October 2005

Mr Teixeira
International Accounting Standards Board
30 Cannon Street
LONDON
EC4M 6XH

Dear Mr Teixeira

IFRS 3, IAS 27 and IAS 37

The UK Society of Investment Professionals ("UKSIP") is a professional organisation whose main aim is to foster and maintain high standards of professional ability and practice in investment analysis, portfolio management and related disciplines. UKSIP currently has some 5,500 members who work or have an interest in the UK financial services industry. Most members hold the ASIP, CFA or IMC designation. The ASIP designation is held primarily by those who successfully completed UKSIP's former Associate examination, which was similar to the CFA. UKSIP is the UK-based member society of the CFA Institute, the organisation that develops and administers the Chartered Financial Analyst (CFA©) Program.

UKSIP also develops and administers the Investment Management Certificate (IMC), the benchmark qualification for those working in investment management in the UK. Over 15,000 investment professionals have passed the IMC.

As you are aware the UKSIP has long been an enthusiastic supporter of the project to develop a set of high quality financial reporting standards that can be applied globally. The Society is therefore grateful for the opportunity to comment on the Board's latest proposals contained in the Exposure Drafts relating to IFRS3 Business Combinations, IAS27 Consolidated and Separate Financial Statements and IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

UKSIP would like to make two initial remarks about the process you have undertaken before commenting broadly on a number of aspects of the proposals.

First, the proposed amendments to IAS27 and IAS37 contain what the Society believes are quite profound changes to the current basis of financial reporting. UKSIP believes it would have been more appropriate for the issues surrounding the introduction of the economic entity as a basis for reporting and the removal of the probability assessment in establishing the existence of liabilities to have been aired initially in Discussion Papers rather than Exposure Drafts. Moreover, introducing these new concepts at this stage - and ahead of the formal conclusion to the discussions about the changes to the conceptual framework - could be seen as pre-determining the outcome of those discussions.

This issue is made all the more relevant by the Society's second general concern. These Exposure Drafts all form part of the second phase of your Business Combinations project. The three Exposure Drafts comprise a total of 393 pages. This represents a formidable, and arguably almost incomprehensible, set of documents for many intelligent committed but essentially lay users of accounts. Such an approach, therefore, runs the risk of discouraging discussion of these highly important issues by the very people for whom these statements are drawn up - the users of financial reports. A shorter, more succinct paper would have facilitated and encouraged a much wider debate amongst the user community.

As regards the detail of the proposed amendments themselves UKSIP will only comment on those issues upon which it has particularly strongly held views.

1 The proposed revision of IAS27 adopts the economic entity view of the consolidated accounts.

At present consolidated accounts are prepared from the perspective of the parent company. Thus minority (non-controlling) interests in subsidiaries are not regarded as equity of the consolidated parent entity. The claims over equity that these minorities have are restricted only to particular subsidiaries of the group. They are another source of capital for the entity albeit with both equity and liability characteristics (hence your difficulty assessing it within the context of the existing Framework). Minority capital does not, however, form part of the consolidated equity capital of the parent company itself. This is an important distinction retained for the purpose of general financial reporting.

Whilst there is a hierarchy of users of financial reports, the focus of financial reporting has to be the owners of the parent company. This is because the equity shareholders in the parent company are the ultimate providers of equity risk capital. Hence, if their financial reporting needs are met all those who rank ahead of them will also be satisfied in the event of default. Equally, if information provided does not meet creditors' needs, then shareholders, by definition, will find the reporting inadequate for themselves. Consequently, if the focus for financial reporting is turned away from equity shareholder its value would be undermined.

A number of consequences flow from the economic entity view. Transactions with minorities will no longer generate profits or losses in the income statement as they will be deemed to be transactions with owners and gains and losses will go direct to equity. This may encourage gaming of the standards as you already partly recognise. Moreover, it seems difficult to see how any meaningful concept of earnings attributable to the shareholders of the parent company will be able to drop out of the income statement.

The income statement will presumably now look at net income in terms of the entity's income rather than the income attributable to the actual owners of the parent company in which are invested. So no meaningful concept of earnings attributable to the parent equity holders can drop out of the income statement at all. The income statement forms a basis for reporting some sense of financial performance. You cannot report performance meaningfully to the entity. You report performance to the ultimate providers of risk capital, the shareholders of the parent company.

The economic entity approach will therefore require further, as yet unconsidered, changes to the shape of the general financial statements themselves. Perhaps a whole new statement of transactions with owners could be engineered to address these issues but it would be simpler and more logical to retain the parent entity concept.

Establishing the current equity investor at the pinnacle of the hierarchy of users will also influence the debate on the role of stewardship. Many regard one of the central purposes of financial reporting as helping to address the agency problem, providing part of the information shareholders require as the owners of the business. In part it enables owners to form their own assessment of management and the strategies being adopted for the business. That process is not simply about valuing the company and whether to buy or sell shares.

UKSIP is of the view that widening the focus of financial reporting to an entity's perspective with the intention to provide information to a wide range of users will result in a loss of focus for financial reporting and may undermine the very purpose of the financial statements themselves. As stated above, the essential focus of reporting financial performance to the parent company shareholders must not be lost. Accordingly UKSIP is not persuaded that the economic entity approach forms an acceptable basis for financial reporting.

The Society would especially endorse the comments made to you by the CFA Institute in its letter to the Chairman of both the FASB and IASB (copy attached) of (6 September 2005?). UKSIP participated in the preparation of this letter which also encourages the retention of the current focus of financial reporting.

2 The Exposure Drafts propose that in a business combination in which the acquirer gains control but with less than 100% then the non-controlling interests would represent the sum of their proportional interest in the net identifiable assets and the goodwill attributable to the non-controlling interest.

Essentially UKSIP regards this approach as fair valuing the non-controlling interest on the basis of the fair value established by the transaction. Conceptually the Society agrees that this is the most appropriate basis to adopt but remains uneasy that no transaction has occurred involving the non-controlling interests themselves. Nevertheless if this approach were to be adopted it is crucial that the accounts clearly disclose the goodwill attributable to the non-controlling interests separate from their attributable share of identifiable net assets.

3 The Exposure Drafts propose that the costs incurred by the acquirer in connection with a business combination should be excluded from the measurement of the consideration transferred for the acquiree.

The heart of this question seems to lie with whether value is better measured by considering either the buyer's or the seller's perspective. Yet in many transactions both buyers and sellers have costs. UKSIP's primary concern here, however, is that corporate management should be held accountable for the full cost of the transaction. They will be considering the total amount they pay for the acquiree and will presumably be able to justify the total price paid including costs on the basis of the cash flows they expect to generate from the acquisition. UKSIP is, therefore, very uneasy about the proposed approach and will expect sufficient disclosures to be maintained so that any transaction costs that are expensed will be separately and severally identifiable.

4 In UKSIP's view contingent consideration arises because effectively fair value cannot be established at the acquisition date. Therefore, any subsequent changes to the contingent consideration should be reflected as an adjustment to the value of goodwill which should be clearly disclosed and not be recognised as a gain or loss in the income statement as is proposed.

5 The Exposure Draft proposes omitting the probability recognition criterion in the recognition of liabilities. Whilst the underlying logic for the approach adopted is clear UKSIP remains concerned that this may have profound practical implications which are not yet apparent. In particular, it seems likely that a large number of small liabilities may now be recognised. It is however unlikely that those large liabilities with low probabilities will be caught as managements will prefer to decide that they are in effect un-measurable. Moreover, UKSIP would cite Merck's position on Vioxx as another case in point. Clearly there is a liability. Equally Merck would for sound commercial reasons be most unlikely to state what they actually thought the liability would be.

The Society, therefore, remains to be persuaded as to whether these proposals actually represent an effective advance in financial reporting.

6 Amendments to IFRS3 Para A110 – disclosures

UKSIP considers these disclosure requirements to be inadequate and would expect to see, in summary form, the acquired assets and liabilities under the same sub headings as used in the balance sheet itself. In particular, total net debt and its components must be clearly identifiable and the principal individual elements of both fixed and working capital.

7 Bargain transactions.

The proposals maintain the fiction that bargain transactions are so commonplace that a separate set of accounting principles can exist for them. However, UKSIP believes that in most cases an apparent bargain transaction simply represents a failure to measure either the assets or liabilities properly. Moreover, conceptually if consideration that exceed identifiable net assets and creates something called goodwill which is an asset then when the obverse occurs should this not create negative goodwill which should be recorded as a liability? There would seem to be little justification for taking the supposed credit to income.

8 Fresh start

With the abolition of merger accounting, the assumption is that an acquirer can always be identified in a business combination. However, there are some complex combinations (either practically or legally) where this is not the case. UKSIP had understood that the IASB would be taking an urgent look at fresh start accounting whereby such combinations would be based on fair valuing all the parties to the combination rather than just the company being acquired. The Society would encourage the IASB to complete its business combinations project by moving to consideration of fresh start accounting as soon as possible.

If UKSIP can be of any further help or you wish to seek further clarification of its views please do not hesitate to make contact. I look forward to participating in the London round-table meeting in November.

Yours sincerely

A R Good ASIP

Chairman UKSIP Accounting Advocacy Committee