Comments on Amendments to IFRS 3 Business Combinations, Combinations by Contract Alone or Involving Mutual Entities

15 July, 2004
The Life Insurance Association of Japan

The Life Insurance Association of Japan (LIAJ) would like to express respect for the efforts that have been made by the International Accounting Standards Board to develop international accounting standards. We appreciate this opportunity to comment on the exposure draft Amendments to IFRS 3 Business Combinations, Combinations by Contract Alone or Involving Mutual Entities.

The LIAJ is a trade association composed of 40 life insurance companies, whose purpose is to promote development and public trust in the Japanese life insurance industry.

Question in "Invitation to Comment"	Answers and Comments
Question 1	
The Exposure Draft proposes:	We strongly oppose to the amendment.
(a) to remove from IFRS 3 the scope exclusions for business combinations involving two or more mutual entities and business combinations in which separate entities are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest. (b) to require the acquirer to measure the cost of a business combination as:	In the ED 3 *Business Combinations,* published in December, 2002, it was proposed to delay the application of IFRS 3 to business combinations involving two or more mutual entities until the IASB issued the guidance on the application of the purchase method. The guidance on the application of the purchase method has not been fully developed in the subsequent discussions of the board. It is against the due process to make such a proposal in an attempt to apply IFRS 3 to business combinations involving mutual entities, despite the current situation of the discussions.
(i) the aggregate of the following amounts when the combination is one in which the acquirer and acquiree are both mutual entities: • the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities; and • the fair value, at the date of exchange, of any assets given, liabilities incurred or assumed, or equity instruments issued by the acquirer in exchange for control of the acquiree. Therefore, goodwill would be recognised in the accounting for such transactions only to the extent of any consideration given by the acquirer in exchange for control of the acquiree.	Furthermore, it would be currently impracticable and impermissible at practice level to measure fair value of insurance liability, even if it was required to apply the purchase method to such business combinations. The first priority should be placed on thoroughly considering whether the application of the purchase method to the combination involving mutual entities would be appropriate or not. It is preferable that the IAS 22 should continue to apply to such transactions until achieving a conclusion. There are certain cases to which we cannot simply apply the purchase method. Here are the examples below. We hope that the Board takes these cases into consideration when making any decision.
(ii) the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities when the combination is one in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.	• In the case of mutual insurance companies, the company's equity owners are normally policyholders (participating members). Therefore, in a business combination of mutual companies, except particular cases such as an entire transfer, the fairness and impartiality among the policyholders are sought from the perspective of actuarial gains and losses, and a method to preserve the equity of policyholders (participating members) of both companies is taken. (That means that equity carries on.)

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Therefore, no goodwill would arise in the accounting for such transactions. Is this an appropriate interim solution to the accounting for such transactions until the Board develops guidance on applying the purchase method to such transactions as part of a subsequent phase of its Business Combinations project? If not, what other approach would you recommend as an interim solution to the accounting for such transactions, and why?	- Thus, it is inappropriate to simply apply IFRS 3 (the purchase method) to the business combination of mutual insurance companies. (There might be the cases to which the purchase method would not adequately apply.) For your reference, we make some comments on the preferred accounting method for the business combination of mutual life insurance companies as follows; - Assuming that the purchase method is inappropriate, the other available options judging from the perspective of accounting theory would be the pooling of interests method or the fresh start method. However, under the circumstances where no clear definition of insurance contract and measurement method exists, (furthermore, we are not even sure that insurance contracts could be measured at fair value.) we suggest that the application of the pooling of interests method would be the appropriate one in case of business combination of mutual insurance companies. (*) (*) Enforcing the fair value measurement only at the time of business combinations will result in an accounting procedure that does not adequately reflect the shared risk and profit between policyholders before and after the combinations.
Question 2 The Exposure Draft proposes that no amendments be made to the transitional and effective date requirements in IFRS 3. This would have the effects set out in paragraph 6(a)-(c) above on the accounting for business combinations in which the acquirer and acquiree are both mutual entities or in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest. Is this appropriate? If not, what transitional and effective date arrangements would you recommend for such business combinations, and why?	As we commented on Question 1, with regard to the accounting procedure for business combinations between mutual companies, it should be considered first that thorough consideration whether the application of the purchase method to such a case would be appropriate or not. Thus, it is preferable that the former IAS 22 should continue to apply until achieving the conclusion.