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Sir David Tweedie
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Dear Sir David

Exposure Draft 3 Business Combinations

This is the response of AVIVA plc to 'Exposure Draft 3 Business Combinations'. As the world's seventh largest insurance group and the largest insurer in the United Kingdom we are pleased to have the opportunity to comment on proposals that have significant implications for all companies. We have also provided comments on the exposure draft through our participation in preparing the response from the Association of British Insurers, dated 4 April 2003. We have the following responses to the specific questions raised in the Exposure Draft.

Question 1 – Scope

1a) We agree with the proposal.

1b) We consider the definition of business combinations involving entities under common control and additional guidance on identifying such transactions helpful.

Question 2 – Method of accounting for business combinations

2) As a group we have used merger accounting in the past in our UK GAAP financial statements. We believe that for genuine mergers of similar sized organisations this approach is appropriate and meaningful. It is evident that the Board's proposal for purchase accounting is in line with US GAAP. We are less supportive of this approach as we consider that it does not measure the true economic reality of a transaction where two similar groups are engaged in a genuine merger.

Question 3 – Reverse acquisitions

3a) We agree with the proposal.

3b) We regard the proposed additional guidance as appropriate.

Question 4 – Identifying the acquirer when a new entity is formed to effect a business combination

4) We agree with the general principle that in business combinations an acquirer has to be identified based on the evidence available. The newly formed entity individually has little economic substance and can therefore not be considered as the acquirer. The legal form of the transaction should not change the general principle and therefore we support the Board's proposal that one of the combining entities that existed before the combination should be determined to be the acquirer on the evidence available.

Question 5 – Provisions for terminating or reducing the activities of the acquiree

5) We agree with the proposal.

Question 6 – Contingent liabilities

6) The proposals require the fair value measurement and recognition of contingent liabilities in the circumstances of a business combination whereas in other circumstances IAS 37 requires only note disclosure. It would seem inconsistent to have different accounting treatments, as the nature of a contingent liability does not change as a result of an acquisition. In our view, it may be difficult to fair value such contingent liabilities objectively on an ongoing basis. We recommend the Board provide guidance on how to how calculate fair values in such instances.

Question 7 – Measuring the identifiable assets acquired and liabilities and contingent liabilities assumed

7) We note the apparent inconsistency in recognising assets and liabilities acquired through a business combination at fair value, but not recognising similar assets and liabilities established through normal business activity. Given that US GAAP experience has demonstrated the extensive modelling and estimation that would be required to value intangible assets we recommend the board provide us with practical guidance on how to value intangible assets.

Question 8 – Goodwill

8) We note that an alternative treatment of goodwill existed under UK GAAP, which was to write off all goodwill to reserves in the year of acquisition. This is an approach which the Board should consider. Some commentators have commented that under US GAAP in practice the impairment test requirements appear to be applied at a higher level than proposed under ED 3 and to that extent are less complex. More extensive impairment test requirements may be onerous to implement with little incremental benefit given the judgements underlying intangible and goodwill calculations. We suggest the Board should consider steps to mitigate this. At a minimum the Board should ensure that for the sake of consistency and reduced complexity the final IFRS follows the US GAAP impairment test requirement.

The proposed disclosures will be more extensive and detailed than those required by the existing guidance. Such detailed disclosures may have a negative impact on the practical understandability of the financial statements. We consider the amount of disclosures required by the proposal to be excessive and therefore recommend that the Board consider reducing the level of detailed disclosure required.

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

9) We support the proposal that negative goodwill be recognised immediately in profit or loss after reassessing the identification and measurement of the net assets acquired and the measurement of the cost of the combinations.

Question 10 – Completing the initial accounting for a business combination and subsequent adjustments to that accounting

10a) We agree with the proposal.

10b) We agree with the proposal.

We remain committed to supporting the work of the IASB to establish practical guidance in these areas. Should you have any questions relating to the content of this letter, we would be pleased to discuss them with you.

Yours sincerely

Tim Harris
Director of Group Financial Reporting Projects