Dear Alan


1. This letter sets out the Accounting Standards Board’s views on the above Exposure Drafts. Our main points are set out below. Our responses to the specific questions raised in each of the Exposure Drafts are set out in Appendices to this letter.

2. The ASB continues to have strong reservations whether the proposals, overall, will lead to a significant improvement in financial reporting. In our view, the proposals introduce new concepts and we do not support the conversion of the Exposure Drafts into International Financial Reporting Standards (IFRSs) until a proper debate on these concepts has been undertaken.

Relationship with the Framework

3. Where it can be demonstrated that the proposals being introduced into IFRSs will bring about sufficient benefits, in terms of convergence and improvements in financial reporting, it would be acceptable to issue standards which introduce principles that are inconsistent with or go beyond the Framework (including re-interpretation of existing principles). However we are concerned that the proposals within these Exposure Drafts introduce new principles into IFRSs and may pre-empt in-depth debate within the Conceptual Framework project and within the work that is being undertaken on Measurement. As discussed in paragraphs 7 to 9 below, the ASB believes that the benefits of the proposals are questionable.
4. The Conceptual Framework project and the work regarding Measurement are addressing the core principles of financial reporting. It is therefore essential that these more fundamental projects do not have predetermined conclusions as a result of the Business Combinations project. Should the current proposals be developed into IFRSs (despite our reservations) it is essential that the principles being introduced are re-debated as part of these far reaching and fundamental projects. We believe that such principles are being introduced through:

- the application of the “entity approach”. The ASB continues to believe that the “parent entity approach” provides a better focus for financial reporting than the entity approach. We consider that reporting transactions between the parent entity and non-controlling interests merely as transfers within equity fails to recognise that the primary objective of consolidated financial statements is to provide information about the financial performance of an entity to the investors in the parent entity. The information requirements of non-controlling equity interests are in our view better satisfied by the financial statements presented by the entity in which they hold their interests;

- the requirement to measure the acquiree at fair value. This extends the use of the fair value principle and implies that, conceptually, transactions should be recorded at fair value, rather than cost. We are disconcerted to note that the IASB states that it has embraced this general principle\(^1\) without full discussion and debate; and

- the proposed amendments to IAS 37, that liabilities should be measured at fair value—and that this means settlement, or ‘exit’ values. Whilst there are some exceptions to the proposed requirement, the exceptions seem to be made on pragmatic grounds.

*Proposed amendments to IAS 37*

5. We have further concerns about the proposed amendments to IAS 37. The amendments arise from two projects; the Business Combinations project and the Short-term Convergence project. The amendments that arise from the Business Combinations project result in the elimination of the terms ‘contingent liabilities’ and ‘contingent assets’ and a new analysis is applied to such items. The implications of these proposals may give rise to practical difficulties. In particular, in the absence of a threshold for recognition, it may be difficult to ensure all liabilities are recognised. Also the proposals, arguably, introduce a greater degree of subjectivity in measuring liabilities.

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\(^1\) See IFRS 3, BC52, last sentence.
Whilst the draft Standard requires that only liabilities that can be reliably measured be recognised, a significant degree of judgement will sometimes be required both as to whether that criterion is met and, if so, the appropriate amount at which the liability should be stated. We consider these amendments need not be introduced as part of the second phase of the Business Combinations project. As such we believe it might be better to delay the proposed amendments to IAS 37 until further analysis, including field-testing of the proposals, has been completed on the practical implications that arise.

**Fresh start accounting**

6. We wish to emphasise that in our view it is inappropriate to require a single method of accounting for all business combinations. Acquisition accounting is capable of providing a representationally faithful depiction of reporting the acquisition of one business by another. It is, however, not a representationally faithful way of reporting a business combination in which one entity does not acquire another—no party to the transaction is an acquirer and accounting should not be based on the fiction that one of them is. For this reason ASB continues to advocate research into ‘fresh start accounting’.

**Benefits of the proposals**

7. We are not sure of the extent to which the Exposure Drafts address a deficiency in financial reporting and thereby what contribution the proposals make to the improvement of financial reporting:

- we recognise that one consequence will be that goodwill is reported at the same amount whether an acquisition is achieved in stages or in a single transaction—however we doubt that, if this is a deficiency of current financial reporting, it seriously undermines the workings of the capital markets;

- we note that the amendments to IAS 37 will result in contingent liabilities being stated at similar amounts whether or not they arose from a business combination. However, it is not unusual for a discontinuity in financial reporting to arise in the case of a business combination, and, if this is a deficiency, it is not obvious that it is significant in practice; and

- it may perhaps be preferable to treat minority interests as equity rather than as liabilities—but to do so involves the introduction of detailed requirements explaining whether transactions are to be regarded as linked, and so accounted for as a single transaction or dealt with independently. This is an important issue that needs resolution—but
it arises in a far wider range of transactions than business combinations and needs to be addressed at a fundamental level, and not re-debated in the context of each Standard.

8. Although there is obviously some benefit for those entities reporting under both IFRS and US GAAP, views differ on the extent of those benefits, and in any event similar benefits could be achieved by closer alignment of existing IASB and FASB Standards. We are not clear what benefits the proposals bring to those reporting only under IFRS. We also have a concern that the proposals may be difficult for smaller entities to comply with.

9. We have the impression that IASB considers the other advantage of its proposals to be the wider use of ‘fair value’—but we do not believe the IASB has a mandate for this at this stage, given the confusion that exists as to what ‘fair value’ represents and how it should be measured. We consider that further research and in-depth debate on the appropriateness of the fair value measurement basis is required before the proposals are adopted.

Due process

10. As noted above we are concerned that by introducing principles as part of the Business Combinations project wider debate is pre-empted in the more fundamental projects. We also query why the IASB chose to propose such significant changes to existing Standards without issuing a discussion paper on the proposals before an Exposure Draft. Specifically we note the IASC Foundation Constitution (July 2005) states the IASB shall:

   “publish an Exposure Draft on all projects and normally publish a discussion document for public comment on major projects”

11. We would also like to take this opportunity to record our concern regarding the Board’s decision at its September 2005 meeting to issue the FASB’s final statement on fair value measurement as an IASB Exposure Draft with an Invitation to Comment. As detailed in ‘IASB Update’ the IASB will only be briefed on and discuss the FASB document in order to identify issues that should be included in the Invitation to Comment before issuing the Exposure Draft. Only after the comment period for the Exposure Draft will the Board debate the issues identified by the Board and constituents, and make any required changes to the Exposure Draft before issuing an IFRS. We consider that it is incumbent on the IASB only to issue an Exposure Draft when it has fully debated the issues and is satisfied it has fulfilled its objective to develop high quality, understandable and enforceable global accounting standards.
Suggested way forward

12. As set out in paragraph 2 we do not consider the proposals should proceed in their current form to IFRSs. We suggest the following course of action:

- in relation to the Exposure Drafts of proposed amendments to IFRS 3 and IAS 27 the significant changes of principle outlined in paragraph 4 above should be debated in relation to the Conceptual Framework Project and work being undertaken in relation to Measurement. Only once these proposals have been debated and conclusions drawn should the Exposure Drafts be developed into IFRSs;

- we also suggest that in the interim period, whilst these exposure drafts are deferred, the proposals are more extensively researched and field testing is carried out. At the same time research into 'fresh start accounting' should take place;

- in relation to the Exposure Draft of proposed changes to IAS 37 we consider:

  - the new analysis applied to contingent assets and contingent liabilities (including changes made to the probability recognition criterion) is a conceptual improvement but we are concerned as to the practical implications of these proposals. We consider these proposals should be deferred until after further analysis and field testing has been completed on the practical implications that may arise;

  - we do however consider the changes that arise from the Short-term Convergence project should amend the Standard.

- in relation to the Exposure Draft of proposed changes to IAS 19 we consider these proposals, subject to our comments in Section D of Appendix 4 to this letter, should amend the Standard.

13. The ASB has issued the outputs from Phase I and the proposals from Phase II of the Business Combinations project as a package of UK and Republic of Ireland Financial Reporting Exposure Drafts (FREDs 36 to 39). We have invited comments on these FREDs by 28 October 2005. We have forwarded to you all comment letters received to date, other than those that are confidential. As our response date is simultaneous with that of the IASB’s we have not finished analysing comment letters, thereby this letter (and its appendices) makes no attempt to summarise the comment letters received to date or to make comment on them.
14. We hope that our comments contribute to your discussions. Should you have any questions regarding the contents of this letter please do not hesitate to contact either Andrew Lennard (020 7492 2430) or Michelle Crisp (020 7492 2432).

Yours sincerely

[Signature]

Ian Mackintosh
Chairman
Section A: Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations

1 Objective, definition and scope

The proposed objective of the Exposure Draft is:

...that all business combinations be accounted for by applying the acquisition method. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). In accordance with the acquisition method, the acquirer measures and recognises the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date. [paragraph 1]

The objective provides the basic elements of the acquisition method of accounting for a business combination (formerly called the purchase method) by describing:

(a) what is to be measured and recognised. An acquiring entity would measure and recognise the acquired business at its fair value, regardless of the percentage of the equity interests of the acquiree it holds at the acquisition date. That objective also provides the foundation for determining whether specific assets acquired or liabilities assumed are part of an acquiree and would be accounted for as part of the business combination.

(b) when to measure and recognise the acquiree. Recognition and measurement of a business combination would be as of the acquisition date, which is the date the acquirer obtains control of the acquiree.

(c) the measurement attribute as fair value, rather than as cost accumulation and allocation. The acquiree and the assets acquired and liabilities assumed would be measured at fair value as of the acquisition date, with limited exceptions. Consequently, the consideration transferred in exchange for the acquiree, including contingent consideration, would also be measured at fair value as of the acquisition date.

The objective and definition of a business combination would apply to all business combinations in the scope of the proposed IFRS, including business combinations:

(a) involving only mutual entities

(b) achieved by contract alone

(c) achieved in stages (commonly called step acquisitions)

(d) in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date.

(See paragraphs 52-58 and paragraphs BC42-BC46 of the Basis for Conclusions.)

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?
As set out in our response to IAS 3 we have reservations about requiring the acquisition method for all business combinations. In certain circumstances it may not be possible to identify an acquirer and therefore the use of acquisition accounting (which reflects that acquisition of one entity by another) may not faithfully represent the business combination. We consider that "true" mergers do occur and therefore we do not agree that a business combination is necessarily a transaction or other event in which an acquirer obtains control of one or more businesses.

The measurement of the acquiree, as a whole, results in the recognition of goodwill attributable to non-controlling interests. We have set out our concerns in relation to the recognition of goodwill attributable to non-controlling interests in response to question 3.

As set out in our covering letter, we are concerned that the requirement to measure the acquiree at fair value extends the application of the fair value measurement principle and implies that, conceptually, transactions should be measured at fair value, rather than cost.

We do not consider the objective is appropriate. We consider that the IASB should actively pursue research into 'fresh start accounting' as a potential alternative to the acquisition method where an acquirer cannot be identified.
2 Definition of a business

The Exposure Draft proposes to define a business as follows:

A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:

(1) a return to investors, or

(2) dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants. [paragraph 3(d)]

Paragraphs A2-A7 of Appendix A provides additional guidance for applying this definition. The proposed IFRS would amend the definition of a business in IFRS 3. (See paragraphs BC34-BC41.)

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?

We consider the three elements (inputs, processes and outputs) are well placed and provide a useful tool to determine whether an integrated set of activities represents a business. It is our view that the acquiree must meet the definition of a business as set out in paragraph 3(d) of the draft Standard. In this regard we are concerned with the use of the expression “capable of being conducted and managed...” We consider this expression is too wide: it could embrace circumstances where an acquirer is able to demonstrate that a particular set of assets is “capable of being conducted as a business” although alone the set of assets is not a business. Consider the example of an entity that operates in the outsourced catering market acquiring a canteen currently managed as an in-house canteen. The set of assets (canteen) is capable of being managed as a business although the assets are not currently managed as a business. As the assets are capable of being conducted as a business it might be argued that, if the assets are acquired above fair value, goodwill should be recognised which would be inappropriate. We consider the definition and application guidance should be modified such that the term “capable of being conducted and managed” is replaced with “are conducted and managed”.

We note that paragraph A7 states that if goodwill is present in a particular set of assets and activities then (in the absence of evidence to the contrary) the set shall be presumed to be a business. In our view this allows paragraphs A2 to A6 to be circumvented. It would appear that the acquisition of a set of assets above fair value should “raise the question” whether the set of assets acquired is a business – then paragraphs A2 to A6 should be applied. The possible existence of goodwill follows from the conclusion that what has been acquired is a business.
3 Measuring the fair value of the acquiree

The Exposure Draft proposes that in a business combination that is an exchange of equal values, the acquirer should measure and recognise 100 per cent of the fair value of the acquiree as of the acquisition date. This applies even in business combinations in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at that date. In those business combinations, the acquirer would measure and recognise the non-controlling interest as the sum of the non-controlling interest's proportional interest in the acquisition-date values of the identifiable assets acquired and liabilities assumed plus the goodwill attributable to the non-controlling interest. (See paragraphs 19, 58 and BC52-BC54.)

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 are of the view that the recognition of 100 per cent of the acquiree, where an acquirer holds less than 100 per cent, requires a hypothetical transaction to be recognised. Paragraph 82 of FRS 2 'Accounting for subsidiary undertakings' sets out that recognition of goodwill attributable to minority interests would in effect recognise an amount of goodwill attributable to the minority interest that is hypothetical because the minority is not a party to the transaction by which the subsidiary undertaking is acquired.

Similarly, we do not recognise a parallel between the recognition of full goodwill and the recognition of 100 per cent of the value of other identifiable assets acquired and liabilities assumed. The ASB does not consider goodwill to be a separable asset – but part of a larger asset, the investment. Under the parent entity concept goodwill relates to the cost of the investment and provides useful information for users of the financial statements on the decisions and actions management has made. The recognition of full goodwill introduces a "notional" item into the Balance Sheet and distracts from the existing clarity of financial statements.

We note that the Basis for Conclusions states the amount of goodwill recognised in a business combination achieved in stages and that achieved in a single transaction will not be the same because goodwill is a mixture of some current exchange prices and some carry-forward book values. This gives rise to inconsistent information that is not as complete or as useful as it would be without them. The Basis for Conclusion does not identify the negative impact on financial reporting that these inconsistencies create.
Response to IASB Invitation to Comment Business Combinations

Appendix 1

4 Measuring the fair value of the acquiree

The Exposure Draft proposes that a business combination is usually an arm’s length transaction in which knowledgeable, unrelated willing parties are presumed to exchange equal values. In such transactions, the fair value of the consideration transferred by the acquirer on the acquisition date is the best evidence of the fair value of the acquirer’s interest in the acquiree, in the absence of evidence to the contrary. Accordingly, in most business combinations, the fair value of the consideration transferred by the acquirer would be used as the basis for measuring the acquisition-date fair value of the acquirer’s interest in the acquiree. However, in some business combinations, either no consideration is transferred on the acquisition date or the evidence indicates that the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer’s interest in the acquiree. In those business combinations, the acquirer would measure the acquisition-date fair value of its interest in the acquiree and the acquisition-date fair value of the acquiree using other valuation techniques. (See paragraphs 19, 20 and A8-A26, Appendix E and paragraphs BC52-BC89.)

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 provided in paragraphs A8 to A26 is inconclusive. We are concerned that measuring the fair value of an acquiree is particularly subjective and attempting to provide detailed guidance may not be practical.

We note that the IASB has recently decided to issue the FASB final statement on Fair Value Measurement as an IASB Exposure Draft with an Invitation to Comment. We presume Appendix E of the Exposure Draft will be revised in light of this decision. We consider this is a better alternative to that proposed in the Exposure Draft or proposed amendments to IFRS 3 which suggests that the IASB could amend the guidance without further consultation prior to issuing the IFRS. We are however concerned that the IASB has decided to issue a FASB document and, only after the
5 Is the consideration transferred the best evidence of the fair value of the acquiree?

The Exposure Draft proposes a presumption that the best evidence of the fair value of the acquirer’s interest in the acquiree would be the fair values of all items of consideration transferred by the acquirer in exchange for that interest measured as of the acquisition date, including:

(a) contingent consideration;
(b) equity interests issued by the acquirer; and
(c) any non-controlling equity investment in the acquiree that the acquirer owned immediately before the acquisition date.

(See paragraphs 20-25 and BC55-BC58.)

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?

We are of the view that where a controlling interest is acquired but less than 100 per cent of a business is acquired, estimating the fair value of the acquiree had 100 per cent been acquired is extremely subjective. Using the consideration transferred to estimate the fair value of the acquiree may not be appropriate because:

(i) it may fail to recognise any control premium included in the consideration transferred. The control premium may be difficult to measure with sufficient reliability; and

(ii) the consideration transferred is based on the acquirer’s assessment of future returns it anticipates the investment will generate. These returns may include an assessment of future synergy benefits the acquirer anticipates it will achieve. Some of the synergy benefits may benefit the parent entity rather than the acquired entity and thereby have little or no relevance to the non-controlling interests in the acquired entity.

As noted in our earlier comments we are concerned about the extension of the fair value principle; it thereby follows that we have concerns about the remeasurement of non-controlling equity investments immediately before the acquisition date (see also our responses to questions 6 and 10).
6 Contingent consideration

The Exposure Draft proposes that after initial recognition, contingent consideration classified as:

(a) equity would not be remeasured.
(b) liabilities would be remeasured with changes in fair value recognised in profit or loss unless those liabilities are in the scope of IAS 39 Financial Instruments: Recognition and Measurement or [draft] IAS 37 Non-financial Liabilities. Those liabilities would be accounted for after the acquisition date in accordance with those IFRSs.

(See paragraphs 26 and BC64-BC89.)

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

The proposed treatment of contingent consideration reflects the view that changes that revise the estimate for contingent consideration and have arisen since the acquisition date represent events that have occurred since the date of acquisition. It is our view that contingent consideration arrangements often arise where the acquirer and vendor are unable to agree the level of consideration at the acquisition date due to a measurement uncertainty – for example the level of sales. We therefore consider a revision to the estimate for contingent consideration may provide more information about conditions that existed at the date of acquisition and should, in such circumstances, be reported as a change in the fair value of consideration and a corresponding change to goodwill.

We further believe that it is inevitable that managements will exercise extreme caution in determining at the outset the provision for any contingent consideration so as to give rise to future profits rather than losses.
7 Acquisition costs

The Exposure Draft proposes that the costs that the acquirer incurs in connection with a business combination (also called acquisition-related costs) should be excluded from the measurement of the consideration transferred for the acquiree because those costs are not part of the fair value of the acquiree and are not assets. Such costs include finder’s fees; advisory, legal, accounting, valuation and other professional or consulting fees; the cost of issuing debt and equity instruments; and general administrative costs, including the costs of maintaining an internal acquisitions department. The acquirer would account for those costs separately from the business combination accounting. (See paragraphs 27 and BC84-BC89.)

**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 with the logic the IASB has developed for the treatment of acquisition related costs. We agree such costs are not assets themselves but note that they arise directly from the decision to acquire the asset; an input price (replacement cost) perspective justifies treating these costs as part of the cost of the asset. Further, we consider the inclusion of acquisition related expenses provides a more economically significant benchmark against which to assess the return on investment. Where the costs of acquisition are excluded from the investment cost managers are, in subsequent accounting periods, not held accountable for the full costs of acquisition as such cost will have been charged to the profit and loss when incurred.

We agree with the dissenting opinions in paragraph AV18 of the Exposure Draft that the proposed treatment creates an inconsistency with the accounting for purchases of property, plant and equipment and non-controlling equity investments. In our view the accounting for these assets is correct.

8 Changes to exceptions to the fair value measurement principle from IFRS 3

The Exposure Draft proposes that an acquirer measure and recognise as of the acquisition date the fair value of the assets acquired and liabilities assumed as part of the business combination, with limited exceptions. (See paragraphs 28-41 and BC111-BC116.) That requirement would result in the following significant changes to accounting for business combinations:

(a) Receivables (including loans) acquired in a business combination would be
measured at fair value. Therefore, the acquirer would not recognise a separate valuation allowance for uncollectible amounts as of the acquisition date.

(b) An identifiable asset or liability (contingency) would be measured and recognised at fair value at the acquisition date even if the amount of the future economic benefits embodied in the asset or required to settle the liability are contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events. After initial recognition, such an asset would be accounted for in accordance with IAS 38 Intangible Assets or IAS 39 Financial Instruments: Recognition and Measurement, as appropriate, and such a liability would be accounted for in accordance with [draft] IAS 37 or other IFRSs as appropriate.

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 with the proposed changes to measurement of receivables. In relation to identifiable assets or liabilities (contingencies) we agree with the requirements to measure these at fair value but we refer to our response on the Exposure Draft of proposed amendments to IAS 37.

9 Exceptions to the fair value measurement principle

The Exposure Draft proposes limited exceptions to the fair value measurement principle. Therefore, some assets acquired and liabilities assumed (for example, those related to deferred taxes, assets held for sale, or employee benefits) would continue to be measured and recognised in accordance with other IFRSs rather than at fair value. (See paragraphs 42-51 and BC117-BC150.)

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?

In general we agree with the exceptions to the application of the fair value measurement principle. We would like to take this opportunity to express our view that there is an urgent requirement to review (outside the current convergence project) the fundamental principles of accounting for deferred tax.
10 Remeasurement of non-controlling equity investments held immediately before acquisition

The Exposure Draft proposes that, for the purposes of applying the acquisition method, the fair value of the consideration transferred by the acquirer would include the fair value of the acquirer's non-controlling equity investment in the acquiree at acquisition date that the acquirer owned immediately before the acquisition date. Accordingly, in a business combination achieved in stages (step acquisition) the acquirer would remeasure its non-controlling equity investment in the acquiree at fair value as of the acquisition date and recognise any gain or loss in profit or loss. If, before the business combination, the acquirer recognised changes in the value of its non-controlling equity investment directly in equity (for example, the investment was designated as available for sale), the amount that was recognised directly in equity would be reclassified and included in the calculation of any gain or loss as of the acquisition date. (See paragraphs 55, 56 and BC151-BC153.)

**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?

We have highlighted in both our covering letter and our responses to specific questions that we are concerned that the requirement to measure the acquiree at fair value is an extension of the fair value principle. In our opinion the acquisition should be measured at the carrying value of any non-controlling equity investment at the acquisition date plus the consideration transferred at the acquisition date. We do not consider it appropriate to remeasure non-controlling equity investments held immediately before the the Business Combination (although they may be held at fair value).

We consider the measurement of the business combination at cost more appropriately reflects the transactions that management has entered into in a particular accounting period. By obtaining control through additional investment or other means, management acquire the right to direct the entity; it has not disposed of the original non-controlling investment. We do not consider the recognition of a gain or loss arising on the remeasurement of non-controlling equity investments held at the acquisition date reflects the value of a transaction that management has entered into.

Should this treatment be adopted we question why the gain or loss is recognised in the profit and loss account. The gain or loss arising on the remeasurement is not realised and is comparable to the revaluation of property, plant and equipment and should therefore be recognised directly in equity.
We note the Basis for Conclusions to the Exposure Draft explains the gain or loss arises as a result of the mixed attribute accounting model that exists today for financial instruments (i.e. the gain or loss recognised at acquisition is merely delayed recognition of an economic gain or loss present in the financial instrument). We are happy to debate and consider the accounting measurement of assets, including financial instruments, but do not consider fair value should be introduced on a piecemeal basis.

11 Business combination in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest

The Exposure Draft proposes that in a business combination in which the consideration transferred for the acquirer’s interest in the acquiree is less than the fair value of that interest (referred to as a bargain purchase) any excess of the fair value of the acquirer’s interest in the acquiree over the fair value of the consideration transferred for that interest would reduce goodwill until the goodwill related to that business combination is reduced to zero, and any remaining excess would be recognised in profit or loss on the acquisition date. (See paragraphs 59-61 and paragraphs BC164-BC177.) However, the proposed IFRS would not permit the acquirer to recognise a loss at the acquisition date if the acquirer is able to determine that a portion of the consideration transferred represents an overpayment for the acquiree. The boards acknowledge that an acquirer might overpay to acquire a business, but they concluded that it is not possible to measure such an overpayment reliably at the acquisition date. (See paragraph BC178.)

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 accept that the accounting for business combinations in which the consideration transferred is less than the fair value of the acquiree is a complex accounting issue where the IASB has attempted to be pragmatic.

We also note that limiting a gain recognised by reducing goodwill is not consistent with the fair value measurement principle, and calls into question the extended use of the fair value measurement principle.
12 Overpayments

**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?

The ASB is of the view that perceived overpayments are often economically justified due to "entity specific" circumstances such as synergistic benefits to the acquirer. In such circumstances the acquirer will recognise the acquiree at cost and generate returns that justify the cost of the investment. Were the acquirer required to impair the cost of the investment (e reduce the cost to a market determined fair value), future returns generated by the investment could be overstated. This indicates that cost is a more appropriate measure than the fair value model proposed in the Exposure Draft.

We believe an alternative to the treatment proposed is to require additional disclosures in IAS 36 Impairment of Assets of an impairment that arises within a specified time period (say two years) from the acquisition date. Disclosure should be made of the reason for the impairment together with the investment rationale leading to the acquisition.

13 Measurement period

The Exposure Draft proposes that an acquirer should recognise adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements would be adjusted, including any change in depreciation, amortisation or other profit or loss effect recognised as a result of completing the initial accounting. (See paragraphs 62-68 and BC161-BC163.)

**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 acknowledge that the proposals do not amend IFRS3 but we do not agree that comparative information should be adjusted for the effects of measurement period adjustments. We consider that comparative information should not be adjusted but that the adjustments should be made in accordance with IAS 8 and specifically "changes in accounting estimates". We do however consider that supplementary disclosure should be made where there is significant estimate uncertainty to the provisional values of the assets acquired and liabilities assumed.
14  Assessing what is part of the exchange for the acquiree

The Exposure Draft proposes that an acquirer assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred by the acquirer and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree would be included in the business combination accounting. (See paragraphs 69, 70, A87-A109 and BC154-BC160.)

**Question 14** – Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

The guidance is a little detailed - in practice it will often be a matter of judgement as to what is and what is not part of the business combination. We do however consider the guidance to be useful.

We would, however, note that we disagree with paragraph 41 of the Exposure Draft. In our opinion the acquisition of a right that the acquirer had previously granted should not give rise to the recognition of an intangible asset because it is internally generated.

15  Disclosures

The Exposure Draft proposes broad disclosure objectives that are intended to ensure that users of financial statements are provided with adequate information to enable them to evaluate the nature and financial effects of business combinations. Those objectives are supplemented by specific minimum disclosure requirements. In most instances, the objectives would be met by the minimum disclosure requirements that follow each of the broad objectives. However, in some circumstances, an acquirer might be required to disclose additional information necessary to meet the disclosure objectives. (See paragraphs 71-81 and BC200-BC203.)

**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 disagree that the disclosure requirements secure adequate information and in particular note that the fair value table previously required by paragraph 68(f) of IFRS 3 is no longer required. Although we accept the information provided by the table does not provide information about an economic transaction, it does provide a valuable insight into management’s assessment of the fair value of assets acquired and liabilities assumed. The information is of a similar character to that required by IFRS 1 paragraphs 38 and 39.

16 Reliable measurement of intangible assets

The Exposure Draft is the result of the boards’ projects to improve the accounting for business combinations. The first phase of those projects led to the issue of IFRS 3 and FASB Statement No. 141. In 2002, the FASB and the IASB agreed to reconsider jointly their guidance for applying the purchase method of accounting, which the Exposure Draft calls the acquisition method, for business combinations. An objective of the joint effort is to develop a common and comprehensive standard for the accounting for business combinations that could be used for both domestic and cross-border financial reporting. Although the boards reached the same conclusions on the fundamental issues addressed in the Exposure Draft, they reached different conclusions on a few limited matters. Therefore, the IASB’s version and the FASB’s version of the Exposure Draft provide different guidance on those limited matters. A comparison, by paragraph, of the different guidance provided by each board accompanies the draft IFRS. Most of the differences arise because each board decided to provide business combinations guidance that is consistent with its other standards. Even though those differences are candidates for future convergence projects, the boards do not plan to eliminate those differences before final standards on business combinations are issued.

The joint Exposure Draft proposes to resolve a difference between IFRS 3 and SFAS 141 relating to the criteria for recognising an intangible asset separately from goodwill. Both boards concluded that an intangible asset must be identifiable (arising from contractual-legal rights or separable) to be recognised separately from goodwill. In its deliberations that led to SFAS 141, the FASB concluded that, when acquired in a business combination, all intangible assets (except for an assembled workforce) that are identifiable can be measured with sufficient reliability to warrant recognition separately from goodwill. In addition to the identifiability criterion, IFRS 3 and IAS 38 required that an intangible asset acquired in a business combination be reliably measurable to be recognised separately from goodwill. Paragraphs 35-41 of IAS 38 provide guidance for determining whether an intangible asset acquired in a business combination is reliably measurable. IAS 38 presumes that the fair value of an intangible asset with a finite useful life can be measured reliably. Therefore, a difference between IFRS 3 and SFAS 141 would arise only if the intangible asset has an indefinite life. The IASB decided to converge with the
FASB in the Exposure Draft by:

(a) eliminating the requirement that an intangible asset be reliably measurable to be recognised separately from goodwill; and

(b) precluding the recognition of an assembled workforce acquired in a business combination as an intangible asset separately from goodwill.

(See paragraphs 40 and BC100-BC102.)

**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 are surprised the Exposure Draft omits the reliable measurement criterion for intangible assets. The Basis for Conclusions that accompanies IFRS3 sets out in paragraphs BC97 to BC103 the reasons why the IASB decided to amend ED 3 and include the criterion in IFRS3.

We note that the Basis for Conclusions to the Exposure Draft states the reason for amending the position in IFRS3 is “that an estimate of fair value and the separate recognition of intangible assets, rather than subsuming them in goodwill, provides better information to the users of financial statements, even though a significant degree of judgement could be involved in determining that fair value”. We accept that in the absence of amortisation of goodwill the separate recognition of intangible assets provides better information to users of financial statements. It is our concern that the requirement does not consider the practicable implications of measuring intangible assets.

We do not believe that you can reliably measure all intangible assets. In the absence of an active market, valuation will be based on estimated future cash flows. Whilst it might be possible to estimate the cash flows arising from the business combination, requiring these cash flows to be disaggregated to individual assets can only be done on an arbitrary basis.

An example of an intangible asset that arises from a legal or contractual right that cannot be sold and where the cash flows are inextricably linked with the cash flows that the business generates as a whole is a customer list which exists in a regulated market. The ability to sell the customer list is prohibited or rendered ineffective by prohibitions on cold calling.
17 Recognition of acquirer deferred tax benefits

For the joint Exposure Draft, the boards considered the provisions of IAS 12 *Income Taxes* and FASB Statement No. 109 *Accounting for Income Taxes*, relating to an acquirer's deferred tax benefits that become recognisable because of a business combination. IAS 12 requires the acquirer to recognise separately from the business combination accounting any changes in its deferred tax assets that become recognisable because of the business combination. Such changes are recognised in post-combination profit or loss, or equity. On the other hand, SFAS 109 requires any recognition of an acquirer's deferred tax benefits (through the reduction of the acquirer's valuation allowance) that results from a business combination to be accounted for as part of the business combination, generally as a reduction of goodwill. The FASB decided to amend SFAS 109 to require the recognition of any changes in the acquirer's deferred tax benefits (through a change in the acquirer's previously recognised valuation allowance) as a transaction separately from the business combination. As amended, SFAS 109 would require such changes in deferred tax benefits to be recognised either in income from continuing operations in the period of the combination or directly to contributed capital, depending on the circumstances. Both boards decided to require disclosure of the amount of such acquisition-date changes in the acquirer's deferred tax benefits in the notes to the financial statements. (See paragraphs D4 and BC119-BC129.)

**Question 17**—Do you agree that any changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

We agree that changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination.
18 Disclosure differences

The boards reconsidered disclosure requirements in IFRS3 and SFAS 141 for the purposes of convergence. For some of the disclosures, the boards decided to converge. However, divergence continues to exist for some disclosures as described in the accompanying note Differences between the Exposure Drafts published by the IASB and the FASB. The boards concluded that some of this divergence stems from differences that are broader than the Business Combinations project.

**Question 18**—Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

We consider the disclosure differences should be eliminated, unless the information is required by another Standard. We have considered the following disclosure differences:

**Comparable prior period**

Paragraph 74(b)(2) is not used by the IASB. We concur with the IASB decision and consider the FASB pro forma requirements are suited to the requirements of investment circulars. We do not consider historical pro forma information is of benefit to the users of financial statements.

**Changes to amounts recognised in a business combination**

Paragraph 76(d) appears to be an anti-abuse paragraph aimed at providing information about gains and losses relating to the measurement of identifiable assets acquired and liabilities assumed in a business combination. We believe it is fundamentally difficult to identify whether a gain or a loss arises from an unintended error in the measurement of an asset acquired or liability assumed or abuse of the fair value principle. As such we are not convinced that information in this disclosure will benefit users of financial statements.

**Goodwill**

The additional information that is required by the FASB provides the user with information about the amount of goodwill arising during the year by segment. We believe this information would benefit users of the financial statements.
19 Style of the Exposure Draft

The Exposure Draft was prepared in a style similar to the style used by the IASB in its standards in which paragraphs in bold type state the main principles. All paragraphs have equal authority.

**Question 19**—Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

The style and format of the Exposure Draft were debated when the Preace to International Financial Reporting Standards was issued in April 2002. We have supported the presentation of Standards in bold type and have not changed position since that time.