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The Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6 XH
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Dear Sir David

ED – 3 Business Combinations

Attached is my response to the Exposure Draft 3 *Business Combinations*

Yours faithfully

Michael Bradbury
April 1, 2003

Comments on ED-3

Invitation to Comment

Questions: - Q1, Q3, Q5, Q6, Q7, Q9, Q10.
I am in general agreement with the Board's proposals addressed in these questions and therefore make no comments.

Question 2 – Method of accounting for business combinations
I agree that "pooling" (as traditionally accounted) should be eliminated. However, "fresh start pooling" is an appropriate method of accounting for "non-control" business combinations. I therefore support the Boards intention (BC23) to examine "fresh start". My preference would be to deal with this issue in this phase of the project, however I can understand the reasons for reviewing it at a later phase.

Question 4 – Identifying the acquirer when a new entity is formed to effect a business combination
I disagree with the Boards position. Where a new entity (*C*) is set up to acquire two existing entities (*A* and *B*) the purchase method should be applied to the acquisition of both entities - in effect a fresh start approach should be applied.

The Boards reasoning for its position is based on substance over form (BC45). Consider the following counter-arguments.

- In New Zealand the directors are required to issues shares a share at its "present cash value". For entity *C* to issue the shares at fair value and record the net assets of *A* at fair value and then *B* at historic cost is pure nonsense. The substance of the transaction is that *C* has acquired both entities *A* and *B*.
- If entity *C* is newly formed by a set of independent shareholders to acquire entities *A* and *B*. We would want account for this as two purchase acquisitions by *C*. Just because entity *C* is now formed with shareholders of either A and B, it should not affect the substance of how *C* accounts for the entities it has just purchased. We are accounting for the acquisition of subsidiaries by an entity – why should it matter who the shareholders of the acquirer are?
- At a more philosophical level – how can the choice of historic cost accounting over fair value accounting ever be said to represent substance over form? I think this is an abuse of terminology. The substance of the transaction is that two sets of shareholders have decided to establish a new company to combine net assets. This decision will have been based on the relative fair value of both entities not the historic cost of one and the fair value of another.

Question 9 – Excess over the cost of a business combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

I agree with the Boards position, but I suggest an amendment is required to the logic in BC112.

When I initially read BC112 I disagreed with the phrase: "The net fair value of those items is also 80 and not 100….". My initial reaction was that the net fair value should still be at 30 (the amount if no restructuring is done). However, on reflection it is the 30 that is wrong, because the market would bid up the 30 until the PV (or fair value) of 80 was reached. The 30 might be correct if it is a scrap value but not if it is a PV.

My solution would be to drop the reference to 30 from BC112. It does not enter any decisions and is therefore irrelevant and distracting.