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Dear Annette

Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations: Combinations by Contract Alone or Involving Mutual Entities

I set out below and in the attached note the views of the UK Accounting Standards Board (ASB) on the Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations: Combinations by Contract Alone or Involving Mutual Entities.

We do not believe that all such combinations can be characterised as acquisitions and therefore the purchase method may not be an appropriate method of accounting for them. Instead we would like to see 'fresh start' accounting examined further.

In addition, we believe that the IASB's decisions to adapt the general requirements of IFRS 3 for these combinations need better explanation. It is not clear why, if the transactions are deemed to be acquisitions, IFRS 3 cannot be applied without further amendment.

If you have any questions concerning this letter, or would like any further information on the comments made, please contact either Jenny Carter (020 7611 9712) or myself on 020 7611 9702.

Yours sincerely

Mary Keegan

Appendix

Method of accounting for combinations by contract alone or involving mutual entities *(Question 1)*

1 The Board believes that combinations by contract alone or involving mutual entities often may not have the characteristics of an acquisition of one entity by another, and therefore the purchase method may not be the most suitable method of accounting for them. We would encourage the IASB to proceed quickly with the remaining aspects of its business combinations project, particularly 'fresh start' accounting, which might be suitable for the combinations addressed in this exposure draft.

2 We note that the exposure draft does not explain the 'other side' of the accounting entry required to recognise the 'cost' of these business combinations. We assume that this credit (equivalent to the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities) will be recognised directly in equity, but this could usefully be clarified.

3 We note that the Board seems to wish to limit the recognition of goodwill in respect of these combinations. However, assuming that the acquiree has net assets (rather than net liabilities) a standard application of IFRS 3 would seem to lead to an excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost, which would be recognised as a gain in profit or loss (rather than in equity, as we have assumed above). Clarification of the reasons for this difference would be useful.

4 We note that the proposals require any costs directly attributable to the combination to be recognised as an expense when incurred, which is contrary to the general requirements of IFRS 3. We agree with the general requirements of IFRS 3 and in general the ASB believes that the cost of acquiring something (be it a business or individual assets or liabilities) includes those costs directly attributable to bring the item to its working condition. As a result those costs should be taken into account in the initial recognition of the item, and not immediately recognised in profit or loss (assuming an asset's recoverable amount is greater than its cost). We understand the proposal in the Exposure Draft is consistent with the IASB's decisions in phase II of its business combinations project, but this exception to the general requirements of IFRS 3 could be seen as pre-empting phase II. In addition, the reasons for the departure could be more clearly explained.