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30 Cannon Street
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Dear IFRIC members

Tentative Agenda Decision — Potential effect of revisions to IFRS 3 and IAS 27 on equity accounting

The global organisation of Ernst & Young is pleased to respond to the above Tentative Agenda Decision as published in the IFRIC Update of May 2009, including the recommended reasons for not adding the item to its agenda (together the Tentative Decision).

The IFRIC deliberated two issues considered considered by the US Emerging Issues Task force (EITF) in EITF 08-6, under the converged standard on business combinations, as follows:

- How the initial carrying value of an equity method investment should be determined.
- How an equity method investee's issue of shares should be accounted for.

We agree with the conclusions reached by the IFRIC, however believe that greater clarification would be helpful around the determination of the initial carrying value of an equity method investment, with respect to the following points:

- How contingent consideration is reflected in the initial carrying value.
- How gaining significant influence via step acquisitions are reflected in the initial carrying value.

Contingent consideration

The IFRIC Update notes that 'the cost of an investment in an associate ….comprises its purchase price and directly attributable expenditures necessary to obtain it.' This still leaves open the issue as to what exactly the 'purchase price' is, where contingent consideration exists in an arrangement. We note that paragraph 10 of the IASB Staff Paper on this issue provides some clarity and recommend that some of these words are incorporated into the final agenda decision.

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Paragraph 10 of the IASB Staff Paper on this issue referred to cost as 'all amounts paid (or payable or liabilities assumed) at the inception of ownership of the investment'. This statement clarifies that it is the measurement of the liability at inception that matters. We believe that in most circumstances contingent arrangements would meet the definition of a financial liability and would be within the scope of IAS 39. Accordingly, the fair value of the contingent payment would need to be determined at inception of ownership and therefore comprise part of the cost. All subsequent changes are then a financing cost. We do not believe that an analogy to IFRIC 1 - where changes in the liability are adjusted against the carrying value of the asset – is appropriate. We do however have concerns that such an analogy may be drawn.

Step acquisitions

We believe the reference to a 'purchase price' provides some clarify that in the case of a step acquisition, this will be the cumulative amounts actually paid. However, this conflicts with the approach taken within IFRS 3 *Business Combinations* and IAS 27 *Consolidated Financial Statements* when there is a loss of control while maintaining an ownership interest. The key reason for the approach taken in IFRS 3 and IAS 27 is that the change from a subsidiary to an associate, and vice versa, is a significant change in the nature of, and economic circumstances surrounding, the investment. That is, the existing investment is 'given up' as consideration for acquiring a different type of investment. We believe that this rationale is just as relevant when determining cost as it is when applying a fair value approach under IFRS 3.

We are therefore concerned that without a more explicit statement by the IFRIC, divergent practices may still develop.

Please contact Lynda Tomkins on 0207 951 0241 if you any questions regarding the above.

Yours faithfully