30 July 2004

Annette Kimmitt
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International Accounting Standards Board
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Dear Annette

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

The Financial Reporting Standards Board (FRSB) of the Institute of Chartered Accountants of New Zealand (the Institute) is pleased to submit its comments on Amendments to IFRS 3 Business Combinations – Combinations by Contract Alone or Involving Mutual Entities.

The FRSB does not support the proposed amendments, particularly as business combinations involving mutual entities or by contract alone are considered in Business Combinations Phase II and the IASB proposes to issue an Exposure Draft on this project before the end of this year. As the FASB also intends to address these issues in Phase II of its Business Combinations project, the FRSB considers that the IASB should propose amendments at the same time as the FASB in order that the proposed amendments would align international financial reporting standards and US generally accepted accounting practice.

Our detailed comments on the specific questions are attached. If you have any queries, or require clarification of any matters in the submission, please contact me or Vanessa Sealy-Fisher (vanessa.sealy-fisher@icanz.co.nz)

Yours sincerely

Joanna Perry
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IASB Exposure Draft Proposed Amendments to IFRS 3 ***Business Combinations - Combinations by Contract Alone or Involving Mutual Entities***

IASB 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 IASB 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?

FRSB response

We are aware that an Exposure Draft on Business Combinations Phase II is due soon and these types of transactions are being considered in that project. While we appreciate that no final decisions have been made with respect to Phase II, we understand that the accounting treatment proposed in this exposure draft is unlikely to be the same as that being considered under Phase II. In other words, it seems that this exposure draft is proposing an accounting treatment that the Board may not believe is appropriate.

We understand that the Board is concerned that entities would be able to apply a variety of treatments to such transactions if the IFRS 3 exemption continues. Therefore, there is likely to be inconsistency in reporting. The FRSB shares the Board's belief that comparability is an important characteristic of financial statements but we do not believe it should be applied at the expense of other, equally important characteristics. In particular, if this exposure draft is finalised, it will mandate the use of an arguably inappropriate accounting treatment and *prohibit* preparers from using arguably more appropriate treatments (including, potentially, the treatment that comes out of Phase II). Furthermore, if the treatment is inconsistent with the proposals in Business Combinations Phase II, this will result in inconsistent and incomparable financial reporting over a relatively short period of time. Entities will be required to make several changes to the accounting for same-type transactions, which could be costly and disruptive for entities adopting international financial reporting standards (IFRSs) for the first time.

No submissions were received from New Zealand constituents. This indicates that business combinations by contract alone or involving mutual entities is not common in New Zealand.

The FRSB does not support the proposals set out in the exposure draft.

With respect to the accounting treatment proposed, the FRSB does not believe it is appropriate. The model is inconsistent with the requirements of IFRS 3, in that goodwill will only be recognised in respect of the consideration given by the acquirer to obtain control. There will, therefore, be no recognition of goodwill that represents the future benefits that will be generated by the business but could not be separately identified.

If the Board proceeds with the proposals contained in this exposure draft, we believe that the standard should also clarify the treatment of any goodwill recognised by one of the combining entities as a result of a business combination completed before the business combination falling within the scope of the proposed amendments (this is distinct from the previously recognised goodwill subject to the proposed transitional arrangements set out in paragraphs 79 and 80). One interpretation is that such goodwill is not an identifiable asset and therefore should not continue to be recognised in the consolidated financial statements. If it is to be recognised, should this be at its previous carrying value or at fair value?

IASB 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) of the IASB ED 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?

FRSB response

We agree with the transitional and effective date requirements as proposed if the IASB adopts the proposed amendments.

However, if the IASB adopts the proposed amendments we recommend that this be done as soon as possible so that first-time adopters of IFRSs are aware of the proposals and can properly apply them.