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Mr. Alan Teixeira
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
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IASB Exposure Draft of Proposed Amendments to IFRS 3, *Business Combinations*

Dear Mr. Teixeira:

Deloitte Touche Tohmatsu is pleased to comment on the IASB's Exposure Draft of Proposed Amendments to IFRS 3, *Business Combinations,* and the FASB's Exposure Draft of the Proposed Statement of Financial Accounting Standards, *Business Combinations* — a replacement of FASB Statement No. 141 (the "Exposure Drafts" or the "proposed Statements").

Please see the attached for an Executive Summary of Deloitte Touche Tohmatsu's Comments on the Exposure Drafts, Appendix I — Responses to Notice for Recipients, and Appendix II — Other Items for Consideration.

Deloitte Touche Tohmatsu appreciates the opportunity to comment on the Exposure Drafts. We would be pleased to discuss any questions concerning our comments.

Yours truly,

Ken Wild
Global IFRS Leader

cc: Ms. Suzanne Bielstein, Director, Financial Accounting Standards Board
Mr. James V. Schnurr, National Managing Partner – AERS Professional Practice, Deloitte & Touche LLP

EXECUTIVE SUMMARY of DELOITTE TOUCHE TOHMATSU COMMENTS

Deloitte Touche Tohmatsu supports the Boards' joint efforts in developing a single high-quality standard on accounting for business combinations that can be used for both cross-border and domestic financial reporting. Additionally, we support the Boards' desire to improve the completeness, relevance, and comparability of financial information about business combinations provided in financial statements.

We agree that recording 100 percent of the fair value of the identifiable assets acquired and liabilities assumed upon a business combination produces more meaningful and relevant financial information. However, we do not believe that the costs and operational difficulties associated with recording the fair value of the acquiree as a whole (including goodwill attributable to the noncontrolling interest) are justified by the benefits of providing the information at this time. For example, without further development of valuation techniques and sufficient application guidance on estimating fair values of businesses, the proposal may be difficult to implement, may not provide the most useful information to users, and may unnecessarily expose preparers and auditors to second-guessing by regulators and litigants. Further, considering that many companies have recently adopted IFRS, we believe that the incremental costs associated with these additional changes clearly outweigh the benefits of changing the current model.

Additionally, significant portions of the Exposure Drafts are predicated on projects that have not yet been completed (e.g., the Conceptual Framework Project, the Financial Performance Reporting Project, the Fair Value Measurements Project, the Liabilities and Equity Project, and new basis issues). We do not believe the Exposure Drafts should be finalized until such time as the projects forming the foundation for this Standard are completed.

As such, we believe that the IASB should retain IFRS 3, *Business Combinations*, with limited modifications, and that the FASB should converge with this model. We believe that this approach accomplishes a number of objectives: (1) it moves the U.S. standards closer to a full fair value model of accounting for business combinations; (2) it does not significantly change the effort required to measure and record the fair value of assets acquired and liabilities assumed, except goodwill; and (3) it converges with current IFRS standards.

Under the IFRS 3 model:

- One hundred percent of the acquisition-date fair values of identifiable assets acquired and liabilities assumed are recognized upon obtaining control. However, the goodwill recognized is measured as the residual of the cost to acquire the controlling interest (which would include transaction costs) less the acquirer's share of the fair values of identifiable assets acquired and liabilities assumed. Under this approach, goodwill is not allocated to the noncontrolling interest.

- When a business combination involves more than one exchange transaction and the multiple transactions are not viewed as a single arrangement (i.e., a step-acquisition), the cost of the combination is the aggregate cost of the individual transactions, with the cost of each individual transaction determined at the date of each exchange transaction. The cost of each exchange transaction and the acquirer's interest in the fair value of the identifiable net assets acquired at each exchange transaction are used to determine the amount of any goodwill. In order to recognize 100% of the net assets acquired at fair

value, the previously held interest in the acquiree is revalued with an offsetting adjustment to a revaluation account in equity (similar to other comprehensive income).

We support the following provisions of the Exposure Drafts because they improve existing International Financial Reporting Standards at little cost:

- The scope of IFRS 3 should be expanded to include acquisitions of control by means other than the purchase of equity interests (e.g., obtaining control by contract).

- Contingent assets acquired and contingent liabilities assumed should be recognized at their fair values as of the acquisition date.

- Subsequent adjustments to contingent assets acquired and contingent liabilities assumed should be reflected in the income statement of the acquirer.

- All identifiable intangible assets (i.e., those that meet the contractual-legal criterion or the separability criterion), except assembled workforces, should be recognized separately from goodwill.

In addition, we encourage the Boards to develop accounting guidance that addresses other areas related to business combinations for which there is either no guidance or the guidance is unclear. For example, the Boards should address fresh-start (new basis) accounting issues as guidance on these issues is lacking in current accounting literature (e.g., identifying situations in which fresh-start recognition and measurement of an entity's assets and liabilities at fair value would be appropriate). The IASB also should consider developing additional convergent accounting guidance on combinations involving entities under common control.

Finally, while we agree with the Boards' proposal to record the fair values of all of an acquiree's contingent assets and liabilities at the acquisition date, we acknowledge the significant challenges this may present. Such estimates of fair value will generally contain a high degree of uncertainty. These estimates may be determined using valuation techniques that, depending on the item being measured, are likely to contain a significant amount of inputs that are not readily obtainable from observable markets. As noted in our responses in Appendix I, to improve the reliability of the financial information produced, we believe that significantly more guidance on estimating fair values should be provided in conjunction with any issuance of a final Standard.

Deloitte Touche Tohmatsu
Appendix I
Responses to Notice for Recipients

Objective, Definition, and Scope

> *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 believe that obtaining control over a business is a significant economic event that warrants the acquirer recognizing the acquiree's assets and liabilities at their fair values as of the acquisition date. However, as discussed in detail in our response to Question 3, we do not believe the objective of recognizing the fair value of the acquiree, as a whole, is appropriate.

Since the acquisition of control by one entity over another may arise from transactions other than purchases of equity interests in a businesses (e.g., obtaining control by contract), we recommend that the Exposure Draft be renamed "Business Acquisitions" or "Initial Consolidations." These titles are more appropriate because they better reflect the broad range of transactions that should be accounted for under the Exposure Drafts.

In the Exposure Drafts, the acquirer "is the entity that obtains control of the acquiree." Literally read, the distinction that currently exists in practice based on paragraph 9, footnote 3, of FASB Statement No. 141, *Business Combinations*, regarding "Newco" and "Oldco" acquirers is lost. Footnote 3 of Statement 141 states, "This Statement applies to a business enterprise, a new entity formed to complete a business combination, or a mutual enterprise, each of which is referred to herein as an *entity*. That term can refer to any of the various forms in which the participants in a business combination may exist. However, a new entity formed to complete a business combination would not necessarily be the acquiring entity (refer to paragraph 19)." Accordingly, when control is obtained by a Newco, Statement 141 currently requires the transaction to be accounted for as a business combination. However, if an existing Oldco that does not meet the definition of a business obtains control, Statement 141 is often not applied in practice. In other words, a new basis of accounting in the subsidiary's financial statements can be achieved or avoided depending on whether and how a Newco is involved in the transaction. The FASB should explicitly address and eliminate this form-driven distinction in this project.

The Boards should also consider addressing push-down accounting in this Statement given that the New Basis Project was taken off the FASB's agenda in January 2004.

Definition of a Business

> *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 additional guidance?*

We generally agree with the Exposure Drafts' expanded definition of a business. However, we believe the clarity of the definition would be improved through the use of examples. We

recommend that the examples provided in EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," be included in the final Standard. In addition, we believe the guidance should include an example of an acquisition of a single-asset operation such as income-producing real estate.

As a result of certain of the proposals contained in the Exposure Drafts, there would be more differences in accounting for business acquisitions and asset acquisitions (e.g., accounting for transaction costs, contingent consideration, and, under U.S. GAAP, in-process research and development) than under current GAAP. This differential accounting will put additional pressure on the determination of whether acquired assets and assumed liabilities constitute a business. The Boards should consider whether there is a conceptual basis for these differences. As discussed in our response to Question 7, we believe that transaction costs should be included in the cost of the business combination, which is consistent with the accounting for transaction costs in an asset acquisition.

Under U.S. GAAP, certain development stage enterprises were specifically scoped into FASB Interpretation No. 46 (revised December 2003), *Consolidated of Variable Interest Entities*, under paragraph 11 of that Interpretation. Because certain development stage enterprises could meet the Exposure Drafts' definition of a business, these entities could now qualify for the business scope exception in paragraph 4(h) of Interpretation 46(R) (assuming they meet the other conditions in paragraph 4(h)). We ask the FASB to consider whether this was an intended consequence of its Exposure Draft.

Measuring the Fair Value of the Acquiree

> *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 recognize 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 noncontrolling interest? If not, what alternative do you propose and why?*

We agree that it is appropriate to recognize 100 percent of the fair value of the identifiable assets acquired and liabilities assumed upon a business combination. However, goodwill should be measured as the residual of the cost to acquire the controlling interest less the acquirer's share of the fair values of the identifiable assets acquired and liabilities assumed. Under this approach, goodwill would not be allocated to the noncontrolling interest. The noncontrolling interest would be recognized at its percentage of the fair value of identifiable net assets.

As such, we believe that the current IFRS 3, *Business Combinations*, model provides sufficiently relevant and reliable information. International Financial Reporting Standards should retain IFRS 3 (with the limited modifications proposed in the responses to the remaining questions) and U.S. GAAP should converge with that model. Paragraph 51 of IFRS 3 computes goodwill as the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities, and contingent liabilities recognized. Paragraphs 25 and 58 of IFRS 3 indicate that when a business combination involves more than one exchange transaction, the cost of the combination is the aggregate cost of the individual transactions, with the cost of each individual transaction determined at the date of each exchange transaction. Unless multiple arrangements are viewed as forming a single arrangement (as addressed in the noncontrolling

interests exposure drafts), each exchange transaction should be treated separately by the acquirer, using the cost of the transaction and the fair value of the net identifiable assets acquired at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. This results in a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the fair values of the acquiree's identifiable assets and liabilities at each step.

Cost would be comprised of (1) the fair values, at the date of each exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree and (2) transaction costs incurred (as discussed in further detail in the response to Question 7).

To recognize 100 percent of the acquiree's identifiable assets and liabilities at fair value, the acquirer should record a revaluation adjustment in equity for the portion of the appreciation in fair value of the acquiree's net assets (from the date the noncontrolling equity investments were made to the date control was obtained) relating to the percentage of the acquiree held prior to acquisition of control. The revaluation account already exists in equity for International Financial Reporting Standards. For U.S. GAAP purposes, this balance could be added as another component of other comprehensive income. If this guidance becomes part of the final Standard, the Boards should also address the accounting for this balance in equity upon a disposition or liquidation of the acquired business (i.e., should the balance in equity be recycled in earnings?). For example, by analogy to paragraph 14 of FASB Statement No. 52, *Foreign Currency Translation*, and paragraph 48 of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, the revaluation adjustment could remain in equity until a disposition or liquidation of the investment occurs. Upon disposition or liquidation, the revaluation adjustment attributable to that investment and accumulated in the revaluation adjustment account would be removed from the separate component of equity and reported as part of the gain or loss on disposition or liquidation in the period during which the disposition or liquidation occurs. However, if the IASB agrees that the revaluation adjustment in equity should be recognized in profit or loss upon the disposition or liquidation of the acquired business, this position should be reconciled with the model in IAS 16, *Property, Plant and Equipment*, and in IAS 38, *Intangible Assets*, in which revaluation adjustments in equity associated with fixed assets and intangible assets are not recognized in profit or loss when the asset is derecognized.

We believe this IFRS 3-based model eliminates the recognition of assets and liabilities at a mixture of current and historical prices, thus improving the relevance and comparability of financial information. Recording the assets and liabilities at current prices provides a better gauge for assessing the results of the acquired operations and the new management's stewardship. At the same time, this approach will eliminate the difficulties associated with estimating the fair value of the acquiree as a whole, when only a portion of the acquiree has been acquired.

In addition, this methodology would not significantly detract from the relevance or usefulness of information in the financial statements because reporting is primarily directed toward the majority interest's shareholders whose interest would be stated at full fair value.

As stated in our comment letters dated October 26, 2005, related to the June 30, 2005, exposure drafts of proposed amendments to IAS 27, "Consolidated and Separate Financial Statements," and proposed Statement on "Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries," the Boards should provide guidance on

the accounting for acquisitions of interests in the subsidiary subsequent to obtaining control as well as dispositions that do not result in a loss of control.

Question 4 — Do paragraphs A8–A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

As outlined in our response to Question 3, we currently advocate a model that does not require measuring the fair value of the acquiree as a whole, in part because we do not believe that there have been sufficient advances made in the areas of reliability of this measure.

However, if the Boards retain the Exposure Drafts' requirement to measure the fair value of the acquiree as a whole, additional guidance will be needed to address the issues raised in the remainder of our response to this question. The Exposure Drafts explain that the acquisition date fair value of consideration transferred in exchange for a partial interest in an acquiree is most likely not representative of the fair value of the acquiree as a whole; the Boards attribute this conclusion at least in part to the existence of control premiums. Additionally, under the Exposure Drafts, when the fair value of the acquiree as a whole is not proportional to the fair value of the consideration paid to acquire the partial interest, the allocation of goodwill between the controlling and noncontrolling interests is not proportional either, putting pressure on the estimate of fair value of the acquiree as a whole. As a result, the Boards should provide additional guidance on the measurement and accounting for control premiums, including indicators for when they do or do not exist. We believe such guidance is necessary to improve the comparability of the financial information produced and the operationality of the guidance contained in the Exposure Drafts.

Additionally, we note that there are inconsistencies (both within the Exposure Drafts and relative to the FASB's proposed Statement on Fair Value Measurements) as to whether fair value reflects buyer-specific synergies (i.e., those synergies, over and above those that could be realized by a marketplace participant, that could be realized by a specific buyer, or, put another way, the component of value that represents the difference between fair value and investment value). This issue arises because of the Exposure Drafts' premise that the best evidence of the fair value of the interest acquired is the fair value of the acquirer's consideration. However, as the consideration is that of a particular buyer, it may necessarily reflect buyer-specific synergies, and thus may be more indicative of investment value than fair value.

The notions described in paragraphs B61 and B62 of the FASB's Exposure Draft and BC58 of the IASB's Exposure Draft provide a practical way to address the difficulties in estimating the fair value of an acquiree when less than 100 percent of its equity interests are acquired. Under these paragraphs, in the absence of evidence to the contrary, extrapolation of the consideration transferred to determine the fair value of the acquiree as a whole is more likely to be appropriate as the proportion of the interest being acquired increases. Additionally, in circumstances where an acquirer may obtain control of an acquiree through transactions involving considerably smaller percentages of the acquiree's equity interests or through transactions without acquisition of equity interests, the fair value of the acquiree will likely require the use of other valuation techniques. We recommend that the concepts in these paragraphs be repeated in the final Statements' implementation guidance.

However, when describing this approach in the final Statements, the Boards should reconcile paragraph A11 with paragraphs B61, B62, and BC58. Paragraph A11 indicates that, in an

acquisition of less than 100 percent of the equity interests of an acquiree, the consideration transferred by itself most likely is *not* representative of the fair value of the acquiree as a whole. This statement appears to contradict the discussion in the aforementioned paragraphs, which indicate that as the percentage acquired increases, it *is* appropriate to use the fair value of the consideration transferred to estimate the fair value of the acquiree as a whole.

The Boards should clarify whether estimates of fair value using other valuation techniques (i.e., where the fair value of the consideration transferred is not used) will always be required to prove that "evidence to the contrary" does not exist. If so, estimates using other valuation techniques would generally be required even if a relatively high percentage of the equity interests of a business was acquired. This result appears to conflict with the Boards' intent to mitigate incremental costs of implementation.

Additionally, the Boards should provide guidance or examples on measuring the fair value of a previously held noncontrolling equity interest in an acquiree when business combinations are achieved in stages. It may be difficult to determine whether a portion of the control premium should be attributed to the previously held noncontrolling equity interests of an acquiree before control is obtained or attributed entirely to the acquired portion that gives the acquirer control. For example, assume an acquirer owns a 49 percent equity interest in an acquiree immediately prior to acquiring an additional 2 percent of the acquiree, giving the acquirer control of the acquiree. On the acquisition date, should the fair value of the previously held 49 percent interest in the acquiree include any allocation of the control premium or does it lie solely in the additional 2 percent that is subsequently acquired?

Accordingly, if the Boards were to proceed with the requirement to measure the fair value of the acquiree as a whole, additional measurement guidance needs to be provided by the Boards to ensure the final Statements are operational and can be applied consistently.

> *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?*

In response to Question 3 we have advocated a cost approach, and in measuring cost it is necessary to determine a measurement date. Generally, we believe that the acquisition date fair value of the consideration transferred is the best measure of the cost of the acquired interest.

With respect to contingent consideration, we believe that the Boards should retain the accounting for contingent consideration that is currently provided in IFRS 3. As such, contingent consideration should be recognized as of the acquisition date if the adjustment to the purchase price is both probable and reliably measurable. If the adjustment is not recorded as of the acquisition date, but it subsequently becomes probable and can be measured reliably, the additional consideration should be treated as an adjustment to the cost of the combination, except for those adjustments mentioned in paragraph 35 of IFRS 3 (e.g., additional equity or debt instruments issued in a guarantee of the market price of equity or debt instruments issued). Contingent consideration frequently occurs because the buyer and seller are not able to agree upon the fair value of the acquiree; therefore, estimating the fair value of the contingent consideration is by definition difficult. If such amounts are not reliably measurable, we do not believe that including such amounts in the acquisition-date fair value of consideration transferred

provides more meaningful and relevant information about what was transferred between the buyer and seller.

Additionally, the Boards should provide guidance on whether the consideration transferred includes the fair value of any forward contract or option contract that is created when the terms of the business combination are agreed to and that, when exercised at the acquisition date, provides the acquirer shares of the acquiree.

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

We disagree with the Exposure Drafts' proposed accounting for contingent consideration after the acquisition date and believe that the current guidance in IFRS 3 should be maintained. We believe that all amounts paid to the seller of the acquired business in connection with the business combination should be included in the cost of the acquired business, except for those adjustments mentioned in paragraph 35 of IFRS 3 (e.g., additional equity or debt instruments issued in a guarantee of the market price of equity or debt instruments issued). Accordingly, the difference between the settlement amount of the contingent consideration and the amount recorded as of the acquisition date should adjust the cost of the business combination, which would impact the amount of goodwill recorded as of the acquisition date.

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

We disagree; transaction costs should be included in the measurement of the consideration transferred for the acquiree. The method we advocate, outlined in our response to Question 3, represents a cost approach, not a fair value approach. As such it is appropriate to include transaction costs in the cost of obtaining control of the acquiree. The transaction costs would not have been incurred absent the acquisition. Additionally, the model proposed in our response to Question 3 is the IFRS 3 model — paragraph 24 of IFRS 3 indicates that the cost of a business combination should include costs directly attributable to the acquisition.

Including the transaction costs as part of the business combination is consistent with capitalizing transaction costs in an asset acquisition. Similarly, paragraph 43 of IAS 39, *Financial Instruments: Recognition and Measurement*, includes transaction costs in the initial measurement of financial assets and liabilities.

Measuring and Recognizing the Assets Acquired and the Liabilities Assumed

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

We agree with the proposed changes to the accounting for receivables (including loans), research and development assets, and costs associated with restructuring or exit activities that do not meet the recognition criteria of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, or FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

We also agree that contingent assets acquired and contingent liabilities assumed should be recognized at their fair values as of the acquisition date. However, we have concerns, similar to those expressed in the response to Question 5, about the ability to reliably measure contingent assets acquired and liabilities assumed at the acquisition date. Paragraph 37 of IFRS 3 states that assets and contingent liabilities should not be recognized if they are not reliably measurable. Similarly, paragraph 40 of Statement 141 indicates that preacquistion contingencies should not be recorded if they are not reasonably estimable. The Exposure Drafts require contingencies to be recorded regardless of the ability to reliably measure them. However, the Exposure Drafts do not provide sufficient guidance to advance the reliability or consistency of such measures. Conceptually, we agree with this provision as a change to the existing IFRS 3 model as proposed in Question 3. However, before this provision can be successfully implemented, the Boards need to provide additional guidance on determining the fair values of these items.

In addition, we have the following concerns regarding the Exposure Drafts' accounting for contingent assets and contingent liabilities subsequent to the acquisition date:

- The accounting method outlined in the Exposure Drafts for contingent assets acquired and contingent liabilities assumed in a business combination is inconsistent with subsequent accounting for contingencies absent a business combination. Under the Exposure Drafts, there would be two different models for accounting for contingencies subsequent to initial recognition: one model for an acquirer's contingencies and those of the acquiree that arise subsequent to an acquisition, and a second for an acquiree's contingencies that existed as of the acquisition date.

- There are complexities involved with measuring such contingencies at fair value at each reporting period. For example, difficulties will arise when contingencies of an acquirer and acquiree become commingled (e.g., if an acquirer and acquiree are defendants in the same lawsuit).

Therefore, we propose the following alternative approach. Contingent assets should be carried at their acquisition-date fair values and, based on the nature of the asset, adjusted when the asset is impaired or contingency resolved, or amortized using a systematic and rational method. Subsequent to the acquisition date, contingent liabilities should be measured in accordance with paragraph 48 of IFRS 3 at the greater of (1) the fair value at the acquisition date (less cumulative amortization where appropriate) or (2) the contingent liability amount required to be recognized by FASB Statement No. 5, *Accounting for Contingencies*, or IAS 37, until extinguished. Contingent assets and contingent liabilities that were determined provisionally also should be adjusted during the measurement period to reflect facts and circumstances that existed at the acquisition date.

> *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?*

We agree with the exceptions to fair value for assets held for sale, deferred taxes, operating leases, and employee benefit plans from a cost-benefit and practicability standpoint. However, the final Statements should clarify the guidance relating to operating leases and income taxes.

Paragraph 39 of the Exposure Drafts should be clarified to explain the exception to the fair value measurement requirements under the acquisition method as it relates to operating leases. We

assume this paragraph refers to the fact that the leased asset and the lease obligation are not recognized in the fair value allocation but that only the intangible asset relating to favorable terms relative to market or liability relating to unfavorable terms are recognized. If so, we ask the Boards to clarify this point in the final Statements.

Paragraph 44 of the Exposure Drafts explains that deferred tax assets and liabilities accounted for under FASB Statement No. 109, *Accounting for Income Taxes*, and IAS 12, *Income Taxes*, are not recorded at fair value as of the acquisition date. However, the Exposure Drafts do not provide guidance on how to measure (1) other income tax assets or liabilities, which are accounted for under Statement 109 or IAS 12, or (2) the effects of uncertain tax positions, at the acquisition date. We believe that all other income tax assets or liabilities accounted for in accordance with Statement 109 and IAS 12 should also be given the exception from measurement at fair value as of the acquisition date, since these Statements do not permit measuring income taxes at fair value. Additionally, the final Statements should clarify whether the effects of uncertain tax positions should be accounted for (1) as acquired or assumed contingencies or (2) under other applicable accounting literature (e.g., proposed FASB Interpretation, *Accounting for Uncertain Tax Positions*).

Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations

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

We believe it is not appropriate. Although obtaining control of a subsidiary is a significant economic event requiring revaluation of the acquiree's net assets, the revaluation gain or loss attributable to the net assets of the previously held noncontrolling interest should be recorded in equity as described in our response to Question 3. In order to record 100 percent of the assets acquired and liabilities assumed at fair value, the acquirer must record a revaluation adjustment for the appreciation in fair value of the acquiree's net assets (from the date the noncontrolling equity investments were made to the date control was obtained) relating to the percentage of the acquiree held prior to acquisition of control. After revaluation, the previously held investment is equal to the fair value of the previous ownership interest's percentage of the acquiree's net assets plus the goodwill associated with the previous noncontrolling interest.

Simply acquiring additional interests in the acquiree does not warrant recognizing the revaluation gain or loss in income. There has been no change in the retained investment, nor has there been realization or a culmination of an earnings process.

> *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 do you propose and why?*

We agree.

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

We agree with the Exposure Draft's proposed accounting in which overpayments are subsumed into goodwill.

Measurement Period

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

We agree conceptually with the Exposure Drafts' requirement that comparative information for prior periods presented should be adjusted for the effects of measurement period adjustments. However, similar to the practical concerns expressed in Deloitte & Touche LLP's comment letter on FASB's Proposed Statement of Financial Accounting Standards, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3*, we ask the Boards to consider the practical implications of requiring comparative information for prior periods to be adjusted for measurement period adjustments when predecessor auditors are unable to reissue an audit opinion on statements changed as a result of retrospective application due to independence matters or other predecessor auditor issues.

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

Yes. However, the term "arranged primarily for the economic benefit of the acquirer or the combined entity" in paragraph A88 may not be readily understood.

Disclosures

> *Question 15 — Do you agree with the disclosure objectives and the 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 generally agree with the disclosure objectives and the minimum disclosure requirements. However, certain disclosures should be modified to conform to the IFRS 3-based model outlined in Question 3. Specifically:

- Paragraph 72(e) should be removed as the fair value of the acquiree is not determined in our cost-based model.
- Paragraph 72(f)(6) should be removed as the previously acquired noncontrolling investment would not be included in the consideration transferred because the cost of the business combination is the aggregate of each exchange transaction.
- Paragraph 72(j) should be modified to require disclosure of the amount of any revaluation gain or loss recorded in other comprehensive income.
- Paragraph 72(l) should be modified to require disclosure of the amount of transaction costs included in the cost of the business combination.

Paragraph 72(d) requires disclosure of a description of the factors that contributed to goodwill. It is unclear what such factors might be other than the cost of the business combination exceeded the fair value of the identifiable net assets acquired.

Paragraph 72(f)(5) requires disclosure of the method of determining the fair value of equity instruments included in consideration transferred. The Boards should consider requiring disclosure of the methods of determining the fair value of other items or components of consideration (e.g., contingent consideration, debt instruments, etc.).

The Boards should also provide guidance on how to prepare the pro forma information required by paragraph 74. For example, guidance similar to SEC Regulation S-X, Article 11, "Pro forma Financial Information," should be provided since, in some cases, pro forma information provided in footnote disclosures is different from that prepared under Article 11. For example, additional clarity could be provided on whether items such as transaction costs or obligations incurred to exit an activity should be excluded from the pro forma information.

Additionally, as described in our response to Question 18, disclosure requirements in the FASB's and the IASB's Statements should not differ if the accounting treatment of the items being disclosed is the same in each Standard.

The IASB's and the FASB's Convergence Decisions

Question 16 — Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognized 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 characteristics:

a. The intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability

b. Cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?

We believe that intangible assets that are identifiable should be recognized separately from goodwill. However, to improve the relevance and reliability of the financial information produced, the Boards should provide additional guidance on how to measure the fair value of identifiable intangible assets acquired in a business combination.

Question 17 — Do you agree that any changes in acquirer's deferred tax benefits that become recognizable because of 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?

Yes, we agree.

Question 18 — Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

In light of the Boards' desire to eliminate differences between U.S. GAAP and International Financial Reporting Standards, we recommend that the disclosures required by the FASB and the IASB be the same in all instances, unless the differences stem from differences in accounting. Based on our proposal to converge Statement 141 with IFRS 3, there should be no differences in accounting. The disclosures in paragraphs 74 and 78(b) of the Exposure Drafts should be the same in both the FASB and IASB Statements. The FASB's final Statement should include a requirement consistent with the requirement in paragraph 76(d) of the IASB's Statement to disclose the amount and an explanation of any gain or loss recognized in the current period that (1) relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or the previous annual period and (2) is of such a size, nature, or incidence that disclosure is relevant to understanding the combined entity's financial statements.

Appendix F, which describes all the differences between the two Exposure Drafts, is also helpful. The Boards should include a similar summary in the final Statements.

> *Question 19 — Do you find stating the principles in bold type helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?*

Yes, we find stating the principles in bold type helpful.

Deloitte Touche Tohmatsu
Appendix II
Other Items for Consideration

The Boards should consider the following comments regardless of whether the business combinations model outlined in the Exposure Drafts or the model outlined in our letter is adopted:

- The Exposure Drafts indicate that an intangible asset or liability should be recorded for operating leases at off-market terms. The Boards should also provide similar guidance for other off-market executory contracts.
- The final Statement should provide more detailed guidance on how to measure the fair value of inventory (finished goods, work-in-process, raw materials). The guidance in paragraphs B16(d) of IFRS 3 and 37(c) of Statement 141 is helpful, but does not appear to have been retained in the Exposure Drafts.
- The IASB's final Statement should provide clarifying guidance that upon the acquisition date, derivatives acquired need to be designated anew in order to achieve hedge accounting (i.e., the acquiree's hedge designation does not carry over).
- Paragraphs C3–C5 of the IASB's Exposure Draft should address accounting for contingent consideration in an asset acquisition similar to the guidance provided in paragraph C7(c) of the FASB's Exposure Draft.

The Boards should consider the following comments to the extent the model currently outlined in the Exposure Drafts is adopted:

- Consideration transferred reflecting buyer-specific synergies should be added to the paragraph A18 list of circumstances in which the measurement of fair value should not be based on the consideration transferred.
- The final Standard should include an example similar to that in paragraph A63, except that the consideration transferred is CU 170. This results in an initial calculation indicating that the goodwill attributable to the controlling interest is greater than the total goodwill. The example should show that the maximum goodwill that can be assigned to the controlling interest is the total goodwill, and that the noncontrolling interest is not allocated any goodwill.

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