IFRS 3: COMBINATIONS BY CONTRACT ALONE OR INVOLVING MUTUAL ENTITIES

Memorandum of comment submitted in July 2004 to the International Accounting Standards Board in respect of the Exposure Draft of 'Proposed Amendments to IFRS 3 *Business Combinations* - Combinations by Contract Alone or Involving Mutual Entities', *published in April 2004.*

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales welcomes the opportunity to respond the Exposure Draft of 'Proposed Amendments to IFRS 3 *Business Combinations* - Combinations by Contract Alone or Involving Mutual Entities', published by the International Accounting Standards Board in April 2004.

2. We have reviewed the Exposure Draft and set out below a number of comments. We deal first with major matters, before commenting on the specific questions raised in the exposure draft.

MAJOR MATTERS

3. The objective of the exposure draft is to prevent the application to the specified business combinations of the pooling of interest method or the purchase method as defined by IAS 22 *Business Combinations* (now superseded) until guidance on applying the purchase method in the relevant cases is developed. While we support the objective of the ED, we do not believe that the solution it puts forward is acceptable.

4. The Board's objection to delayed implementation for the specified business combinations is that it would result in the two versions of the acquisition method remaining in use. However, the ED does not narrow the range of alternatives, because it requires the 'modified purchase method', and not the method required by IFRS 3. We suggest, therefore, that the objective of avoiding two acquisition methods is not achieved.

5. The acquisition method set out in the ED is not fully explained. For example, there is no guidance on the accounting in the acquirer's balance sheet. Further guidance would be needed before the ED could be implemented satisfactorily.

6. We also believe that further consideration is required by the Board as to the whether or not an acquirer can be identified. The Board's conclusion in Relation to IFRS 3 was reached only after an extensive consultation process. In the circumstances dealt with in the ED, even finer judgements are likely to be involved.

7. In summary, while we support the objectives of the ED, we believe that the proposed solution amounts to an unsuitable quick fix. The Board should develop a more considered solution.

SPECIFIC QUESTIONS

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 an 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 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.

(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. 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?

8. We do not support the interim solution proposed in the ED. We have previously agreed with the elimination of the pooling of interests method on pragmatic grounds and continue to do so in this case. However, as set out above, we have reservations about the 'modified purchase method' advocated in the draft. Although IAS 22 has now been withdrawn and is therefore no longer available, we suggest that it might be preferable to leave it in place for combinations by contract alone or involving mutual entities, until a permanent solution can be developed. However, a permanent solution should be urgently pursued.

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?

9. We understand the Board's aim of avoiding the risk of different accounting methods being applied for the specified business combinations, which could occur if the ED had a later effective date than IFRS 3. However, we oppose in principle any retrospective application of accounting standards. In this case, the effective date would be before the date of publication of the ED. Entities make decisions based on current standards, and such decisions might well have been different under newer requirements. If the Board were to press ahead with these proposals, the effective date should not precede publication of the amendment.