International Accounting Standards Board
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Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations, to IAS 27 Consolidated and Separate Financial Statements and to IAS 37 Provisions, Contingent Liabilities and Contingent Assets

The Swedish Enterprise Accounting Group (SEAG) is a forum for Chief Accountants from the largest Swedish listed companies. The Group is administered by the Confederation of Swedish Enterprise, to which most participating companies of SEAG are joined.

Representing preparers´ point of view SEAG welcomes the opportunity to give the following comments to selective issues that have caught our attention in the above-mentioned Exposure Drafts. Our comments do not necessarily map to IASB questionnaire.

In general we do not disagree with Fair Value based accounting. Our support is however clearly based upon that Fair Values are not required for items where Fair Values gives, in our view, wrong results, see as an example our comments regarding provisions under item 7 below

Moreover, every new standard represents, in our view, a substantial effort to large entities to make it effective internally, onwards down to all accounting units at the subsidiaries´ level. Standards being too complicated, that use theoretical concepts or a philosophy that is not evident or self-explanatory from the prepares´ practical experience, therefore run the risk of not being generally understood by all persons involved. This constitutes an often neglected burden to the timing demands and to the quality of the accounting process and has to be countered by even more educational/instructional efforts. We take this opportunity to remind you to take further account of this specific cost/benefit issue.

1. Full goodwill

Although we can understand the approach from a theoretical standpoint, we do not believe that the suggested new rules of IFRS 3 for accounting goodwill should be adopted.

We doubt that users of financial information will gain much benefit from full goodwill. There are practical problems to establish a hypothetical purchase price for 100% of the acquired business. Valuation techniques will of course be developed by consulting firms but will lead to the accounting for hypothetical transactions and extra costs for our companies.

In summary, we believe that the possible benefits to the users are smaller than the costs for the full goodwill accounting.

2. Costs directly attributable to a business combination

We do not agree to the conclusion in the ED IFRS 3 that costs directly attributable to a business combination should be recognized as expenses.

We do not concur with the conclusion in BC 87 that the intention of a buyer, including how acquisition-related costs are expected to be recovered, is distinct from fair value measurement of the acquiree. On the contrary we believe that it is the intention of how the buyer intends to recover the total costs of the investment (consideration and acquisition-related costs) combined with the seller´s analysis of economic benefits from retaining ownership of the acquiree versus receiving a consideration minus divestment costs that forms a fair value of the acquiree.

Furthermore we do not appreciate the inconsistency it will create in regard to the way we treat acquisition of other assets. When purchasing e.g. machinery or raw material direct costs shall be included in the recognized amount. We do not see that expensing these type of costs in the income statement improves the financial information, instead we favour the present method of capitalizing acquisition related costs as part of the investment.

3. Business combinations achieved in stages

We find the suggested rules in the ED IFRS 3 p.56, where remeasurement of non-controlling equity investments leads to recognition of gains and losses in the income statement, strange since the profits and losses will not be based on an external transaction. We have the same view concerning the suggested rules in ED IAS 27 when control is lost.

We would prefer that the rules in the current IFRS 3 are kept.

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4. Deferred tax assets and liabilities

We support the suggested treatment of deferred tax assets and liabilities as described in BC 119 – 129 to ED IFRS 3. We especially appreciate the basic reasoning in BC 119 where the Board chooses to avoid post-combination gains or losses in the period immediately following the acquisition and acknowledges the complexity of tracking deferred tax assets and liabilities assumed in a business combination. We also appreciate the suggested convergence with the FASB.

5. Description of non-financial liabilities in financial statements

In ED IAS37 p.9 it is stated that entities may describe some classes of non-financial liabilities as provisions in the entities financial statements. We think that the wording might be misleadingly interpreted as an option, which allows for two descriptions of the same item. Moreover, it is not obvious to a reader that variations among jurisdictions justifies the use of 'provision' in the consolidated accounts as is stated in p.9, keeping in mind the cancellation of the same term from the standard itself. We suggest that the paragraph is revised and/or that clarifying comments are included in the Basis for Conclusions.

6. Recognition criteria

As stated in IAS 37 p.11 an entity shall recognize a non-financial liability when the definition of a liability has been satisfied and the non-financial liability can be measured reliably. We question the second criteria. A liability that meets the definition of a liability shall be recognized. The criterion ´measured reliably´ is, in our opinion, a measurement issue and should be described in the standard as such.

7. Measurement

ED IAS 37 p.29 states that "an entity shall measure a non-financial liability at the amount that it would rationally pay to settle the present obligation or to transfer it to a third party on the balance sheet date". For some, if not most, obligations no market evidence exists for trading such obligations. The proposed method is therefore purely theoretical. We believe that the value, due to lack of market evidence, must in most cases be measured by using best estimates as described in p.30 and p.31 and as demonstrated in example 17. Therefore, p.29 should describe both methods (" transfer to third party" and "expected cash flow approach"). It should also be stated that in situations where there is a market for a transfer to third party, but the intention of the entity is to internally fulfill the obligations (warranty repairs as an example) and market value is expected to be higher than the internal cost (cash flow approach); in such situations an entity shall apply the "expected cash flow method". Otherwise too high financial liabilities will be recognized that later have to be partly reversed.

8. Changes in carrying amount resulting from the passage of time (Unwinding)

In ED IAS 37 p.45 it is stated "changes in carrying amount of a non-financial liability resulting from the passage of time are recognized as borrowing cost". IFRIC Interpretation 1 p.8 clarifies the treatment by stating "The periodic unwinding of the discount shall be recognized as a finance cost as it occurs". US GAAP, FAS 146 p.6 states that changes due to the passage of time shall be recognized as an increase in the carrying amount of the liability and as an expense (for example, accretion expense). In a footnote to this sentence, Footnote 6, it is stated that "Accretion expense shall not be considered interest cost for the purpose of […] or for purposes of classification in the income statement". The difference in classification in the income statement is not in line with the Convergence project. We suggest that the difference is removed.

9. Reimbursements

In ED IAS 37 p.46 it is stated "The amount recognized for the reimbursement right shall not exceed the amount of the non-financial liability". The wording in IFRIC 5 p.5 implies that there exist situations in which the reimbursement right may exceed the amount of the non-financial liability. E. g. in Sweden payments are made to the Swedish Nuclear Waste Fund for the purpose of covering the future costs for the nuclear power producers' obligation for decommissioning. Nuclear power producers' have the right to any surplus values. We suggest that also these situations are mentioned in the wording in the Reimbursement section of the amended IAS 37 and that reference is made to IAS 39 as being done in IFRIC 5 p.5.

10. Discount rate

There is a difference between IFRS (IAS 37 p.47) and US GAAP (SFAS146 p.6) as regards subsequent changes in discount rates. IFRS requires that the discount rate, when relevant shall be updated subsequent to the initial recognition of a provision while no such update shall be made according to US GAAP. As the present ED IAS 37 is a result of the Short-term Convergence project we have expected that this difference would be eliminated. As stated in BC83 we understand that the Board has evaluated this difference. From a preparers point of view, we ask FASB and IASB to agree on one way of dealing with this matter. We suggest that the approach in SFAS146 is also used in IFRS to avoid unnecessary volatility in the financial statements. The provision at date of payment is the same under both principles (assuming no other changes).

11. Convergence with FASB on revised recognition and measurement rules for liabilities

As far as we have understood, the FASB does not plan to implement the revised recognition and measurement rules for liabilities (i e eliminating contingent liabilities and reconsidering the probability criterion), at least not at present. If so,

companies that are registered on U.S. stock exchanges, or for other reasons have to make reconciliations between IFRS 3 and US GAAP, will incur a lot of extra work. Having to treat all liabilities of a big international group of companies according to two different set of rules will require a lot of resources.

12. Transition rules

The suggested transition rules in ED IFRS 3 and ED IAS 27 with mostly prospective application are very good.

13. Effective date

We understand from the IASB timetable in the July edition of Insight that the final standards might be issued during the third or fourth quarter of 2006. We believe that the time from the publication to implementation will be too short, especially considering the endorsement process of the European Union.

14. Project summaries

As pointed out in an earlier letter from us to the IASB, the project summaries play a vital role in order for us preparers to join the discussion at an early stage. Unfortunately, the project summary for Business Combination II has not been kept updated, where the last version on the home page still is dated November 1, 2004. Moreover we found it difficult to work with and fully understand the positions taken by the Board. The progress can of course be followed in IASB Update, but to have a good and updated summary of decisions and open questions is very helpful.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

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Carl-Gustaf Burén
Secretary of the of the Swedish Enterprise Accounting Group