of what constitutes a business, we recommend that the Boards:

- eliminate the phrase *is capable of being* from the definition of a business
- clarify the guidance in paragraph A3 to provide a robust distinction between a business and an asset group that can be applied to determine consistently whether an integrated set of activities is a business. We believe that the application of the proposed guidance could lead to inconsistent and inappropriate results. The guidance should be clear that the determination of whether an entity is a business should not be acquirer-specific; that is, the identification should not depend on whether a specific acquirer can provide inputs and processes. In addition, until the Boards have considered whether additional issues need to be addressed and concluded that business combinations accounting should apply to asset acquisitions, the definition of a business should not be expanded to the extent that it could apply to an asset or asset group.
- provide examples, like the following, to illustrate and clarify the application of the guidance to identify groups of assets and activities that fail to meet the definition of a business.

To gain an understanding of the proposed guidance, we considered the application of the existing and proposed definitions in the following three scenarios in which a company purchases a legal entity holding:

1. an investment property portfolio with tenants, staff, and services. We think this entity would be considered a business under the existing and proposed definitions.

2. an investment property with one tenant but no employees or services. Under both the existing and the proposed definitions, we think it may not be clear whether this entity is a business. We also think that the assessment of this scenario under the existing IASB and FASB definitions could be affected by the differences between them. The purchase could be considered an asset acquisition because the company did not acquire processes/activities. On the other hand, the acquired entity might be considered a business because the existence of the tenancy agreement brings service obligations that can be outsourced.
3. a completed investment property with no tenants, no employees or services. Under the existing definition, we believe that this purchase would be an asset acquisition because the acquired entity lacks processes/activities and is not producing outputs (generating revenue). For the same reason, the acquired entity could also be considered an asset under the proposed definition. However, the property is capable of generating revenue with outsourced services or services the buyer already has and, therefore, might be considered a business under the proposed definition. We believe the analysis in this scenario could apply to many acquisitions, including, for example, the acquisition of a retail store, a ship, or a technology patent. We also believe that the acquired entity in this scenario is more appropriately identified as an asset than as a business.

We support the Boards’ efforts to converge and clarify the existing definitions of a business in IFRS 3 and Statement 141. However, we believe the examples we provided illustrate that the proposed definition of a business and related application guidance include changes from the existing definitions and guidance that could, in some circumstances, effectively expand the scope of the business combinations standard to include asset acquisitions. We believe that such changes would not be appropriate until the Boards conclude that business combinations accounting should apply to asset acquisitions.

We do not believe the presumption in paragraph A7 that a particular set of assets and activities is a business if goodwill is present is useful guidance for identifying a business. Goodwill is defined as “future economic benefits arising from assets that are not individually identified and separately recognized.” (paragraph 3) It is measured as a residual, that is, the difference between the values of the identifiable net assets acquired and the fair value of the acquired business. Because the measurement attributes for a business differ from those for an asset acquisition, it might be necessary to know whether the acquired assets and activities constituted a business before determining whether the transaction includes goodwill. To make the presumption more useful, we suggest that the Boards clarify that it could be applied based on a qualitative assessment of whether core goodwill, as described in paragraphs B102 and B105 of FASB Statement 141 exists.

**Question 3: Recognition of full fair value of acquiree at the acquisition date**

We agree with the Boards’ proposed requirement to recognize the full acquisition-date fair value of the acquired business in all combinations, including those in which the acquirer holds less than 100 percent of the equity interests in the acquiree. We believe the proposed accounting is an appropriate application of the proposed standard’s objective. We also believe that the proposal will
be an improvement over existing accounting practice because it requires similar reporting for all change of control events regardless of whether the acquisition is achieved through the purchase of some or all of the acquiree's equity interests or through a single transaction or a series of transactions. Although we have some concern about the ability to reliably measure the full fair value of the acquiree in all circumstances, we believe the proposal has the advantage of requiring a fair value determination only at the point at which control is gained, as compared to current practice where subsequent purchases of noncontrolling interests in a subsidiary require a further fair value determination.

**Question 4: Sufficiency of fair value measurement guidance**

We believe that the Exposure Drafts' fair value measurement guidance is sufficient, but will need to be updated to conform to the guidance in the FASB's standard on fair value measurement if that standard is finalized before the business combinations standard. However, we question the implication in the last sentence of paragraph A19 that the market and income approaches, or variations thereof, are the only other valuation techniques relevant to the measurement of an acquiree. We suggest that the Boards not preclude the use of an asset-based approach (referred to as the cost approach). We believe that such an approach would be a relevant valuation technique in limited circumstances, such as in valuing some development stage companies and real estate entities.

We also suggest that the application guidance address how the existence of a control premium in the transaction that conveys control should be considered in the remeasurement of the previously acquired noncontrolling interests, especially if the acquirer will own less than 100 percent of the equity interests in the acquiree at the acquisition date. In our view, if there were evidence of an acquisition-date control premium in the consideration transferred in a step-acquisition, a careful analysis of all relevant facts and circumstances should be made to determine what affect, if any, the control premium would have on the measurement of the fair value of the acquirer's previously acquired noncontrolling interests.

**Question 5: Consideration transferred**

We support the use of the rebuttable presumption that the consideration transferred for the acquirer's interest in the acquiree provides the best basis for determining the fair value of that acquiree. We believe the presumption provides a practical approach to valuation of the acquiree and is based on market principles.

We agree that contingent consideration and equity interests issued by the acquirer should be measured and recognized at acquisition-date fair value. The proposed recognition and
measurement requirements are consistent with the proposed accounting objective for business combinations.

We also agree that the noncontrolling equity investment in the acquiree owned by the acquirer immediately before the acquisition date should be adjusted to acquisition-date fair value. That remeasurement would be consistent with the proposed objective of recognizing the full acquisition date fair value of the acquiree as a whole and with the underlying premise that gaining control of a business is an economic event to be recognized.

We do not agree that the previously acquired noncontrolling equity interest should be characterized as consideration transferred in exchange for the acquirer's interest in the acquiree. Such interests are not part of the exchange with the seller and are not transferred to the seller or other outside party as part of the acquisition-date exchange.

**Question 6: Subsequent accounting for contingent consideration**

We support the proposed subsequent accounting for contingent consideration.

**Question 7: Acquisition-related costs**

Although we agree that costs\(^1\) are not assets, we understand that the "asset" to be recognized is the acquired business as a whole. Therefore, we addressed the question of how to account for acquisition-related costs by considering the basis for measuring the fair value of what the acquirer acquired—a business. We believe that the amount of direct acquisition-related costs (transaction costs) incurred in connection with a business combination represents part of the measure of the fair value of the acquired business and should be accounted for as part of the business combination.

\(^1\) Paragraph 26, note 19 of FASB Concepts Statement No. 6. *Elements of Financial Statements*, defines cost as follows:

Cost is the sacrifice incurred in economic activities—that which is given up or forgone to consume, to save, to exchange, to produce, and so forth. For example, the value of cash or other resources given up (or the present value of an obligation incurred) in exchange for a resource measures the cost of the resource acquired. Similarly, the expiration of future benefits caused by using a resource in production is the cost of using it.
One measure of the estimated fair value of a business as a whole acquired in a single transaction for 100 percent ownership would be the expected present value\(^2\) of the cash flows acquired. For practical reasons, the proposed standard presumes that the fair value of consideration transferred by the acquirer for its interest in the acquiree is the best basis for measuring the fair value of the acquiree. We note that, like consideration transferred to the seller, transaction costs represent economic resources transferred by the acquirer. We believe that the measure of the fair value of the acquired business would be understated if transaction costs were not included as a component of that measurement.

We have observed that potential buyers consider whether an acquired business would provide an acceptable return on the total investment, that is, the aggregate of transaction costs and the price paid to the seller. Accordingly, the price offered to the seller by any potential buyer (market participant) would be limited to the amount by which the expected present value of the estimated cash flows acquired (the fair value of the acquirer's interest in the acquiree) exceeds the amount of estimated transaction costs. Although the exact amount of transaction costs incurred would be entity-specific, all willing buyers in the market for a business would incur some amount of such costs. Therefore, marketplace expectations of the amount of recoverable transaction costs have a direct impact on the market price of the seller's interest in the business being sold. A specific potential buyer that expects to recover transaction costs significantly in excess of marketplace expectations would, all else being equal, be prepared to pay less to the seller. A seller unwilling to accept a price that would allow a buyer to recover transaction costs from the cash flows acquired could have trouble achieving its price expectation. We believe that those market interactions ensure that, in an arm's-length transaction involving unrelated willing parties, the measure of the fair value of the acquirer's interest in the acquiree (the expected present value of estimated cash flows acquired) includes both the price paid (fair value of the consideration transferred) to the seller and the amount of transaction costs incurred by the acquirer. Therefore, the inclusion of the amount of transaction costs incurred in the business combinations accounting as a component of the measure of the fair value of the acquirer's interest in the acquiree is necessary to provide a faithful representation of what the buyer acquired—the business as a whole.

\(^{2}\) *Expected present value*, as the term is used in this letter, has the meaning provided in FASB Concepts Statement 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, which defines *expected present value* as follows:

*Expected present value* refers to the sum of probability-weighted present values in a range of estimated cash flows all discounted using the same interest rate convention.
Question 8: Measuring and recognizing assets acquired and liabilities assumed at fair value

We support the proposed changes to accounting for receivables, contingencies, costs associated with restructuring or exit activities (FASB), and research and development assets (FASB). We believe those changes are consistent with the proposed accounting objective for business combinations.

We recommend that the FASB clarify paragraph 36a in its Exposure Draft. We understand that paragraph 36a is intended to provide guidance on subsequent accounting for assets and liabilities arising from contingencies that were recognized a part of the business combination. A contingency that did not meet the definition of an asset or liability on the acquisition date would not have been recognized at fair value initially. However, as drafted, paragraph 36a appears to apply to all contingencies, not only to those that are recognized as part of the business combination accounting because they meet the definition of an asset or liability. Based on our understanding, we suggest paragraph 36a be revised as follows:

An asset or liability arising from a contingency—that would be within the scope of Statement 5 if it were acquired or incurred in an event other than a business combination—shall continue to be measured at fair value. Any changes in fair value shall be recognized in income in each reporting period.

Question 9: Exceptions to the fair value recognition principle

We support the proposed exceptions to the fair value recognition principle for deferred taxes, assets held for sale, and employee benefits.

We suggest that the guidance on operating leases in paragraph 47 be clarified. That paragraph appears in the proposed standard in the section describing assets and liabilities not recognized at fair value. Therefore, it is unclear whether the first sentence in paragraph 47 would require recognition of net fair value of the asset and liability embodied in an operating lease because no measurement attribute is provided. Consequently, it is also unclear whether recognizing the net fair value of a market-rate lease at an amount greater than zero would be permitted under the proposed standard. We believe that the guidance in paragraph 47 should be consistent with the FASB's conclusion, stated in paragraph 173 of Statement 141, that at-the-money operating leases are contracts that "...may have value for reasons other than terms that are favorable relative to market prices."

Finally, the Board should also clarify how the asset and liability for a favorable and unfavorable lease differs from the acquisition date net value recognized in accordance with the first sentence of paragraph 47.
Question 10: Recognition of gain or loss on previously acquired noncontrolling equity investments

We do not agree that the acquisition-date remeasurement gains or losses on the previously acquired noncontrolling equity interests should be recognized in profit or loss (IASB)/income (FASB). Those remeasurement gains and losses would not have been realized through an acquisition-date exchange with an outside party. Therefore, we do not believe that they should be recognized in a measure of performance. We think that those acquisition-date remeasurement gains and losses are analogous to unrealized gains and losses on available-for-sale securities. Accordingly, we recommend that the effect of remeasuring previously acquired noncontrolling equity interests in the acquiree as part of a business combination be recognized in equity (other comprehensive income (FASB)) and recycled to profit or loss (IASB) (reclassified to income (FASB)) upon impairment or disposal of the related interests. We acknowledge that preparers will need to account for those gains and losses subsequent to the acquisition-date.

Question 11: Consideration transferred less than fair value of interest acquired

We support the proposed accounting for acquisitions in which the fair value of the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest.

We suggest that Example 6 (paragraph A67) be clarified by explaining in the introductory text that goodwill is allocated to noncontrolling interests in the example for calculation purposes only and that, if the acquirer recognizes a gain, then none of the acquiree’s goodwill would be recognized.

Question 12: Measurement of overpayment

We support the Exposure Drafts’ treatment of overpayments, that is, an acquirer would not be permitted to recognize an acquisition-date loss for an overpayment for the acquiree. We think that it might be possible to identify and measure obvious overpayments in some situations (for example, in a hostile takeover situation that has significantly restricted the acquirer’s due diligence before acquisition and that does not provide any mechanism to adjust consideration to acquisition-date fair value of the acquired interest). However, we believe that it would be difficult in most combinations to reliably determine whether control premiums and routine revisions to preacquisition financial estimates used in the acquisition negotiations represent overpayments. It would also be difficult to separate an overpayment from the normal operation of a competitive market in which the acquirer, in order to win the bid, must pay a price that is usually higher than any other market participant is willing to bid. We believe that to reliably measure an overpayment in a business combination, there
would need to be a clear definition of what constitutes an overpayment, in addition to clear, compelling, and timely external evidence as to the existence and amount of a significant overpayment. We believe the existence of such evidence would be rare.

**Question 13: Measurement Period**

We support the proposed financial statement presentation of the effects of measurement period adjustments.

**Question 14: Assessing what is part of the acquiree**

We agree with the proposed requirement to determine what should be accounted for as part of the business combination. However, we believe the application guidance needs to be clarified.

Paragraph A88 provides that a transaction or event arranged primarily for the economic benefit of the *combined entity* would *not* be accounted for as part of the business combination, in contrast to the treatment of a transaction or event arranged primarily for the benefit of the *acquiree*. Because the acquiree is *part* of the combined entity, we believe the Boards should either (1) eliminate references to the acquiree from the guidance on identifying elements of a transaction that are not part of the business combination or (2) clarify (a) how a transaction or event could benefit the acquiree without also providing the same benefit to the combined entity and (b) whether transactions that provide significant benefits to both the acquiree and the combined entity should be included in the business combination accounting.

Paragraph A98 attempts to explain how the recognition principle in paragraph A88 should be applied to arrangements to pay for employee services as follows:

To assist in that determination, it is important to understand whether the transaction includes payments or other arrangements for the economic benefit of the *acquirer* or combined entity *with little or no benefit received by the acquiree or its former owners*. To the extent that it is, that portion of the transaction price (and related liabilities) should be accounted for separately from the business combination. (Emphasis added)

Our comment on paragraph A88 also applies to paragraph A98. In addition, the application of the criterion in paragraph A98 is not useful and is confusing in the context of arrangements with former owners because arrangements that effectively provide compensation in exchange for continued employment benefit both the combined entity and the former owners/employees. We note that the
analysis of each of the additional factors in subparagraphs A99a through A99c considers only whether the combined entity benefits, not whether the employee or former owner benefits, from the arrangement. Therefore, we believe that the general guidance in paragraph A98 could be clarified by eliminating the phrase, "...with little or no benefit received by the acquiree or its former employees."

Paragraph A99d guidance on the distinction between the types of contingent payments that may be indicators of fair value adjustments, and the types that may indicate compensation arrangements, could be clarified. We suggest that the Boards clarify the difference between multiples of earnings and percentages of earnings, and why they would be treated differently. For example, we suggest the Boards consider whether contingent payments based on performance measures that are part of a continuing employment arrangement could be a postcombination performance bonus rather than a fair value adjustment that is part of the business combination.

**Question 15: Disclosures**

We agree with the proposed disclosure objectives. However, we believe the following required disclosures should be eliminated or revised:

- **eliminate paragraph 74b.** The disclosures in paragraph 74b are required in the U.S. only in financial statements of public companies, as unaudited pro forma information, and therefore, would be more appropriate in Management’s Discussion and Analysis of Financial Condition and Results of Operations.

- **eliminate paragraph 76d (LASB).** We believe that this disclosure imposes additional costs and effort in return for questionable benefits. Acquirers would incur costs to track separately and consider the significance of any gain or loss realized on any of the identifiable assets acquired or liabilities assumed in a business combination. Regardless of the cost or effort expended, we do not believe the proposed disclosure would be effective for its apparent purpose of deterring or identifying the use of unreasonable valuations in accounting for a business combination. We believe that purpose is served by financial statement audits that address the reasonableness of significant valuation estimates used in financial reporting.

- **replace paragraph 72k.** We suggest replacing paragraph 72k with a broader, more general disclosure of the elements of the transaction that are not included in the business combination. We recognize that paragraph 72k is part of the codification of EITF Issue 04-1, “Accounting for Preexisting Relationships between the Parties to a Business Combination.” However, requiring detailed disclosures only for preexisting relationship settlements and not for other elements of the transaction excluded from the business combination, incorrectly implies that, in
all circumstances, any preexisting relationship element of the transaction is itself significant and is more significant than other elements of the transaction.

- eliminate paragraph 72/(6). An acquirer’s previously acquired noncontrolling equity interests in the acquiree should not be characterized as consideration transferred because such interests were not part of an acquisition-date exchange with an outside party.

**Question 16: Recognizing intangible assets apart from goodwill**

We support full convergence with the FASB recognition criteria, which includes the presumption that identifiable intangible assets can be reliably measured and the requirement that an assembled workforce be subsumed into goodwill. However, we believe that it is not clear whether the proposed amendments to IFRS 3 achieve or are intended to achieve full convergence.

In Statement 141, the FASB specified *identifiability* characteristics as a recognition criterion, not as part of the definition of an intangible asset. In developing Statement 141, the FASB concluded the following:

...identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill... [Statement 141, paragraph B151]

...an intangible asset that meets the contractual-legal criterion or the separability criterion presumably also would meet the asset recognition criteria. The Board agreed with those respondents that it was not necessary to explicitly state that an intangible asset that meets the recognition criteria in paragraph 39 also meets the asset recognition criteria in Statement 5. [Statement 141, paragraph B155]

To be recognized as an asset in accordance with FASB Concepts Statement 5, an item must meet the definition of an asset, which is provided in FASB Concepts Statement 6, paragraph 25, as follows:

Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

18 *Probable* is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, *Accounting for Contingencies*, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is
Concepts Statement 6, paragraph 26 describes the essential characteristics of an asset as follows:

An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

Therefore, the FASB's presumption that an identifiable intangible has met the asset recognition criteria includes a presumption that the acquirer has the ability to obtain and control others' access to the future benefits of the asset. Appendix A of the proposed standard provides extensive guidance on the application of the identifiable criterion but provides no guidance on assessing whether control exists. Appendix A incorporates the guidance from EITF Issue 02-17, "Recognition of Customer Relationship Intangible Assets Acquired in a Business Combination." In its consensus opinion that some customer relationships meet the contractual/legal criterion for recognition even though a contract does not exist at the acquisition date, the EITF did not explicitly address whether control exists. Therefore, Appendix A guidance is consistent with the FASB's presumption that an intangible that meets the identifiable criteria has also met the control element of the definition of an asset.

Paragraph 40 of the IASB Exposure Draft would require an intangible to be recognized separately from goodwill if it meets the definition of an intangible asset in IAS 38, Intangible Assets. Paragraph 10 of IAS 38 lists the elements in the definition of an intangible asset as "identifiability, control over a resource and existence of future economic benefits." Because IAS 38 explicitly incorporates both identifiability and control as separate elements of the definition, meeting the identifiability criterion by itself may not be conceptually sufficient for recognition apart from goodwill. Under IAS 38, the recognition of an intangible also requires an assessment of whether control exists, as illustrated in paragraphs 15 and 16 of IAS 38.

In particular, paragraph 16 of IAS 38 states that

An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty
of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (e.g., portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

In practice, we have found that the determination of whether control exists for specific intangibles, especially customer relationship intangibles, can be difficult. We believe that constituents could reach different conclusions under international and U.S. accounting standards as to whether a specific intangible should be recognized apart from goodwill.

Therefore, we believe the proposed amendments to IFRS 3 should explain and illustrate how the control element of the definition of an intangible asset should be considered in the context of a business combination. We also believe IAS 38 should be clarified for intangible assets acquired in a business combination if the IASB has adopted the presumption that the control element of the asset definition is satisfied for an intangible that is identifiable.

**Question 17: Recognition of the acquirer's existing deferred tax benefits**

We support the FASB's convergence decision to account for any change in the recognition of the acquirer's existing deferred tax benefits separately from the business combination accounting.

**Question 18: Disclosure convergence**

Our comments on specific disclosures are provided under Question 15. We do not believe that the benefit from convergence on the remaining disclosures would be worth the time and effort required to achieve that convergence.

**Question 19: Style of Exposure Draft**

We like the style of the document. However, please see our comment below on guidance in the Basis for Conclusions.
Other matters

- *effective date.* We recommend that the effective date of the standard be at least six months from the issue date of the final standards on business combinations and noncontrolling interests. We urge the Boards not to underestimate the amount of time it takes preparers, especially small and mid-sized entities, to understand and implement a new accounting standard.

- *guidance in the Basis for Conclusions.* We suggest that the Boards consider whether any material currently only in the Basis for Conclusions provides guidance that should be included in the authoritative application guidance for the consistent application of the standard in accordance with their intentions. For example, we believe that the discussion in paragraphs BC18 (IASB)/B23(FASB) about the fundamental principles underlying the standard is relevant to the understanding and application of the standard and should be incorporated into authoritative literature. Additional examples of matters discussed in the proposed Basis that provide guidance that we think would help constituents better understand and apply the standard as the Boards intended include (IASB/FASB):
  - paragraphs BC 37/B37, which describe the nature of the changes made to the definition of a business
  - paragraphs BC 87/B97, which describe why some alternatives to recognizing transaction costs separately from the business combination were considered and rejected by the Board
  - paragraphs BC149-150/B154-155, which explain the reasons for adopting a particular method of allocating goodwill between controlling and noncontrolling interests
  - paragraphs BC 151-152/B156-157, which explain the logic for recognizing gains and losses on the noncontrolling interests
  - paragraph BC163/B164, which discusses the measurement period.

We appreciate that our suggestion is challenging because the proposed standard, including the application guidance, is already lengthy and because the Basis for the IASB and FASB Exposure Drafts are not fully converged. Each Basis addresses the converged provisions of the proposed standard in the context of existing international or U.S. generally accepted accounting principles. However, we believe that the treatment of such guidance is an important issue because we understand the Basis is issued in English only, and therefore, is not accessible to some constituents. In addition, we are concerned about the potential to lose track of the connection between authoritative and the related nonauthoritative but vital guidance in the FASB codification process.

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We would be pleased to discuss our comments and recommendations with Board members or staff. Please direct your questions or comments to Joseph Graziano at +1 (732) 516-5560 on behalf of Grant Thornton LLP, or April Mackenzie at +1 (732) 624-5428, on behalf of Grant Thornton International.

Sincerely,

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John L. Archambault, Partner
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