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CHINA ACCOUNTING STANDARDS COMMITTEE

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April 3, 2003

Sir David Tweedie
Chairman
International Accounting Standards Board
First Floor, 30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David Tweedie,

Comments on ED3 “Business Combination”

This letter responds to the IASB Exposure Draft Business Combination. On behalf of the China Accounting Standards Committee, I commend the IASB for its continuing efforts to improve the quality of international accounting standards and appreciate this opportunity to comment on the Exposure Draft.

Best Regards,

Yours sincerely,

Feng Shuping
Secretary-General
China Accounting Standards Committee

CASC Comments on IASB ED3

Question 1 – Scope

The Exposure Draft proposes:

(a) to exclude from the scope of the IFRS business combinations in which separate entities or operations of entities are brought together to form a joint venture, and business combinations involving entities under common control (see proposed paragraphs 2 and 3 and paragraphs BC9-BC11 of the Basis for Conclusions).

Are these scope exclusions appropriate? If not, why not?

(b) to include in the IFRS a definition of business combinations involving entities under common control, and additional guidance on identifying such transactions (see proposed paragraphs 9-12 and Appendix A, and paragraphs BC12-BC15 of the Basis for Conclusions).

Are the definition and additional guidance helpful in identifying transactions within the scope exclusion? If not, what additional guidance would you suggest, and why?

We believe that these scope exclusions in ED are appropriate and the definition and additional guidance is helpful in identifying transactions within the scope exclusion.

Question 2 – Method of accounting for business combinations

The Exposure Draft proposes to eliminate the use of the pooling of interests method and require all business combinations within its scope to be accounted for by applying the purchase method (see proposed paragraphs 13-15 and paragraphs BC18-BC35 of the Basis for Conclusions).

Is this appropriate? If not, why not? If you believe the pooling of interests method should be applied to a particular class of transactions, what criteria should be used to distinguish those transactions from other business combinations, and why?

We support that IASB just allowed one method for accounting of business combination. However, if all business combinations within the scope are required to be accounted for by applying purchase method. However, purchase method has some shortcomings, for example, it may occur that both historical cost and fair value measurement attribute apply to the same balance sheet item. Moreover, it is quite difficult for the acquirer in some countries to obtain reliable fair value information. We suggest that IASB should consider how to solve the above problems.

Question 3 – Reverse acquisitions

Under IAS 22 Business Combinations, a business combination is accounted for as a reverse acquisition when an entity (the legal parent) obtains ownership of the equity of another entity (the legal subsidiary) but, as part of the exchange transaction, issues enough voting equity as consideration for control of the combined entity to pass to the owners of the legal subsidiary. In such circumstances, the legal subsidiary is deemed

to be the acquirer. The Exposure Draft:

(a) proposes to modify the circumstances in which a business combination could be regarded as a reverse acquisition by clarifying that for all business combinations effected through an exchange of equity interests, the acquirer is the combining entity that has the power to govern the financial and operating policies of the other entity (or entities) so as to obtain benefits from its (or their) activities. As a result, a reverse acquisition occurs when the legal subsidiary has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities (see proposed paragraph 21 and paragraphs BC37-BC41 of the Basis for Conclusions).

Is this an appropriate description of the circumstances in which a business combination should be accounted for as a reverse acquisition? If not, under what circumstances, if any, should a business combination be accounted for as a reverse acquisition?

(b) proposes additional guidance on the accounting for reverse acquisitions (see proposed paragraphs B1-B14 of Appendix B).

Is this additional guidance appropriate? If not, why not? Should any additional guidance be included? If so, what specific guidance should be added?

We believe that the description of the circumstances in which a business combination should be accounted for as a reverse acquisition is appropriate. The additional guidance is appropriate to identify the reverse acquisition.

Question 4 – Identifying the acquirer when a new entity is formed to effect a business combination

The Exposure Draft proposes that when a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination should be adjudged the acquirer on the evidence available (see proposed paragraph 22 and paragraphs BC42-BC46 of the Basis for Conclusions).

Is this appropriate? If not, why not?

With respect to a new entity being formed to effect a business combination, we suggest two alternative methods: one method is to consolidate all balance sheet items of combining entities at their book value. Another method is to treat as a new-formed entity and account all items at fair value. We also suggest that additional guidance regarding available evidences similar to paragraph 20 is necessary and should be given a certain order to maintain consistency in practice.

Question 5 – Provisions for terminating or reducing the activities of the acquiree

Under IAS 22, an acquirer must recognise as part of allocating the cost of a business combination a provision for terminating or reducing the activities of the acquiree (a ‘restructuring provision’) that was not a liability of the acquiree at the acquisition date, provided the acquirer has satisfied specified criteria. The Exposure Draft proposes that an acquirer should recognise a restructuring provision as part of allocating the

cost of a business combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets (see proposed paragraph 40 and paragraphs BC55-BC66 of the Basis for Conclusions).

Is this appropriate? If not, what criteria should an acquirer be required to satisfy to recognise a restructuring provision that was not a liability of the acquiree as part of allocating the cost of a combination, and why?

We agree with IASB on the recognition criteria for restructuring provisions in business combination.

Question 6 – Contingent liabilities

The Exposure Draft proposes that an acquirer should recognise separately the acquiree's contingent liabilities at the acquisition date as part of allocating the cost of a business combination, provided their fair values can be measured reliably (see proposed paragraphs 36 and 45 and paragraphs BC80-BC85 of the Basis for Conclusions).

Is this appropriate? If not, why not?

We support the requirement in ED with regard to contingent liability.

Question 7 – Measuring the identifiable assets acquired and liabilities and contingent liabilities assumed

IAS 22 includes a benchmark and an allowed alternative treatment for the initial measurement of the identifiable net assets acquired in a business combination, and therefore for the initial measurement of any minority interests. The Exposure Draft proposes requiring the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree will be stated at the minority's proportion of the net fair values of those items. This proposal is consistent with the allowed alternative treatment in IAS 22 (see proposed paragraphs 35 and 39 and paragraphs BC88-BC95 of the Basis for Conclusions).

Is this appropriate? If not, how should the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of a business combination be measured when there is a minority interest in the acquiree, and why?

We believe that the treatment of identifiable assets acquired, liabilities and contingent liabilities assumed in ED is appropriate, and minority interests as well.

Question 8 – Goodwill

The Exposure Draft proposes that goodwill acquired in a business combination should be recognised as an asset and should not be amortised. Instead, it should be accounted for after initial recognition at cost less any accumulated impairment losses (see

proposed paragraphs 50-54 and paragraphs BC96-BC108 of the Basis for Conclusions).

Do you agree that goodwill acquired in a business combination should be recognized as an asset? If not, how should it be accounted for initially, and why? Should goodwill be accounted for after initial recognition at cost less any accumulated impairment losses? If not, how should it be accounted for after initial recognition, and why?

We agree that goodwill acquired in a business combination should be initially recognized as an asset. After initial recognition, we don't believe it is always appropriate that goodwill should be accounted for at cost less any accumulated impairment losses, because in many cases impairment test result is not very reliable. We suggest that goodwill should be amortized in certain period, for example, 10 years, and subject to impairment test periodically.

Question 9 – Excess over the cost of a business combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities

In some business combinations, the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities recognized as part of allocating the cost of the combination exceeds that cost. The Exposure Draft proposes that when such an excess exists, the acquirer should:

- (a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and*
- (b) recognise immediately in profit or loss any excess remaining after that reassessment.*

(See proposed paragraphs 55 and 56 and paragraphs BC109-BC120 of the Basis for Conclusions.)

Is this treatment appropriate? If not, how should any such excess be accounted for, and why?

We believe that it is appropriate for the acquirer first to reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of combination. However, we don't think it is appropriate to recognize immediately in profit or loss any excess remaining after that reassessment. Regarding the excess, we suggest that first it should deduct the identifiable long-term assets amounts, then deduct the identifiable current assets amounts. After all these deductions if there is still any excess left, it can be recognized as a gain.

Question 10 – Completing the initial accounting for a business combination and subsequent adjustments to that accounting

The Exposure Draft proposes that:

- (a) if the initial accounting for a business combination can be determined only*

provisionally by the end of the reporting period in which the combination occurs because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer should account for the combination using those provisional values. Any adjustment to those values as a result of completing the initial accounting is to be recognised within twelve months of the acquisition date (see proposed paragraphs 60 and 61 and paragraphs BC123-BC126 of the Basis for Conclusions).

Is twelve months from the acquisition date sufficient time for completing the accounting for a business combination? If not, what period would be sufficient, and why?

(b) with some exceptions carried forward as an interim measure from IAS 22, adjustments to the initial accounting for a business combination after that accounting is complete should be recognised only to correct an error (see proposed paragraphs 62 and 63 and paragraphs BC127-BC132 of the Basis for Conclusions).

Is this appropriate? If not, under what other circumstances should the initial accounting be amended after it is complete, and why?

We believe that twelve months from the acquisition date is sufficient for completing the accounting for a business combination and it is better to shorten this period. Also, we believe that adjustments to the initial accounting for a business combination after that accounting is completed should be treated as correction of accounting error as proposed in ED.