Mr A Teixeira  
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Dear Mr Teixeira

Amendments to IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements

The Chartered Institute of Management Accountants (CIMA) is pleased to have the opportunity to comment on these consultations. CIMA is a global professional body representing accountants in business. CIMA represents over 65,000 members and 85,000 students in 156 countries. CIMA is committed to high quality, global, principle-based, neutral financial reporting standards and supports the widespread adoption of International Financial Reporting Standards.

We attach responses to the detailed questions raised by both of these consultations but would like to make some general points first.

We support convergence between international standards and US GAAP and accept that as a result some of the principles of IAS may evolve and change. However, we believe that the current pace of change is both too rapid to allow proper consideration of implied changes to the fundamental concepts and too rapid for the accounting community in Europe to absorb.

We believe that some of the changes proposed in this draft amendment should have more appropriately been introduced by way of a discussion paper rather than an exposure draft. The reasons for the change of mind by the Board on the issues below should have been fully discussed in the Basis for Conclusions, but generally are not.

The proposal to use a “whole-entity” approach to an acquisition in cases where less than 100% is acquired is an example where more measured progress is desirable. There seems little point in eliminating “inconsistencies” between stepwise and single transaction acquisitions when the equivalent difference in treatment between internally-generated and acquired goodwill is retained. We are not comfortable with the resulting accounting for partial acquisitions or disposals especially as no gain or loss will arise on such a transaction. In addition, where less than 100% of an entity is controlled, any impairment of goodwill will have a disproportionate impact on reported operating earnings as the relief for the non-controlling interest element will occur below the operating result.

A further example is provided by the proposal to write off acquisition-related costs as they are incurred. This has little to do with underlying economic logic, since any investment
appraisal will surely compare these fees, together with the acquisition cost, with future benefits. This sort of change should have been preceded by a refinement of underlying valuation principles, including a clarification of whether entry or exit values are appropriate for valuations in accounts. Of course a revision of the framework of this nature would need to be properly exposed and discussed.

We continue to believe that the standard for business combinations should provide guidance on accounting for mergers. There are instances in which it is not meaningful to identify an acquirer; true mergers do occur. We would have preferred to have seen guidance on fresh-start accounting in this exposure draft and would urge the Board to bring forward its proposals soon. Accounting standards should not introduce arbitrary obstacles to business combinations which could provide significant economic benefits.

More generally we would urge that steps towards global convergence are only taken when they result in improved standards, and are firmly based on underlying principles. We do not think the standard as drafted meets these criteria. We would like to see it substantially amended and then re-exposed for discussion.

As requested we will put a hard-copy of this letter in the post to you. We would be pleased to discuss with you any aspect of this letter that you may wish to raise with us.

Yours sincerely

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Appendix A: Responses to the specific questions raised by the Amendments to IFRS 3 Consultation:

Q1: 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.)

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?

We do not regard the Board’s proposals as appropriate for the accounting for all business combinations. We continue to believe that there are instances in which true mergers can take place and would have preferred to have also seen guidance on fresh-start accounting in this exposure draft.
We would urge the Board to recognize the importance of this topic and bring forward proposals soon.

In addition, we believe that there is a strong case that business combinations involving mutually controlled entities should not be subject to the proposed standard. In those cases the application of the acquisition method, involving the identification of an acquirer, does not appear to us to reflect economic reality. In these circumstances the proposed approach could be an unnecessary barrier to a transaction which would provide real economic benefits.

Q2: 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 provide additional guidance for applying this definition. The proposed IFRS would amend the definition of a business in IFRS 3. (See paragraphs BC34-BC41.)

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 believe that the definition of a business and the additional guidance are appropriate and sufficient.

Q3: 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.)

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 have several concerns with these proposals:

- We believe that it will be very difficult to establish the fair value to be used for the acquisition. Previously practitioners could fall back to the acquisition cost paid as a measure of fair value. This would be much more difficult under the current proposals. The extent of a control premium within the price paid would need to be assessed. In addition it would appear to us that the fair value of a business acquired would differ from one entity to another depending upon the degree of synergies that could be obtained by combining operations. Extrapolating
these issues to a point appropriate for a level of acquisition not actually achieved, i.e. 100%, would seem particularly difficult.

- We are also not comfortable with the resulting accounting for partial acquisitions or disposals especially as no gain or loss will arise on such a transaction.
- Where less than 100% of an entity is controlled, any impairment of goodwill will have a disproportionate impact on reported operating earnings as the relief for the non-controlling interest element will occur below the operating result.

We would prefer that entities are not required to recognize 100% of the acquisition-date fair value when 100% control has not been achieved.

Q4: 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.)

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?

In our opinion, the proposals do provide sufficient guidance for measuring the fair value of an acquiree. We believe that such guidance should be provided as principles rather than in excessive detail.

Q5: 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-BC59.)

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 believe that the acquisition date is the most appropriate date to establish the fair value of the consideration paid.
Q6: 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.)

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

We agree that the proposed accounting is appropriate.

Q7: 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 BC34-BC89.)

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?

In our opinion the costs that the acquirer incurs in connection with a business combination should be treated as part of the fair value of the consideration paid. These costs do not arise as a result of a separate transaction and are an integral part of the acquisition. The academic argument for the change in the Basis for Conclusions, that the expenditure does not represent assets, is essentially circular. Furthermore, to exclude such costs is inconsistent with the treatment of acquisition costs in relation to other asset purchases.

Q8: Measuring and recognising the assets acquired and the liabilities assumed

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.

Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

We agree that the proposals are appropriate.

Q9: 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.)

Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

We believe that the exceptions are appropriate.

Q10: Additional guidance for applying the acquisition method to particular types of business combinations.

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.)

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?

It strikes us as counter-intuitive to record a gain or loss as of the acquisition date as a result of a change in the value of an existing non-controlling equity investment. It would be better to leave things as they are, in line with our response to Q3.

Q11: 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.)

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 agree.

Q12: 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?

We cannot envisage circumstances that would result in a measurable overpayment being made.

Q13: 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.)

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 believe that prior period comparatives should only be adjusted for material errors or omissions; not for general measurement period adjustments.

Q14: 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.)

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?

We do not consider it necessary for the Board to issue further guidance in this respect.

Q15: 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.)
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?

In general, we believe that there is too much disclosure within financial statements of detail. Excessive detail without an explanation of the broader context often masks useful information and can be misleading. These proposals, unfortunately, continue this trend.

Q16: The IASB's and the FASB's convergence decisions

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.)

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
We believe that this change is a logical extension to IAS and support it.

Q17: 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.)

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?

There are instances in which an acquisition takes place solely or largely as a result of the tax-losses that are acquired. In addition, the realization of deferred tax benefits can be a very real intentional product of an acquisition. As a consequence, we think this is an instance where the US approach makes more economic sense and see no reason why these tax benefits should be accounted for separately.

Q18: The boards reconsidered disclosure requirements in IFRS 3 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.

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 accept that there will be differences of opinion along the road to convergence. These should be minimized, consistent with due consideration of the principles involved. Parties involved should aim to eliminate such disclosure differences over the long-term.

Q19: 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.
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?

We agree with the approach.