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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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27 July 2004

Dear Sir David

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

We are responding to your invitation to comment on the above exposure draft on behalf of the worldwide organisation and Global IFRS Board of PricewaterhouseCoopers. We have responded to the questions posed in the “Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations - Combinations by Contract Alone or Involving Mutual Entities” ("ED" or "the proposed amendments") in the appendix to this letter.

Need for the proposed amendments as an immediate interim solution

We support reducing the number of transactions that are excluded from the scope of the IFRS literature. However we believe that priority should be given to developing guidance for those transactions that occur more frequently and particularly for business combinations involving entities under common control. Business combinations between mutual entities or where control is obtained without an ownership interest occur much less frequently than the other transactions that are excluded from the scope of IFRS 3.

The proposals are inconsistent with the model required by IFRS 3, since goodwill is not measured and recognised, and with the full goodwill model that is expected to be proposed as part of Phase II of the Business Combinations project. This will require companies to make multiple changes to the accounting for the same types of transaction, in a period when many companies are already under significant pressure to apply IFRS for the first time. This will create more disruption that will outweigh the benefits of issuing interim guidance.

Most of the transactions covered by the proposals will meet the definition of a business combination in IAS 22 and, in almost every case, would be accounted for as acquisitions in which goodwill is recognised, absent the current scope exclusion. The proposals in the ED could enable some to structure transactions as a combination by contract to avoid the recognition of goodwill. We believe that users will have difficulty in understanding this difference.

No guidance has been given for the subsequent reconstruction of a group established by contract to a classical parent/subsidiary relationship. This does not seem to be a new business combination, thus it would appear to be outside the scope of IFRS 3. We do not believe that the recognition of goodwill should be avoided in these circumstances, but nor do we believe that this should trigger a whole new fair value exercise. Any final amendment to IFRS 3 should address these circumstances.

The FASB also intends to address these issues as part of the Phase II of their Business Combinations project. The proposals in the ED, will therefore introduce a difference between IFRS and US GAAP and will result in some of the decisions in connection with these transactions being taken by the IASB at a different time to the FASB. We support amended guidance being implemented by both Boards at the same time. We do not share the Board's view of the immediate necessity for the issuance of this guidance independently from the FASB and so soon before the publication of the Phase II literature.

Our detailed responses to the questions in the ED are enclosed in the appendix. If you have any questions in relation to this letter please do not hesitate to contact Jochen Pape, Chair of the PwC Global IFRS Board (+49 211 981 2905), or Mary Dolson (+44 207 804 2930).

Yours faithfully

PricewaterhouseCoopers

Appendix

Exposure Draft of Proposed Amendments to IFRS3 Business Combinations
Combinations by Contract Alone or Involving Mutual Entities

Responses to detailed 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?

Answer

No, we do not believe that the proposed treatment is an appropriate interim solution.

We recognise that it is not ideal to have two methods of accounting for business combinations effective at the same time. However, these proposals do not resolve the complex issues associated with combinations by contract and combinations of mutual entities. The proposals would also require companies to adopt a short term solution that is inconsistent with the proposals that will be included in the forthcoming exposure draft in connection with Phase II of the business combinations project.

The proposals will also result in another change to the stable platform of standards that many companies will be required to adopt in 2005. The guidance will not be finalised until late in 2004 and might require companies to revisit transactions that have already been considered in the context of the existing guidance. The transactions covered by the proposals are infrequent and we do not see there is any requirement for the proposed changes at this time.

Goodwill acquired in a business combination represents the expected future benefits that will be generated by the business but could not be identified as separate assets. This is relevant information for the users of financial statements. Most of the transactions covered by the proposals would be acquisitions in the context of IAS 22 and would result in goodwill recognition. The proposals will create an incentive for companies to structure transactions as a combination by contract to avoid the recognition of goodwill.

We do not believe there is a requirement for an interim solution in connection with these transactions and they should be dealt with in the forthcoming exposure draft.

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?

Answer

If the IASB proceeds with the ED, we believe the transitional arrangements are appropriate. The new guidance should be finalised as soon as possible to so that first time adopters are able to properly apply the new guidance.