Organización Internacional
de Comisiones de Valores

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Organização Internacional
das Comissões de Valores

OICU-IOSCO

May 27, 2003

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom
VIA FAX 011 44 207-246-6411

Dear Sir David:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our thoughts regarding Exposure Draft 3 on Business Combinations and the accompanying Exposure Draft of Proposed Amendments to IAS 36, Impairment of Assets, and IAS 38, Intangible Assets.

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement[1]. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all the comments that might be provided by individual members on behalf of their respective jurisdictions.

Standing Committee No. 1 is pleased that the Board has undertaken a project to improve accounting standards on a matter that has such frequent and widespread application around the world. Business combinations occur frequently, and the need for improved accounting guidance has been widely noted as needing attention in standards setting. To the extent possible, we hope that the Board's work will be successful in increasing comparability in an accounting area that provides important information to investors.

We note that the Board and staff have made a significant effort in conducting field visits in this project, in order to gather input about the implications of implementing the proposed standard. Our perception is that this investment of time and resources has improved the understanding of

[1] See IOSCO website, www.iosco.org

others and confidence in the process. We look forward to the utilization of the information obtained in these field visits for successful completion of a final standard.

It appears that the Board's work on business combinations issues in Phase 1 and Phase 2 agenda projects will address numerous issues and needs for improvement in accounting guidance. Some of these issues are interdependent, whereby work in Phase 2 will impact decisions and guidance developed in Phase 1. We hope that the Board will find a way to manage this project so as to issue one comprehensive set of guidance after all relevant decisions have been made. At a minimum, the Board should avoid issuing guidance that could be implemented one year and would have to be changed shortly thereafter, or would apply for only a few reporting periods and would hinder comparability in future years. This could be confusing and inefficient, both for investors and for issuers.

IOSCO Standing Committee No. 1 would like to offer the following additional comments for the Board's consideration:

1.) The idea of income created by negative goodwill is troubling to many members. While we understand the fair value measurement rationale that by technical execution results in such income being created, it is difficult to accept that one can generate income – whether revenue or a gain – simply by buying something. The income thus generated in the ED's present provision is viewed by many as fragile and subjective, and also prone to be arising because of unrecorded contingent liabilities, or excess valuations of assets – such as intangibles – whose valuation involves highly judgmental decisions. Certainly, such income has not been subjected to any test of realizability.

2.) The interplay of recognition criteria for assets and liabilities acquired in a business combination with general recognition criteria for such items is of concern to some. Under the ED, the acquirer would recognize certain assets and contingent liabilities only as a result of the business combination. While there is recognition that in a purchase of a business the acquirer is "paying" a certain amount that includes consideration of known contingent liabilities, those who are concerned about the ED's provisions point out that this is also true where contingent assets are concerned. The Board needs to explore further whether lack of symmetry in purchases of contingent assets and liabilities is warranted and why, and fully explain the rationale for this in the Basis for Conclusions in the final standard.

3.) The impairment test guidance, and how goodwill should be allocated, are areas that need further clarification. Some jurisdictions that have previously adopted similar guidance in national standards have found the provisions difficult to apply or enforce in practice.

An example of an especially difficult area is the case whereby the apparent goodwill relates to a pervasive intangible asset that is fundamental to the plan and operation of the business, as in the case of cable or wireless licenses and other examples where the intangible relates to the entire reason for the business. There is a need to strengthen the guidance about how to separate and value intangible assets that are required to operate the business but have little or no intrinsic value of their own because they often are not exclusive rights to operate in a certain area.

Another issue that has arisen is the view of some that a limited service life can sometimes be identified for some portions of goodwill -- examples cited as to when this might occur include elements such as an assembled workforce in a labor intensive company -- raising the question of whether non-amortization is appropriate for such elements.

In light of the complexities involved in analyzing and allocating goodwill, we considered whether it might be appropriate in defined circumstances for the standard to permit companies to elect to amortize goodwill rather than subject it to an annual impairment test; however, we could not identify sufficiently robust criteria that would not amount to a free choice option, and normally investors do not benefit from issuers being permitted to choose from having elective choices in accounting.

An ideal answer would be to simplify the impairment test approach, yet retain a method that is rigorous and effective and can be applied consistently by preparers without undue cost. This is an area where national standard setters have been struggling to come up with sound solutions that are both logical and capable of being consistently applied. The IASB has the opportunity to consider the experience and best thinking of all standards setters in seeking an answer that might ultimately provide improved information for investors and worldwide comparability.

4.) The Standing Committee believes it will be important to clarify further "what is a business" for the purpose of having a clear definition of "what is a business combination". It will also be helpful to explain all ways in which a business combination can occur, e.g, acquisition of a set of assets and liabilities that together form a business entity, or an interest in a legal entity, by contract or agreement as well as by acquisition of ownership (equity interests or voting rights), and what is needed to identify or demonstrate the combination in such a situation. We recognize that this is extending into some of the issues to be addressed in Phase 2 of the project, and it is one of our reasons for believing that ideally one final business combinations standard should include determinations in both phases. For consistent application there is also a need to clarify what is meant by terms such as "may involve" or "may result in" - are the items following these phrases all-inclusive or just some examples of business combinations?

5.) We understand that some discussion is taking place on the idea of stepping up 100% of the goodwill in transactions where the acquisition of a controlling interest involves less than a 100% ownership. While we understand that such an accounting would be consistent with the full revaluation of acquired assets and liabilities as proposed by ED 3, questions have arisen as to the reliability of the grossed-up assumed purchase price that would be used to calculate the goodwill and resulting minority interest figure. It should be acknowledged that the acquisition of the remaining minority interests would often have been made at a different price, due to the control premium paid for the controlling interest, and that if its acquisition was to take place at a later date, it would likely be based on different criteria and result in a figure different from the value ascribed to the minority interest. We offer no solution at this stage but encourage the Board to complete the testing of this new concept and think about whether this provides an appropriate measure of an assumed purchase price, should the proposed accounting be included in the final standard.

Standing Committee No. 1 appreciates the Board's efforts to improve accounting for business combinations. If the Board or staff should have any questions regarding the comments in this letter, please call me on 202-942-4400.

Sincerely,

Scott A. Taub

Scott Taub
Chairman
IOSCO Standing Committee No. 1