EUROPEAN SAVINGS BANKS GROUP
GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
EUROPÄISCHE SPARKASSENVEREINIGUNG

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CPE (0653/04)

Brussels, 30 July 2004

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

Dear Ms Kimmit,

The European Savings Banks Group (ESBG) appreciates the opportunity that it has been given by the International Accounting Standards Board (IASB) to comment on the IASB's Exposure Draft (ED) of proposed amendments to IFRS 3 Business Combinations *Combinations by Contract Alone or Involving Mutual Entities.*

The ESBG appreciates the suggested improvements in the IASB's Exposure Draft having in mind that they were planned as an interim solution to the issue of accounting for combinations involving mutual entities or combinations in which separate entities are brought together by contract alone. The ESBG understands that a "vacuum" for the business combinations as specified in the Exposure Draft is neither optimal nor desirable but, nevertheless, believes that it is in the best interest of all parties if the IASB would refrain from issuing the proposed amendments as final amendments to IFRS 3.

The specific comments while highlighting the positions and problems associated with the IASB's proposed improvements will endeavour to focus on those issues of particular interest to our members.

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Question 1

The Exposure Draft proposes:

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 ownership interest.

b) to require the acquirer to measure the cost of a business combination as:

i) the aggregate of the following amounts when the combination is one in which the aquirer and acuiree 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.

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 from a reporting entity by contract alone without the obtaining of an ownership interest. 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 approaches would you recommend as an interim solution to the accounting for such transactions, and why?

The ESBG does not believe that it is necessary to incorporate these business combinations (i.e. combinations by contract alone or involving mutual entities) in the scope of IFRS 3. The ESBG supports the views expressed by the Board while developing IFRS 3 that the application of the purchase method to these two kinds of business combinations is too complex and cannot be solved in the short run. The reasons being for example that it is difficult to identify the acquirer and that such transactions do not involve the payment of any reliably measurable consideration (see BC7 of the Exposure Draft). Therefore the ESBG would welcome the resumption of the IASB's original intention to solve the questions of these two kinds of business combinations together with the far more important business combinations e.g. joint ventures and business combinations involving entities or businesses under common control, which still have been left open, in phase II of the Business Combinations Project. In this regard, the ESBG feels that the argument of closing a "vacuum" is not very suitable.

The ESBG would like to raise the following main concerns on question 1:

a) The purchase method does not reflect the economic impacts of business combinations in these two cases.
b) The definitions provided by IFRS 3 are inadequate to solve the problems faced in business combinations as specified under the current Exposure Draft.
c) Due to the following facts the purchase method as envisaged under this Exposure Draft is different from the purchase method under IFRS 3:
   - goodwill may only be recognized under special circumstances (see BC 9)
   - any costs directly attributable to the business combination shall be recognized as an expense in the period in which they are incurred (see paragraph 31B)

   The following argument brought forward by the IASB under BC6 should therefore be reviewed: *"The Board also observed that if such a transaction were classified as acquisition, IAS 22 would require to be accounted for by applying the purchase method, but a version of the purchase method different from that now contained in IFRS 3."*
d) The provisions for the application of the purchase method to merger situations of these two kinds of business combinations should be elaborated in more detail before scoping them into IFRS 3.

The ESBG appreciates IASB's work in the development of a single set of high quality Financial Reporting Standards but proposes the following interim solution: The IASB should allow the prolonged use of IAS 22 until Phase II of IFRS 3 has been completed or leave the vacuum as originally intended.

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?

Regarding the transitional and effective date requirements the ESBG would like to point out that it does not support the IASB's intention to use standards with retrospective application requirements. Taking into account the "sound business manager's approach", companies do rely on the set of standards in place when planning and taking their business decisions. Standard-setting should therefore only be made on a prospective basis, which is also in line with most European legislation procedures. Backdating an amendment to a date where the Exposure Draft has not even been published yet seems even more contradictory.

The ESBG believes that the IASB should not include the amendments proposed in the current Exposure Draft in IFRS 3. We encourage the IASB to continue with the research on appropriate accounting solutions for the four business combinations which are currently scoped out of IFRS 3 in Phase II of the Business Combinations Project. Generally, the ESBG would call upon the IASB to refrain from issuing amendments on standards that have been recently revised thereby pre-empting future projects.

On behalf of the ESBG, I would be happy to discuss the above-mentioned issues with you as you may wish.

Yours sincerely,

Chris DE NOOSE
Chairman of the Management Committee