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9 November 2005

Dear David

**ED 139 Proposed Amendments to AASB 3 *Business Combinations* and ED 141 Proposed Amendments to AASB 127 *Consolidated and Separate Financial Statements***

This letter is in response to ED 139 Proposed Amendments to AASB 3 *Business Combinations* and ED 141 Proposed Amendments to AASB 127 *Consolidated and Separate Financial Statements*. As part of the worldwide organisation of PricewaterhouseCoopers, our comments on the matters raised in the International Accounting Standards Board (IASB) exposure draft have been considered in the firm's response to the IASB and the Financial Accounting Standards Board. A copy of that response is enclosed for your information.

The response indicates we agree that some of the proposals are improvements to the current financial reporting model for business combinations. However, PricewaterhouseCoopers does not support many of the more significant changes, such as the single economic entity model of consolidations and the recognition of holding gains and losses on pre-existing interest when control is obtained.

If the IASB amends IFRS 3 and IAS 27 as a result of these proposals we believe AASB 3 and AASB 127 should be amended to be equivalent to those revised standards. As we have said in our previous comment letters on the international convergence exposure drafts, we strongly support the Financial Reporting Council's (FRC) policy of adopting in Australia the standards of the International Accounting Standards Board (IASB) and believe:

- Australian reporting entities must be permitted to prepare their financial reports in accordance with IFRS, as they apply to entities in other IFRS jurisdictions; and

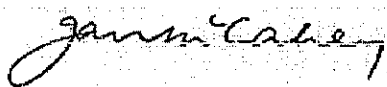
Professor David Boymal

9 November 2005

- Australia should be adopting the International Financial Reporting Standards (IFRS) as they are written by the IASB, except in the rare circumstance where modifications are necessary because applying IFRS as written would cause contraventions of specific Australian legislative requirements.

Please contact me directly on 03 8603 3868 if you would like to discuss this or any other comments in our response.

Yours sincerely



Jan McCahey

Partner

Assurance

October 28, 2005

Mr. Alan Teixeira  
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London EC4M 6XH  
United Kingdom

Ms. Suzanne Bielstein  
Director, Major Projects and Technical Activities  
Financial Accounting Standards Board  
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Dear Mr. Teixeira and Ms. Bielstein:

PricewaterhouseCoopers appreciates the opportunity to provide comments on the Financial Accounting Standards Board's and the International Accounting Standards Board's (the "Boards") Exposure Drafts (EDs) related to their joint project on business combinations and consolidation accounting, including the accounting for non-controlling interests. We recognise the importance of convergence to a single high quality set of global accounting standards and commend the Boards for their efforts on this project.

As articulated in our responses to the detailed questions, we agree that certain of the proposals are improvements to the current financial reporting models for business combinations. However, we do not support many of the more significant changes, such as the single economic entity model of consolidation and the recognition of holding gains and losses on pre-existing interests when control is obtained. We believe these proposals will not enhance the quality and usefulness of the financial information provided to the primary users of the consolidated financial statements, who we believe are the shareholders and creditors of the parent company.

We are also concerned that these proposals were subjected to very limited "field visits" and that constituents outside the United States were not solicited in any meaningful way to provide input before the proposals were published. Given the significance of the proposals, we recommend the Boards perform substantial field testing both in and outside the United States to identify implications and better assess operability.

*Single economic entity model of consolidation*

We do not agree with the Boards' proposed model for consolidation and urge the Boards to reconsider the existing conceptual framework as it relates to non-controlling interests.

We acknowledge that the existing IFRS and US GAAP conceptual frameworks do not provide for separate classification in the financial statements of non-controlling interests outside consolidated equity, since those interests are not liabilities as defined in either framework. However, we believe a non-controlling interest is a different type of equity interest, separate and distinct from the equity interests of the parent entity shareholders. Accordingly, we recommend that the conceptual framework be enhanced to include another category of equity to be presented separately from consolidated equity.

Furthermore, we do not agree with the Boards' proposal to reflect transactions with the non-controlling interests as equity transactions. We believe the economic substance of such transactions from a parent company perspective is similar to exchange transactions between the parent and a third party. Purchases of additional interests are investments of available resources for which parent company shareholders expect to realize economic returns.

Our views are predicated on what we believe is the primary purpose of consolidated financial statements and the information needs of the users of the consolidated financial statements. Both the IFRS and US GAAP conceptual frameworks state that a key characteristic of financial information is that it is useful for decision making. We believe the key underlying questions in assessing this characteristic are: Who are the primary users of the information and what information is most useful to them? We met with a group of users from the investor community to consider these questions and solicit their views on the primary purpose of consolidated financial statements and many other financial reporting issues. While these discussions broadened our understanding of their views on financial reporting, they were not conclusive given our limited outreach. However, the discussions helped confirm our belief that information regarding investment performance from the perspective of the parent company's stakeholders is of critical importance. We believe the Boards' proposals do not reflect this perspective as they do not enhance the ability of an investor in the parent company to assess performance and make more informed investment decisions. Further, the ability of an investor to evaluate the stewardship of company management and the return on a company's invested capital would, in our view, be severely hampered under the Boards' proposals.

*Full fair value of acquired businesses*

We agree that the non-controlling interest should be recorded at its fair value when it is initially recorded in the consolidated financial statements. As such, when control is obtained in a single step, the acquirer would record 100% of the fair value of the assets acquired (including goodwill) and liabilities assumed. However, when control is obtained in multiple steps, we believe it is not appropriate to re-measure the parent's pre-existing interest in the underlying assets and liabilities. Specifically, when a parent's pre-existing interest is accounted for under the equity method, the parent's interest in the underlying assets and liabilities is recognised initially at fair value when the investment is acquired, albeit as a single line item in the financial statements. We believe there is no basis to re-measure those assets and liabilities merely because control is obtained. This is consistent with the principles underlying the equity method, which are an extension of consolidation principles.



We have set forth in Appendix A to this letter an alternative approach for the Boards' consideration. This approach would recognize the non-controlling interest at fair value on the date control is obtained. However, this approach would not generally result in re-measurement gains and losses on pre-existing interests because we believe no economic gain or loss results from the acquisition transaction relative to such interests. We have articulated the accounting and economic principles that underlie our approach in Appendix A.

#### *Valuation Issues*

We support the use of fair values when their use enhances the relevance of the financial statements, without compromising the reliability of the financial information. Thus, while we support recording acquired contingencies and contingent consideration at fair value at the acquisition date, we have concerns about the framework for the determination of fair value of these liabilities and the bridge between acquisition accounting and the ongoing accounting model for contingencies.

While we believe valuation professionals are generally skilled in valuing assets and businesses, there is still considerable diversity in practice. We are concerned that there is even less standard valuation practice regarding the valuation of liabilities. The EDs (including the Fair Value Measurements ED issued by the FASB) do not include sufficient conceptual guidance on the application of valuation techniques to liabilities. We are also concerned that the legal profession will be required to provide significantly more information as inputs to valuation models for legal contingencies than at present, including probabilities of the occurrence of various outcomes. We therefore believe more in-depth research, consideration and field testing of these valuation issues should be conducted by the Boards, perhaps jointly with valuation and legal professionals, to provide greater clarity on the underlying thought process and objectives related to the determination of the fair value of liabilities, particularly acquired contingencies and contingent consideration.

We also believe it is necessary to bridge the initial recognition of contingent liabilities at fair value in acquisition accounting with the existing liability recognition models. This is necessary to ensure an appropriate transition from initial recognition to subsequent accounting, particularly for liabilities that are similar to or the same as those that do not arise from a business combination. For example, we believe the ongoing financial statements should not reflect changes in a litigation reserve under different accounting models solely based on whether the liability was assumed in a business combination.

While we agree with the proposal to record contingent consideration at its estimated fair value on the date of acquisition, we do not agree with the proposal to include all subsequent changes in that estimated fair value in earnings. Such changes should be accounted for based upon their economic substance, which we believe in many instances relates to, and therefore should be reflected as, additional purchase consideration.

#### *Asset Transactions*

There are significant differences between the proposed accounting for business combinations and the accounting for asset purchases. For example, transaction costs



would be capitalized in asset purchases but expensed in a business combination under both US GAAP and IFRS. In-process research and development would be expensed in asset transactions and capitalized in a business combination under US GAAP. There is little difference between the economics of a business combination and a transaction in which an asset or a group of assets is acquired. Accordingly, the accounting for these types of transactions should not produce differences that economically do not exist. Further, the differences in the proposed accounting treatment could lead to pressure to structure transactions in a particular manner to achieve a desired accounting result. We therefore encourage the Boards to take the opportunity to address both the convergence issues and the inconsistencies between the asset acquisition model and the business combinations model as part of their re-deliberations.

#### **Future Standard Setting Activities**

Finally, we believe that convergence to a single high quality set of global accounting standards will better serve the global capital markets. However, significant changes in accounting standards, such as those that would result from the proposals, will likely necessitate interpretive guidance as the new standards are implemented in practice and as transaction structures continue to evolve. We recommend that the Boards develop a plan for interpreting the new standards, as many of the benefits of convergence will be lost if aspects of the joint standards are not interpreted in a joint fashion. For example, in the United States, additional interpretive guidance could be issued by the SEC, the EITF or the FASB staff. Likewise, additional guidance under IFRS may be provided by the IFRIC and by national professional bodies and standard setters. We recommend that the Boards agree on a process for interpreting the joint standards prior to their finalization and release.

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Once again, we appreciate the opportunity to express our views on the EDs. Although we have some differences of opinion with respect to how the Boards can best achieve the objectives of providing decision-useful financial information to the capital markets, we remain supportive of the Boards' efforts to improve financial reporting in the areas of business combinations and consolidation accounting. Our detailed comments on the Boards' questions in the EDs are attached to this letter. We look forward to presenting our views in greater detail at the upcoming roundtable discussions. If you have any questions regarding our comments, please contact David B. Kaplan (973-236-7219) or John P. Brendon (+44 20 7804 4816).

Sincerely,

A handwritten signature in cursive script that reads "PricewaterhouseCoopers".

PricewaterhouseCoopers

## **Appendix A**

### **Summary**

The Boards have proposed a consolidation model that presents consolidated financial statements as those of a single economic entity. Under this model, non-controlling equity interests in a consolidated subsidiary ("non-controlling interests") are presented on the balance sheet as a component of consolidated equity, as required by the current version of IAS 27. Further, transactions that increase or decrease the parent company's ownership in a subsidiary while control is maintained are accounted for as equity transactions. The Boards have also proposed measuring and recognising the full fair value of the non-controlling interest on the date control is obtained. These proposed changes will significantly modify the accounting for business combinations, step acquisitions, and dispositions of partially-owned subsidiaries under both IFRS and US GAAP.

We do not believe that the Boards' proposals will improve the quality and usefulness of financial reporting. Specifically, we do not agree that:

- 1) Non-controlling interests should be presented as part of consolidated equity.
- 2) A pre-existing interest in the acquiree should be re-measured at the date control is obtained.
- 3) Transactions with non-controlling interests should be accounted for as equity transactions.

We do believe, however, that the accounting for business combinations in which the acquirer obtains less than 100% of the acquiree ("partial business combinations") can be improved and converged in a way that is consistent with the underlying IFRS and US frameworks by making modifications to the parent company model used in US GAAP. Our approach differs from the Boards' proposals in several areas; however, we believe it better reflects the primary purpose for which consolidated financial statements are prepared. The remainder of this Appendix sets forth our approach as compared to the Boards' proposals. We suggest that the Boards consider our approach during their re-deliberations.

### **Underlying principles**

The principles underlying our approach are as follows:

- 1) Consolidated financial statements are prepared primarily for the benefit of parent company stakeholders
- 2) Non-controlling interests are not a component of consolidated equity and, accordingly, should be classified and treated separately
- 3) Fair values should be used for the initial recognition of assets, liabilities and non-controlling interests in acquisition accounting when fair values can be determined reliably.

- 4) Changes in ownership of a subsidiary are discrete economic events that are relevant to parent company shareholders. The effect of these economic events should be displayed in a way that is meaningful for parent company shareholders.

#### **Purpose of consolidated financial statements**

There is no specific IFRS guidance dealing with the purpose of consolidated financial statements. Under current US GAAP, however, paragraph 1 of ARB 51 states “The purpose of consolidated financial statements is to present, *primarily for the benefit of the shareholders and creditors of the parent company*, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions.” We believe the current guidance in ARB 51 remains true today as the primary users of consolidated financial statements continue to be shareholders and creditors (“stakeholders”) of the parent company and the potential stakeholders of the parent company. Our view is that consolidated financial statements should provide information from the perspective of those stakeholders. Non-controlling interests have different information needs that are mostly met by the financial statements of the relevant subsidiary. This is different from the Boards' view that the financial statements should be presented as if the parent and the non-controlling interests had similar economic interests in a single economic entity.

#### **Nature of non-controlling interests**

The Boards have concluded that a non-controlling interest in a subsidiary is an equity interest that should be reported in the consolidated financial statements as equity. This is based, in part, on the Boards' conclusion that non-controlling interests do not meet the definition of a liability in the conceptual frameworks.

We agree with the Boards' view that a non-controlling interest in a subsidiary is an equity interest and that most non-controlling interests do not meet the definition of a liability in the conceptual frameworks. Nonetheless, we believe that the consolidated financial statements should only include parent company equity in the equity section of the balance sheet. Non-controlling interests are a different type of equity interest, separate and distinct from the equity interests of the parent entity shareholders. We therefore believe the conceptual framework should be enhanced to include another category of equity to be presented separately from consolidated equity.

Our view is based on the principle that the financial statements are prepared for the benefit of parent company shareholders who view equity to represent their residual interest. We believe presenting the non-controlling interests separately from consolidated equity results in a clear and meaningful presentation and provides the most decision-useful information from the perspective of the parent company stakeholder.

We believe the accounting for non-controlling interests should be an integral part of an overall debate as there are other types of securities that have features that provide holders with an economic interest or participation in only a portion of the consolidated entity. We believe this debate should be part of the Boards' liabilities and equity project and the current proposals



should not pre-judge the outcome of that project. Until the debate is concluded, for the reasons discussed above, we believe that the non-controlling interests should be presented outside of consolidated equity under both US GAAP and IFRS.

### **Initial recognition of a business combination**

A business combination occurs primarily when an acquirer obtains control of an entity. The combination may be the result of acquiring a 100% ownership interest or a less than 100% ownership interest. These transactions may be accomplished in a single step or in multiple steps. A partial acquisition may be achieved in a single step, for example, the purchase of a 75% controlling interest in another entity. In other situations, an acquirer may have a pre-existing interest at the date it acquires control of an entity and a partial business combination may be achieved in multiple steps.

The Boards have proposed that 100% of the assets, liabilities and goodwill of the acquiree be recorded at fair value at the date control is obtained, whether the combination results from an acquisition of a controlling interest in a single step or multiple acquisitions over time. In the latter case, the Boards' proposals require re-measurement of any preexisting interest to fair value on the date control is obtained with holding gains and losses recognised in earnings.

#### *Recognition of non-controlling interest*

Current US GAAP generally requires that the non-controlling interest is consolidated based upon its interest in the underlying recognised assets and liabilities of the subsidiary (the recorded basis of the subsidiary). IFRS requires that the non-controlling interest in the fair value of the identifiable assets and liabilities is recognised, but not the non-controlling interest in goodwill. We do not believe either approach provides the most relevant information to shareholders of the parent company, since neither requires the initial measurement of the non-controlling interest at fair value. Our proposed approach would modify the current US GAAP and IFRS accounting models to require that the non-controlling interest be recognised at fair value on the date in which control is obtained, as this will be the first time that the non-controlling interest in the underlying net assets is recognised in the parent's consolidated financial statements.

#### *Recognition of the controlling interest*

When control is obtained in a single step, our model would yield the same result on the date of acquisition as the accounting proposed in the ED. That is, the acquirer would record 100% of the fair value of the assets acquired (including goodwill), the liabilities assumed and the non-controlling interest. Our approach would differ when control is obtained in more than one step, as we do not believe it is appropriate to re-measure the parent's pre-existing interest in the identifiable assets, liabilities and goodwill of the acquiree. There generally would be no re-measurement of the pre-existing interest under this model, and no recognition of holding gains and losses in earnings.

This approach is consistent with the view that the equity method of accounting is an extension of the consolidation method. That is, the parent's interest in the assets and liabilities of an equity

method investee are recognised initially at fair value at their date of acquisition albeit as a single line item. Accordingly, we do not believe there is a basis to re-measure a parent's interest absent an exchange transaction involving those assets and liabilities. We agree that it may be time to re-deliberate the equity method of accounting; however, any proposal in this area should be subject to due process.

A pre-existing non-controlling interest may have been a marketable equity security accounted for at fair value or a cost basis investment rather than an investment accounted for under the equity method. When a pre-existing interest was accounted for at fair value, we believe the fair value of that interest should become part of the measurement basis of the parent's interest in the acquiree when control is obtained. Any unrealised gain or loss related to the pre-existing interest at the time control is obtained would remain in other comprehensive income until such time that the investment in the subsidiary had been sold or exchanged.

When the pre-existing interest is a cost method investment, we believe that the investment should be re-measured to fair value upon the date that the parent obtains control, with any gain or loss recognised in other comprehensive income, as this transaction results in the initial recording of the parent's interest in the assets and liabilities of the subsidiary in the consolidated financial statements. We believe the resulting gain or loss on re-measurement should be recognised in other comprehensive income, as the investment giving rise to the gain or loss was not previously accounted for as a trading security.

We also considered the potential benefits that might be derived from presenting newly acquired partially-owned subsidiaries at their full fair value, including the simplicity of the full fair model and the relevance of the information provided to users of the financial statements. We concluded that these benefits do not outweigh the information lost related to the performance of the parent and the conceptual inconsistency of re-measuring assets and liabilities that have already been recognised in consolidated financial statements under the equity method.

#### **Changes in ownership interests in a subsidiary while control is maintained**

The Boards decided that changes in ownership interests in a partially-owned subsidiary without a change of control should be accounted for as equity transactions. Accordingly, transactions between the parent and non-controlling interest shareholders will simply transfer equity between parent company equity and the non-controlling interests' equity.

We believe our approach better reflects the economics of these transactions by recording the purchase of an additional interest after control has been obtained at fair value on the date that it is acquired, similar to the current accounting for step-acquisitions in the US. We agree that the purchase of a non-controlling interest is not a business combination. However, from the parent company perspective, there is an exchange transaction between the parent and a third party. We believe this transaction should be reflected in the financial statements from the perspective of the parent company shareholders as they view such transactions as an investment of available resources, for which the parent company expects to realise an economic return. Our approach would preserve the invested capital on the balance sheet and enable users of the financial statements to evaluate business performance using metrics based on invested capital.

Similarly, we believe that dispositions of interests in a subsidiary that do not result in the loss of control are economic events that should give rise to the recognition of gains or losses. The gains or losses are reflective of the return on the capital invested which is critical to assessing the financial performance of an entity and its management.

*Disposal of a subsidiary when an interest is retained*

The disposition of a portion of the parent company's interest in a subsidiary may result in a loss of control and therefore, de-consolidation of the subsidiary. The Boards' proposal would result in a re-measurement of the retained interest resulting in the recognition of an additional gain or loss.

Our approach reflects the interest that is retained based on the current carrying value of that interest to the parent company at the date control is lost, consistent with the treatment under both US GAAP and IFRS today. This approach provides useful information as the invested capital in the retained interest is maintained on the balance sheet of the parent and provides the basis for evaluating the performance of the investment in subsequent accounting periods.

## Appendix B

### PricewaterhouseCoopers' Responses

#### IFRS 3 Revised/ FAS 141(R)

*Question 1—Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?*

We agree with the objective that all business combinations should be accounted for using the acquisition method. We do not agree that the acquisition method requires the acquirer to recognise and measure the acquiree as a whole or that the acquirer should, in all circumstances, measure the assets acquired and the liabilities assumed at fair value at the date of acquisition. These views are explained in our responses. We have also included an alternative view of accounting for business combinations and non-controlling interests in Appendix A.

#### **Definition of a Business Combination**

We agree that the proposed definition of a business combination is appropriate for many types of business combinations. However, we are concerned that the proposed definition introduces uncertainty into the scope of the standard when there is doubt about whether one entity has obtained control of a business. We expressed this concern in our comment letter to the FASB during the initial deliberations that preceded the issuance of SFAS 141, as the definition of a business combination in that standard requires that control is a necessary feature of a business combination. At that time, we noted concerns in connection with:

- the requirement for control;
- multiple-entity combinations;
- the formation of joint ventures; and
- the use of newcos and non-operating companies.

We acknowledge that the Boards have included further guidance in paragraph 7(f) which states that business combination accounting is required irrespective of whether a group of former owners of one of the combining entities retains or receives a majority of the voting rights of the combined entity. However, this appears to conflict with the proposed definition of a business combination.

The IFRS 3 definition of a business combination is the bringing together of separate entities or businesses into one reporting entity. This definition is broader than the proposed definition and appears to eliminate the uncertainty about whether control must be obtained. We understand that the IASB has concluded that all business combinations within the scope of IFRS 3 would also be within the scope of the proposed definition. However, it is only when the definition in paragraph 4 is combined with the subsequent guidance on the structuring of business combinations in paragraph 7 that it becomes apparent that a controlling party need not be present. We therefore

urge the Boards to reconsider the definition or further enhance how control should be considered in the context of the definition. We believe the definition in IFRS 3 may be a better way to define those transactions to which business combination accounting should be applied.

It would also be helpful for the Boards to develop a common definition of a joint venture, since the formation of a joint venture is specifically excluded from the scope of the proposed standard. We believe that the guidance in paragraphs 4 through 7 on identifying a business combination could easily encompass a joint venture. Although we understand the Boards' desire to avoid addressing joint ventures at this time, we believe that in order to exclude joint ventures from the scope of the new standard and to achieve convergence, the Boards must define the difference between the creation of a joint venture and a business combination so that consistency of application can be achieved.

It is also unclear whether the Boards intended to provide principles to determine the treatment of non-operating companies ("newcos") and transitory newcos in the proposed standard. We note that many practice issues emanate from transactions in which a new entity (a newco) is formed to acquire the equity interests of another enterprise.

Paragraph 16 of the proposed standard deals only with situations in which a new entity is formed to effect the business combination involving two or more combining entities that existed before the business combination. Given the prevalence of transactions involving newcos in practice and the lack of clarity surrounding the accounting, we believe a significant gap in the accounting literature exists. We believe the Boards should develop clear principles for dealing with these transactions.

### **Combinations of mutual entities**

Many entities, including insurance companies, credit unions, savings and loan institutions, certain partnerships and cooperatives, can be mutual entities. We agree that an acquirer may be identified in most combinations involving these and similar entities and that acquisition accounting appears to be an appropriate accounting conclusion. However, we have concerns about how acquisition accounting should be applied.

The interest of a member of a mutual entity is often different from the holder of an equity interest in other entities. The rights of a member of a mutual entity are sometimes limited to the repayment of their investment or savings. They often do not have a fair value ownership interest in the residual benefits to be derived from the entity and therefore do not own a proportionate share of the net assets of the entity. The aggregate of the "fair value" of the interests of the members of a mutual entity may not necessarily equate to the fair value of the acquiree as a whole. Given the complexities associated with such combinations, we do not support including such combinations within this standard unless these issues are addressed comprehensively.

## **Business combinations achieved by contract alone**

The Boards have proposed that business combinations achieved by contract alone be included within the scope of the new standard. We agree with this proposal. However, we believe that the Boards' proposals may create some presentation anomalies when they are applied to dual-headed holding companies and stapled stocks

The proposed guidance requires that an accounting acquirer be identified in a business combination achieved by contract alone and that a portion of the fair value of the acquiree together with a portion of subsequent profit is allocated to the non-controlling interest. We agree with the Boards' proposal that an acquirer can be identified in a business combination achieved by contract alone. However, the accounting acquirer in a dual headed group or a stapling transaction often does not acquire an equity interest in the acquiree. In these circumstances, the definition of a non-controlling interest would require that all of the fair value of the acquiree and its subsequent net income be allocated to the non-controlling interest.

This presentation does not reflect the economic substance of these arrangements in which the shareholders in the acquirer and the acquiree have the same residual economic interest in the net assets and results of the combined entity (as if they had been merged into a single entity). We suggest that the Boards consider this anomaly and revise the definition of a non-controlling interest so that it applies only to that part of the capital and reserves and profit or loss of the acquiree that is not attributable to those that have ownership interests in the reporting entity.

*Question 2 – Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or the additional guidance?*

The definition of a business is important because there are currently significant differences between the accounting for asset purchases and the accounting for business combinations. These differences will not be eliminated by the Boards' current convergence proposals, and, in some instances, further differences may be created. For example, acquired in-process research and development ("IPR&D") would be capitalised in a business combination under the proposed changes to US GAAP but would be charged against earnings when acquired separately. An intangible asset for an acquired workforce is not recognised in business combinations accounting under existing US GAAP but is recognised in certain transactions involving a group of assets that are not a business. Deferred taxes arising on the initial recognition of an asset are recognised in a business combination under IFRS, but not in an asset transaction. Transaction costs are capitalised in connection with asset transactions under both US GAAP and IFRS, but will be charged as expenses in business combinations under both frameworks if the proposals are not amended.

There often is little difference between the economics of a business combination and a transaction in which an asset or a group of assets is acquired. However, the differences in the accounting create an incentive for transactions to be structured as one or the other, with the result that similar transactions might be reported differently in the financial statements. The similarity

in the economics suggests that the substance of the transactions would be best reflected by similar accounting.

We believe the Boards have an opportunity to address both convergence and the inconsistencies between the asset acquisition model and the business combinations model as part of their re-deliberations. We suggest that the Boards explore ways to converge on a solution that would address these issues and that they expose these proposals as an exposure draft.

We agree that it is difficult to establish parameters around a business combination and an asset transaction. However, we believe that the proposed definition of a business and the additional guidance is too broad to establish effective parameters around what a business combination is and what it is not. The Boards have proposed that an integrated set of assets and activities need only be “capable” of being managed and conducted for the purpose of providing a return to investors and that all of the assets and processes need not be present if a willing buyer is capable of acquiring the set and continuing to produce outputs, for example, by integrating the acquired set. We agree with the Boards that the definition of a business under existing US guidance can be too narrow. However, we are concerned that the proposed definition may be too expansive and include in the scope of the standard a variety of transactions for which the impact of business combination accounting may not have been thoroughly considered.

For example:

- When a single investment property is acquired, all of the inputs required to generate outputs are usually present, with the possible exception of employees that could easily be obtained by the acquirer. The operational processes applied to these inputs are generally very simple and could be fully outsourced or operated by a small workforce that is either obtained with the property or already employed by the acquirer. Strategic and management processes are often insignificant. It appears that the acquisition of a single investment property may be a business. However, it is not clear that this is the intended outcome as we note that, in the context of US GAAP, there is no proposal to amend SFAS 67 and EITF 97-11. The guidance in this literature addresses the capitalisation of transaction costs, which would not be permitted under the proposed standard.
- When an entity enters into a contract to provide outsourcing services, it often acquires all of the inputs (computers and employees) and processes (documented operating procedures) necessary to generate outputs. We believe there are a number of transactions of this type for which it would be helpful to understand how the principles in the Boards’ proposals should be applied. Some transactions of this type have been accounted for as business combinations, but it is often difficult to apply the principles in the proposed standard in these circumstances.
- When a development stage mine is acquired, all of the inputs (mineral reserves, property, plant and equipment and employees) and processes (established exploration and evaluation systems) required to generate outputs are usually present. It would appear that such a property could be included in the definition of a business.
- When a reinsurance company assumes the obligations relating to a group of insurance contracts (referred to as a loss portfolio transfer) from another insurance company, either through direct novation of the underlying contracts with policyholders or through the

purchase of ownership shares in an insurance company, it receives inputs (cash and/or investments) and often integrates the acquired contracts with its existing inputs and operational processes (including a workforce that is already employed) to produce outputs (management and payment of claims). In certain instances, accounting for the loss portfolio transfer as a business combination rather than as an assumed reinsurance transaction can produce different accounting results, including those resulting from the requirement to fair value intangible assets in a business combination, and the requirement for a reinsurer to assess risk transfer on contracts assumed.

We suggest that the Boards explain how they believe the proposed definition would be applied in these circumstances and better articulate the principles that should be applied to determine what constitutes a business. We note that there are a number of examples in EITF 98-3 that preparers and users of financial statements have found helpful in interpreting the underlying principles. We suggest that similar examples, based on the revised definition of a business and addressing the concerns set out above, be included in the application guidance in the new standard.

*Question 3—In a business combination in which the acquirer holds less than 100 percent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 percent of the acquisition-date fair value of the acquiree, including 100 percent of the values of identifiable assets acquired, liabilities assumed, and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?*

We believe the non-controlling interest should be recorded at its fair value when it is initially recognised in the consolidated accounts of the parent company. We believe this presentation is more relevant than current practice under US GAAP, which is to record the non-controlling interest at its carryover basis. Recording the non-controlling interest at fair value will also improve current practice under IFRS and US GAAP because goodwill will be recognised for the non-controlling interest resulting in a more complete presentation.

When there is a pre-existing interest and control is subsequently obtained in a step-acquisition, we disagree with the Boards' proposal. No exchange transaction has taken place with an outside party related to the pre-existing interest. When the pre-existing interest has been accounted for using the equity method, we do not believe there is an appropriate basis to re-measure the parent's interest in the assets and liabilities that have already been recognised in a form of acquisition and consolidation accounting. Equity accounting is effectively an extension of existing consolidation principles. The initial recognition and measurement of those assets and liabilities occurred in the application of the equity method. The parent's invested capital has not changed with respect to the pre-existing interest. Consequently, we do not agree that 100 percent of the values of the identifiable assets acquired, liabilities assumed and goodwill should be recorded because we do not believe a pre-existing investment should be re-measured to fair value as of the acquisition date with any "holding" gains or losses recognised in income.

A pre-existing non-controlling interest may have been a marketable equity security accounted for at fair value or a cost basis investment rather than an investment accounted for under the equity method. When a pre-existing interest was accounted for at fair value, we believe the fair value of that interest should become part of the measurement basis of the parent's interest in the acquiree



when control is obtained. Any unrealised gain or loss related to the pre-existing interest at the time control is obtained would remain in other comprehensive income until such time that the investment in the subsidiary had been sold or exchanged.

When the pre-existing interest is a cost method investment, we believe that the investment should be re-measured to fair value upon the date that the parent obtains control, with any gain or loss recognised in other comprehensive income, as this transaction results in the initial recording of the parent's interest in the assets and liabilities of the subsidiary in the consolidated financial statements. We believe the resulting gain or loss on re-measurement should be recognised in other comprehensive income, as the investment giving rise to the gain or loss was not previously accounted for as a trading security.

We have included an alternative view of accounting for business combinations and non-controlling interests in Appendix A.

*Question 4 – Do paragraphs A-8 to A-26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?*

No. We do not believe these paragraphs provide a clear articulation of the underlying principles. While the examples provided in the application guidance are helpful, they deal with straightforward situations and do not address the more complex situations that preparers encounter in practice. We suggest the Boards provide clear principles and a more comprehensive explanation of their thought process and the basis on which the fair value of the acquiree should be determined. This will provide preparers of financial statements and valuation professionals with a framework that allows them to apply valuation techniques to a wide range of different situations in a consistent way.

For example, it would be helpful to understand the Boards' thinking in connection with the allocation of value to a control premium and the valuation issues that arise when an entity that owns 45% of another entity acquires a further 10%, giving rise to a business combination. What should the valuation professional and the preparer consider when using the price paid for the 10% interest as a basis to value the acquiree as a whole?

*Question 5 – Is the acquisition date fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree the best evidence of the fair value of that interest? If not which forms of consideration should be measured on a date other than the acquisition date, when should they be measured and why?*

We agree that the acquisition date fair value of the consideration transferred in exchange for control is often the best evidence of the fair value of the interest acquired at that date. However, we generally believe that additional consideration paid to the seller when contingent consideration arrangements are resolved should be reflected in acquisition accounting rather than in the income statement (see question 6 below).

We acknowledge that there are valid arguments that support measuring the fair value of the consideration given at the date that a substantive agreement is reached and valid arguments that support the proposal made by the Boards. We believe that it is more operational to apply the

model proposed by the Boards and consistent with the principle that the assets and liabilities over which control is obtained are measured at fair value on the date that they are first recognised. We therefore agree with the Boards' proposals in this regard.

*Question 6 – Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?*

We agree that contingent consideration should be recorded at its estimated fair value at the acquisition date as it represents an obligation of the acquirer. However, we do not agree with the Boards' proposal to reflect subsequent changes in the fair value of the contingent consideration in income in each reporting period.

There are several reasons a buyer and seller may enter into a contingent consideration arrangement. Contingent consideration is commonly used by the parties when there is a difference in views about the underlying value of the business being acquired. There are also contingent consideration arrangements that are used for other reasons and represent compensation for post combination services by the selling shareholders. The guidance in EITF 95-8 under US GAAP is used to evaluate whether an arrangement is in substance additional purchase price or compensation for services, the use of property or a profit sharing arrangement. We acknowledge there has been difficulty in applying this guidance, but, we believe the conceptual framework in EITF 95-8 provides a reasonable basis to determine the underlying economics of a transaction.

The Boards have proposed that changes in the fair value of contingent consideration that is classified as a liability be recognised in income in each reporting period. We do not agree with this view as we believe the changes in the fair value of contingent consideration arrangements that reflect an uncertainty about the value of the business at the acquisition date should be included in acquisition accounting. We do not believe reflecting such changes as income or expense reflects the economic substance of the arrangement. For example, there are many contingent consideration payments made to sellers that have no continuing involvement with the acquiree after the combination. We believe that the payment in these circumstances does not represent compensation or payment for use of property. In these circumstances, we have difficulty reconciling recording subsequent changes in the fair value as a component of income with the underlying economic substance of the transaction which we believe is consideration for the purchase of the business.

We also believe the proposed model results in financial reporting that is counterintuitive since gains would be recognized if specified milestones or events requiring the payment of contingent consideration are not met and losses would be recognized if the company is successful and the amount paid under such arrangements exceeds the estimated fair value of the liability at the acquisition date. We noted that changes in the fair value of the assets that underlie many of these contingent consideration arrangements are not subsequently re-measured and as a result, the effect on income in future periods may relate solely to changes in the fair value of the liability for the contingent consideration arrangement.

We believe accounting for contingent consideration arrangements should reflect the economic substance of the arrangements. Accordingly, changes in the fair value of the contingent consideration that reflect an uncertainty in value should be recorded as an adjustment to purchase price. The discount inherent in the initial measurement of fair value should be recognised as a finance cost over the period between the date of acquisition and the date the contingency is resolved. Compensation for services or use of property should be reflected as an expense in the appropriate periods.

In situations where contingent consideration is classified as equity, we agree that the equity instrument should be measured initially at fair value. When the resolution of the uncertainty results in the issue of a greater or smaller number of equity instruments, the acquisition accounting should be amended to reflect the increase or decrease in the consideration given. This should be accomplished by recognising the change in the number of equity instruments to be issued, using the fair value of those instruments on the date of acquisition.

*Question 7— Do you agree that the costs the acquirer incurs in connection with a business combination should be excluded from the measurement of the consideration transferred for the acquiree? If not, why not?*

We do not disagree with the conceptual basis on which the Boards have proposed to exclude transaction costs from the consideration transferred in a business combination. However, we believe this is a broader issue that should be addressed more comprehensively. Current accounting under both US GAAP and IFRS requires capitalisation of transaction costs related to the acquisition of a single asset or a group of assets, real estate, and some financial assets. We are concerned about the disparate accounting treatment between business combinations and asset acquisitions in cases where the transactions are economically similar. We therefore recommend that the Boards address the accounting for transaction costs in a comprehensive project. Until then, we believe that the Boards should retain current accounting practice under IFRS and US GAAP that requires capitalisation of transaction costs.

*Question 8— Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?*

#### Receivables (including loans)

We agree that receivables should be measured at fair value and a separate valuation account should not be recognised as of the acquisition date.

#### Acquired Contingencies

##### *Initial Recognition*

We agree that assets and liabilities arising from contingencies acquired or assumed in a business combination should be recognised at fair value at the acquisition date, except those that are remote. We do not believe remote contingencies are a substantive factor in the determination of

the fair value of a business by either the buyer or the seller. The identification of and determination of fair values for remote contingencies will require a substantial effort by many companies. We do not believe the benefits, if any, that would result from recording the fair value of remote contingencies would justify the costs, particularly given most of these items will not result in an asset or liability that will require settlement. Therefore, for operational and simplicity reasons, we do not believe remote contingencies should be recognised in a business combination.

We agree that contingencies that are other than remote should be recognised at fair value at the acquisition date. However, there are few observable market transactions or other market-based measures for contingencies, so other less-developed valuation techniques will likely be used, which could lead to diversity in practice. We are also concerned that the determination of fair value for many contingencies will require significant input from the legal profession which has in the past found it difficult to provide the information necessary to develop reliable values. We therefore suggest the Boards conduct further research in the area of valuing contingencies, perhaps jointly with the valuation and legal professions, and clearly articulate the principles that should be used to determine fair value. This will enable preparers to work with the valuation profession to determine fair value in a consistent manner.

#### *Subsequent Accounting*

We do not agree with the proposal to record changes in fair value in income in subsequent reporting periods for acquired contingencies that would otherwise be in the scope of SFAS 5 or IAS 37. IFRS and US GAAP currently require that many financial statement items are recorded on a historical-cost basis while others are reflected at fair value. The proposed changes would further exacerbate issues with this mixed-attribute model, by requiring that similar types of financial statement items be treated differently. We also believe it would be difficult for users to understand the operating results of an entity when income reflects the changes in the recorded amounts of similar, or perhaps the same assets and liabilities, on different bases of accounting. We believe the difficulty faced by many preparers trying to estimate the fair value of these assets and liabilities will further undermine the relevance of regular re-measurement. Finally, we do not believe that the income statement is properly constructed at present to delineate changes in earnings that are as a result of changes in fair value from those that result from other operating activities. These issues should be addressed through thorough debate and proper due-process regarding the overall reporting model including the reporting of financial performance.

Accordingly, until such debate regarding re-measurement occurs, we believe it is necessary to bridge the accounting model for initial recognition with the historical cost model for contingencies that arise outside of a business combination. We suggest a model that is similar to that in IFRS 3 whereby the value of the contingency in subsequent periods is the greater of the fair value recognised initially or the amount that would result from applying SFAS 5 or IAS 37. When the contingency comes within the scope of SFAS 5 or IAS 37, it should be accounted for in accordance with those standards and any changes in the acquired contingency as a result of applying this guidance should be recorded in income in each reporting period.

A contingent liability recorded using this model would be removed from the balance sheet if it becomes remote as defined in SFAS 5 and IAS 37 or when it is settled. Contingent assets that

are not otherwise accounted for under existing accounting pronouncements would remain on the balance sheet at initial fair value until the asset is impaired, derecognised or settled.

#### In-Process Research & Development – US GAAP only

We believe that it is appropriate to recognise and measure IPR&D at fair value as of the acquisition date. However, we note that the FASB does not plan to amend the guidance dealing with IPR&D outside a business combination. We do not believe it would be appropriate to capitalise IPR&D in business combinations and not have the same accounting for when a group of assets that do not meet the definition of a business is acquired. The underlying economics of these transactions are too similar to result in different accounting treatment upon acquisition. We are concerned that limiting the proposed change to only the acquisition of a business increases the potential for transactions to be structured to achieve a desired accounting result. Consequently, while we support the FASB's proposal to require capitalisation of IPR&D in business combinations, we encourage the FASB to have the same accounting model applied to the purchase of a group of assets.

We also note that capitalisation of IPR&D in a business combination raises additional questions regarding the overall accounting for research and development costs. Specifically, under US GAAP, subsequent expenditures for acquired IPR&D projects will be expensed. Under IFRS, these costs may be capitalised if certain criteria are met. In addition to conforming the accounting models for business combinations and asset acquisitions, it will ultimately be necessary for the Boards to address the underlying framework for the accounting for ongoing research and development costs.

We also believe that there will be a need for the Boards to articulate their principles related to impairment guidance for capitalised IPR&D. These projects evolve and change over time. They may be combined with other research projects and lose their individual identity. Although the proposed guidance indicates that IPR&D should be treated as an indefinite lived intangible, it is not clear how such a model should be applied when the state of the underlying asset evolves over time.

*Question 9 – Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If, so which ones and why?*

Yes, with the exception of assets held for sale, we agree that these exceptions are appropriate because of the concerns articulated by the Boards.

We understand the Boards' concern that recording assets held for sale at fair value may result in a loss shortly after the acquisition date since SFAS 144 and IFRS 5 would apply and require the recognition of selling costs. However, we have difficulty reconciling this view with other changes proposed by the Boards. The exposure draft refers to the proposed SFAS on Fair Value Measurements for the definition of fair value. That proposed statement would require the use of market participant data to determine fair values. Recording assets held for sale at fair value, less cost to sell, takes into consideration buyer specific intentions with regard to those assets. Under a market participant notion, buyer specific actions are not considered in the determination of fair value. This is consistent with the Boards' proposed treatment of restructuring liabilities

Therefore, we do not believe the exception for assets held for sale is consistent with the framework proposed by the Boards.

We also note that there are circumstances where an intangible asset with a substantial fair value may be acquired for which the buyer has no intention to use or continue to maintain the value of the asset. For example, an entity may acquire a competitor with the intent to withdraw the competitor's brand from the market within a short period after the acquisition. We believe the proposals would require that the acquirer determine fair value based on facts relevant to a hypothetical market place participant. There is current practice within the US where such assets are valued on the basis of buyer specific cash flows resulting in a significantly lower fair value than the amount that would be determined under a market place participant model.

We believe that determining a market participant fair value for an asset that is not expected to be utilised or disposed of might be challenging and likely will result in disparate valuation practices. Should the Boards continue in this direction, we believe they should clearly articulate their principles for valuation of these assets along with their underlying thought process. We also believe the implications for the acquirer's subsequent accounting should be considered, as we believe there are differences of view on how such values should be amortised and/or tested for impairment (including differing views around the "unit of accounting" for impairment tests).

*Question 10—Is it appropriate for the acquirer to recognise in income any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?*

We do not believe it is appropriate to recognise in income a gain or loss resulting from the re-measurement of the acquirer's previously acquired non-controlling equity investments on the date it obtains control of the acquiree. We are not convinced by the Boards' logic about the exchange of a non-controlling interest for a controlling interest. In our view there has been no exchange transaction related to this equity interest and therefore we do not believe there is a basis to recognise a gain or loss.

Our view is consistent with the Boards' principle that the equity method of accounting is an extension of the consolidation method. That is, the principles underlying the equity method of accounting generally are an extension of consolidation principles. The parent's interest in the assets and liabilities of an equity method investee are recognised initially at fair value at their date of acquisition. Accordingly, we do not believe there is a basis to re-measure a parent's interest absent an exchange transaction with a third party involving those assets and liabilities.

A pre-existing non-controlling interest may have been a marketable equity security accounted for at fair value or a cost basis investment rather than an investment accounted for under the equity method. When a pre-existing interest was accounted for at fair value, we believe the fair value of that interest should become part of the measurement basis of the parent's interest in the acquiree when control is obtained. Any unrealised gain or loss related to the pre-existing interest at the time control is obtained would remain in other comprehensive income until such time that the investment in the subsidiary had been sold or exchanged.

When the pre-existing interest is a cost method investment, we believe that the investment should be re-measured to fair value upon the date that the parent obtains control, with any gain or loss recognised in other comprehensive income, as this transaction results in the initial recording of the parent's interest in the assets and liabilities of the subsidiary in the consolidated financial statements. We believe the resulting gain or loss on re-measurement should be recognised in other comprehensive income, as the investment giving rise to the gain or loss was not previously accounted for as a trading security.

In developing our view on the accounting for pre-existing interests, we considered the potential benefits that might be derived from presenting newly acquired partially-owned subsidiaries at their full fair value, including the simplicity of the full fair value model and the relevancy of the information provided to users of the financial statements. We concluded that these benefits do not outweigh the information lost related to the performance of the parent and the conceptual inconsistency of re-measuring assets and liabilities that have already been recognised in consolidated financial statements under the equity method.

We recognise that our approach is inconsistent with the model applied in IFRS 3 where the parent's preexisting interest in the identifiable assets and liabilities are restated to fair value when control is obtained in stages. The adjustment to fair value is recorded in equity. For the reasons articulated above, we do not support the IFRS model.

We have also included an alternative view of accounting for business combinations and non-controlling interests in Appendix A.

*Question 11 – Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative would you propose and why?*

We do not agree with the proposal that any excess of the fair value of the acquirer's interest in the fair value of the identifiable net assets over the fair value of the consideration given should be recognised as a gain in the income statement. We do not believe that a business combination transaction, negotiated at arms' length between unrelated parties, is an event that should give rise to income.

We agree that the excess of the fair values of the acquirer's interest in the net assets over the consideration given for that interest does not meet the definition of a liability in either the IFRS or US accounting framework. However, the excess relates in many cases to uncertainties in the measurement of assets and liabilities or to potential cash outflows of the acquired entity that do not meet the criteria for recognition (for example, actions that the acquirer must undertake to fully realise the remaining value in the assets and liabilities acquired.)

We suggest that the principles used previously in IAS 22 be applied as a practical solution to address our concern about immediate gain recognition. These principles require that any excess of the acquirer's interest in the fair value of the assets and liabilities acquired be recognised according to the substantive reasons for the excess. The associated accounting would recognise

that future anticipated losses or expenses of the acquired business may have formed the basis for the exchange price. Therefore, the credit that results in acquisition accounting is recognised subsequently in the income statement at the same time as losses or expenses that were anticipated by the acquirer prior to the acquisition, but did not meet the criteria for recognition as liabilities at the date of acquisition. The remaining excess is recognised in the income statement over the average useful lives of the non-monetary assets acquired. Any excess over the fair value of the non-monetary assets acquired is recognised in income immediately.

*Question 12 – Do you believe there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?*

We do not believe the overpayment can be measured reliably. We agree with the Board's conclusion that the fair value of the consideration given to acquire an interest in the acquiree is the best evidence of the fair value of that interest on the date of the business combination. The determination of any overpayment is inherently subjective. An attempt to determine the amount of an overpayment would not result in a sufficiently reliable measurement to provide useful information.

*Question 13 – Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effect of measurement period adjustments? If not, what alternative do you propose and why?*

We do not agree that comparative information for prior periods should be adjusted for the effect of measurement period adjustments. We acknowledge the Boards' view that applying measurement period adjustments retrospectively would enhance the comparability of the financial statements. However, we do not believe the benefits are sufficient to justify the cost and complexity of retrospective treatment. Accordingly, we believe that these adjustments should be reflected as changes of estimates that are accounted for in the current period under both US GAAP and IFRS. We do not view these changes in estimates to be different than those that are unrelated to a business combination and therefore believe the accounting should be the same and applied on a prospective basis. We also note that this proposal would be impractical to apply for public companies, particularly those that are required to report financial information on a quarterly basis.

We also suggest that the guidance in paragraph 65 of the proposed standard be amended. We believe the proposal that the measurement period ends as soon as the necessary information is received or is confirmed to be unavailable may not be practical. There are many circumstances in which the acquirer might not know whether it has received all of the information necessary to complete its acquisition accounting. For example, it might become aware of a previously unknown pre-acquisition environmental obligation sometime after it believed that it had recognised all of the liabilities assumed or it might discover a structural fault that existed as of the acquisition date that affects the fair value of a building acquired after the independent appraisal of the building was complete.

We do not believe it would be appropriate to require an acquirer to record charges to income that may result from such additional information if it can be reliably determined that the conditions



on the amount of time an acquirer should have to finalise its acquisition accounting. Therefore, we suggest the standard require that the measurement period does not exceed one year with the understanding that within that one year period, the acquirer should have the ability to determine the time at which the acquisition accounting is complete.

**Question 14** – *Do you believe the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed are not part of the exchange for the acquiree? If not, what other guidance is needed?*

Yes, we believe this guidance is appropriate and helpful. However, we believe it would add clarity to the guidance if paragraph 69 of the proposed standard was expanded to refer specifically to the guidance in paragraphs 88-90 in the application guidance. This guidance helps distinguish between circumstances where part of the consideration is given for something other than the business combination and circumstances where assets and liabilities are acquired or assumed outside of the business combination.

The proposed guidance for determining whether a payment is made for a business combination or for employee services is different from the existing US GAAP guidance in EITF 95-8. The existing guidance states that a vesting requirement is strong evidence that a payment is made in exchange for employee services. The proposed guidance lists vesting requirements as one of the factors that should be considered but does not distinguish it as being a more persuasive indicator. We believe this change will make the guidance more difficult to apply in practice. We therefore suggest that the emphasis on the implications of a service requirement that exists in US GAAP be retained. We have also commented in this letter in connection with contingent consideration on the need to incorporate principles within the proposed statement for determining whether changes in the fair value of contingent consideration should be treated as adjustments to acquisition accounting or as an expense in the subsequent accounting.

**Question 15** – *Do you agree with the disclosure objectives and minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?*

We believe that the proposed disclosure objectives are appropriate and that most of the minimum disclosure requirements are appropriate.

Paragraph 74 (a) requires disclosure of the revenue and net income of the acquiree included in the consolidated income statement subsequent to the business combination. This requirement is impractical in many situations where the acquiree's operations and its reporting systems are integrated with those of the acquirer. We therefore suggest the Boards consider eliminating this requirement.

We are also concerned that in practice, there is an inconsistent determination of the adjustments made for purposes of preparing pro-forma information similar to the pro-forma information required by paragraph 74(b)(1). We suggest replacing this requirement with a disclosure of actual revenues and net income of the acquiree for the period prior to the business combination. The required disclosures should also include information regarding any pre-acquisition

actual revenues and net income of the acquiree for the period prior to the business combination. The required disclosures should also include information regarding any pre-acquisition relationships between the buyer and the seller and the historical income statement data related to these arrangements.

The proposals also require the acquirer to disclose details of the purchase accounting adjustments made by the acquirer and the ongoing impact of these adjustments. We believe our suggested modification to the proposed disclosures would provide transparent information necessary for users to understand the effects of the acquisition on the newly combined entity on a consistent basis.

If the Boards decide to retain the disclosure requirement as proposed, we suggest that the principles on which the pro-forma information is prepared should be more clearly articulated to ensure that the information is prepared on a consistent and reasonable basis.

*Question 16 – Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristic: a) the intangible asset cannot be sold, rented or exchanged individually or in combination with a related contract asset or liability; and b) cash that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?*

We agree that identifiable intangible assets should be able to be measured with sufficient reliability to be recognised separately from goodwill. There has been a requirement in US GAAP to measure the fair value of all of the identifiable intangible assets acquired in a business combination for some years. There is also guidance prohibiting the use of the residual method to value certain of these assets. The determination of fair value for many identifiable intangibles has been challenging, but we believe it has fostered a healthy debate regarding *how* such fair values should be determined. We believe that more needs to be done with respect to providing principles to achieve consistent determination of fair values in practice and we would be pleased to work closely with the Boards to develop this guidance.

For example, we have observed some diversity in practice in valuing certain intangibles, such as reacquired franchise rights that are inextricably linked to the cash flows that the acquired business generates as a whole. Many entities value such rights based on the current market price of a similar franchise right while others use valuation models such as the “greenfield approach” discussed below to determine the fair value. These two approaches typically yield significantly different values. We suggest that the Boards clearly articulate the concepts that they believe should underlie the valuation of such assets. In this regard, valuation guidance related to the interrelationships between groups of assets and their cash flows would be helpful. This would reduce diversity in practice and provide a framework for valuation professionals and preparers of financial statements to determine fair values.

We have identified certain intangible assets that cannot be sold, rented or exchanged individually or in combination with a related contract, asset or liability and that generate cash flows that are

linked inextricably with the cash flows that are generated by the business as a whole. These include a license to operate a nuclear power plant, some broadcast licenses and some liquor/gaming licenses. These licenses are essential to operate the business, but in some situations we believe they cannot be sold separately from the business. The approach often used to value these assets is typically the “greenfield approach”, which assumes a hypothetical situation in which a business is built from a starting point where the operator owns only the license. We believe it would be helpful for the Boards’ to specifically consider this approach and determine whether they agree with its conceptual merits for determining fair value.

*Question 17 – Do you agree that any changes in the acquirer’s deferred tax benefits that arise from the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why not?*

Yes, we agree that this proposal is appropriate.

We have noted some diversity in practice in connection with the measurement of some assets acquired in a business combination. US GAAP requires that the measurement of fair value assumes a tax basis equal to the fair value of the asset. There is no similar requirement in IFRS. We suggest that the Boards clarify that the assets should be valued on the basis that the tax base is equal to the fair value of the asset only when a hypothetical market participant would be able to obtain a tax deduction for the cost of the same asset acquired outside of a business combination.

*Question 18 – Do you believe it is appropriate for the IASB and the FASB to retain these disclosure differences? If not, which of the disclosure differences should be eliminated and why?*

We agree that the disclosures should be harmonised to the extent possible, subject to the requirements of other standards that are not currently being reconsidered by the Boards.

*Question 19 – Do you find the bold type-plain type style of the exposure draft helpful? If not, why? Are there any paragraphs you believe should be in bold type but are in plain type or vice versa?*

We believe that the use of bold and grey text makes the standard easier to read, understand and explain the standards and to see how to apply the standards to different circumstances. Further, we believe that it is a good discipline for boards that set standards to have to identify the key principles they are putting forward separately from detailed requirements and supporting explanations and guidance.

**IAS 27(R)/FASB Proposed Statement – note the responses are to the questions asked by the FASB. Those marked with \* were also asked by the IASB.**

*Question 1—Do you agree that the non-controlling interest is part of the equity of the consolidated entity? If not, what alternative do you propose and why?*

No. The non-controlling interest in the equity of a subsidiary is a residual interest in a component of the consolidated entity. The residual interest in a subsidiary is fundamentally different to a residual interest in the consolidated entity. We believe that the primary users of consolidated financial statements view equity as the financial reporting component that represents the residual interests of the controlling consolidated entity.

Please refer to Appendix A for a complete discussion regarding our views on the accounting for partial business combinations and for details of our suggested alternative approach.

*Question 2—Do you agree with the proposed requirement to present the non-controlling interest in the consolidated statement of financial position within equity, separately from the parent shareholders' equity? If not, what alternative do you propose and why?*

No. The controlling and non-controlling interests should be clearly separated in order to provide decision-useful information to the users of financial statements. We disagree with the Boards' view that there is no compelling reason to create a new element of financial statements for non-controlling interests. Creating a new component of financial statements would allow equity in consolidated financial statements to reflect the residual interests of the parent company shareholders and improve the financial reporting which serves as a communication vehicle to the primary users of that information.

We recognise that this view is inconsistent with the treatment required by the current version of IAS 27. However, we believe that it is important to achieve convergence in this area and therefore we suggested a presentation that displays the noncontrolling interest in less than 100% owned consolidated subsidiaries as a form of equity but outside of parent company equity be used for both the US GAAP model and IFRS.

Please refer to Appendix A for a complete discussion regarding our views on the accounting for partial business combinations and for details of our suggested alternative approach.

*Question 3\*—Do you agree with the proposed requirements for attributing net income or loss and the components of other comprehensive income to the controlling and non-controlling interests? If not, what alternative do you propose and why?*

We agree with the proposed requirement that net income or loss and each component of other comprehensive income should be attributed to the controlling and non-controlling interests based on relative ownership interests unless the controlling and non-controlling interests have entered into a contractual arrangement that requires a different attribution between them.

We do not agree with the proposed requirement that losses applicable to the non-controlling interest of a subsidiary are to be attributed to the non-controlling interest even if those losses exceed the non-controlling interest in the subsidiary's equity. This requirement may result in the non-controlling interest absorbing losses that it will never suffer economically since these losses are generally absorbed by the parent shareholders. Since we believe that the non-controlling interest should be presented separately from parent company equity, it would be consistent for these losses to be charged against the controlling interest. We acknowledge that the parent entity

may not have any legal obligation to contribute assets to the subsidiary, but also note that the non-controlling interest does not have such a legal obligation either. However, because of its relationship with its subsidiary, we have observed in practice that the parent is more likely to fund such losses to protect its investment in the subsidiary. We therefore suggest that current practice under both US GAAP and IFRS should not be altered.

Finally, we do not agree that any guarantees or other support arrangements between the controlling and non-controlling interests should be accounted for separately. This would be inconsistent with the requirement that net income or loss should be attributed to the controlling and non-controlling interests based on contractual arrangements if such contractual arrangements would provide a result that is different from an allocation based upon relative ownership interests. Further, recording guarantees or other support arrangements separately without any effect on the way losses are attributed to the controlling and non-controlling interests would not reflect the underlying economics, which are that one party would absorb the losses of the subsidiary. We therefore suggest that current practice under both US GAAP and IFRS is not altered at present.

*Question 4\* - Do you agree that changes in ownership interests in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as equity transactions? If not, what alternative do you propose and why?*

No, we do not agree that changes in ownership interests in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as equity transactions. Because the non-controlling interest does not have an ownership interest in all of the assets and liabilities of the parent, transactions by the parent with non-controlling interests should be accounted for in accordance with their substance, which, from the perspective of the parent company, are taking place with third parties.

Transactions between the parent entity and a non-controlling interest transfer value between the parent entity shareholders and the non-controlling interest. Parent entity shareholders need information about the economic impact of such transactions to evaluate the return on their investment and the performance of the parent company's management team. The consolidated financial statements should therefore reflect the economic consequences of these transactions from the perspective of the parent entity shareholders which would imply that these transactions should be treated as disposition transactions with gains and losses recognised in the income statement or as additional purchases of an interest.

Please refer to Appendix A for a complete discussion regarding our views on the accounting for partial business combinations and for details of our suggested alternative approach.

*Question 5\*—Do you agree that any gain or loss resulting from the re-measurement of a retained investment in a former subsidiary should be recognised in income of the period? If not, what alternative do you propose and why?*

No. We do not believe that a retained investment in a former subsidiary should be re-measured as there is no exchange transaction with an unrelated third party involving the interest that has

been retained. Re-measuring the retained investment loses the record of the invested capital in that investment along with the basis for evaluating the performance of that investment.

Please refer to Appendix A for a complete discussion regarding our views on the accounting for partial business combinations and for details of our suggested alternative approach.

*Question 6\* —Do you agree with the proposed guidance for determining whether multiple arrangements should be accounted for as a single arrangement? If not, what alternative do you propose and why?*

Our suggested alternative approach included in Appendix A would obviate the need for guidance for determining whether multiple arrangements should be accounted for as a single arrangement. However, if the Boards decide to retain their proposed model, we believe such guidance is necessary, but recommend that the guidance should be principles-based. We suggest an approach in which, for example, transactions structured in multiple steps in order to avoid recognising a loss on disposition (assuming there was otherwise no impairment loss to be recognised under other guidance) or to achieve alternative accounting should be evaluated to determine whether the transactions should be treated as part of a single transaction. The indicators (a)–(d) could be retained as factors to consider in making a determination, but the absence or presence of such indicators should not be determinative.

We believe that embedding a principle to address transactions structured to achieve a desired accounting result would provide more effective method of curtailing such transactions since it will not depend as heavily on meeting the bright-line tests set out in (a)–(d).

*Question 7— Do you agree that earnings per share amounts should be calculated using only amounts attributable to the controlling interest? If not, what alternative do you propose and why?*

Yes. We agree that earnings per share amounts should be calculated using only amounts attributable to the controlling interest since we believe that financial statements should be prepared for the benefit of the parent company shareholders. In our view, including amounts related to the non-controlling interest in earnings per share amounts does not provide relevant or decision useful information to the primary users of the financial statements.

*Question 8 - Do you agree that disclosure of the total amounts of consolidated net income and consolidated comprehensive income, and the amounts of each attributable to the controlling interest and the non-controlling interest should be required? If not, why?*

Yes. If the Boards decide to move towards a consolidation model that views the consolidated financial statements as those of a single economic entity, we believe that these would be appropriate disclosures. Our suggested approach as detailed in Appendix A would obviate the need for these disclosures.

*Question 9—Do you agree that disclosure of the amounts attributable to the controlling interest should be required? If not, why?*

Our suggested alternative approach included in Appendix A would obviate the need for these disclosures. However, if the Boards decide to move towards a consolidation model that views the consolidated financial statements as those of a single economic entity, disclosure of the amounts attributable to the controlling interest should be required because it provides some level of decision-useful information to parent company stakeholders which would otherwise be lost.

*Question 10—Do you agree that a reconciliation of the changes in the non-controlling interest should be required? If not, why?*

Yes. We agree that a reconciliation of the changes in the non-controlling interest should be required, regardless of the consolidation model adopted in the final standard. This would provide useful information about transactions with non-controlling interests and is consistent with providing a reconciliation in the changes of equity of the controlling interest.

*Question 11—Do you agree that disclosure of a separate schedule that shows the effects of any transactions with the non-controlling interest on the equity attributable to the controlling interest should be required? Please provide the basis for your position.*

Yes. We agree that disclosure of a separate schedule that shows the effects of any transactions with the non-controlling interest on the equity attributable to the controlling interest should be required. Disclosure of the effects on parent company equity of disposition transactions would be helpful to parent company shareholders who have experienced an economic gain or loss as a result of those transactions. Disclosure of the effects on parent company equity of the effects of acquisitions of additional interests would be less useful as we believe that the primary users of financial statements would prefer that these transactions be accounted for as an additional acquisition of an interest as discussed in the response to Question 4, above.

We do not believe that the proposed additional earnings per share metric that includes in the numerator of the calculation the effects of any equity transactions with the non-controlling interest should be required. We believe that users will not benefit from a third earnings per share measure in addition to basic and diluted metrics currently required. In addition there appears to be little relevance to this measure since it only selectively adds to earnings per share the effects of one class of equity transactions (i.e. those with non-controlling interests) but it does not include the effects of any other transactions which affect parent company equity. We are also concerned that investors and other users of financial statements could be confused by this additional disclosure, particularly as to how it relates to current earnings per share measurements. This could raise questions regarding which per share metric is most representative of underlying business performance. We believe that any change to the required earnings per share measurements should be addressed as part of the performance reporting project currently being deliberated by the Boards.

*Question 12—Do you agree that disclosure of the gain or loss recognised on the loss of control of a subsidiary should be required? If not, why?*

As noted previously, we do not believe that a retained interest in a subsidiary should be re-measured. However, should the Boards continue with their proposed model, we agree that disclosure of the gain or loss recognised on the loss of control of subsidiary should be required.

*Question 13\*—Do you agree with the proposed transition requirements? If not, what alternative do you propose and why?*

Yes. We agree with the proposed transition requirements. We believe the Boards should consider, however, the transition provisions for entities which have substantial non-controlling interests recognised on their balance sheets. Under US GAAP many of these interests were recorded using historical cost at the time the partial business combination occurred. Subsequent to the effective date of the standards, if the parent entity decides to purchase the non-controlling interest and the non-controlling interest has appreciated over time, the parent entity may record a significant reduction in its equity which would not reflect any underlying economic event.