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Ms Sue Lloyd
International Accounting Standards Board
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30 Cannon Street
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Our ref MV/288

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Dear Ms Lloyd

Comments on Committee's tentative agenda decision on IAS 28 *Investments in Associates and Joint Ventures*—Acquisition of an associate or joint venture from an entity under common control

We appreciate the opportunity to comment on the International Financial Reporting Interpretations Committee's (IFRIC) tentative agenda decision on IAS 28 *Investments in Associates and Joint Ventures*—Acquisition of an associate or joint venture from an entity under common control. We have consulted within the KPMG network in respect of this letter, which represents the views of the KPMG network

Re-pricing intra-group transactions

Regarding the acquisition price, the tentative agenda decision requires an entity to consider whether the transaction includes a *transaction with owners* in their capacity as owners. This implies a point of principle that we do not believe is inherent in the concept of cost and that, if it were, would apply to many other transactions with far-reaching effects.

What it implies is that the purchase price of the associate (in this case) is always restated to fair value to separate out that part that represents a transaction with owners, with the consequent difference from the actual price being dealt with as a distribution/ contribution received/ paid as the case may be. Whilst we agree that there are some cases where a *transaction* is properly *characterised* as a partial owner's transaction, this applies only to a small sub-set of non-arms-length pricing. For example, it applies to a purchase at overvalue, as the over-value will be accounted for other than as the carrying value of the purchased asset: We agree, the difference is not characterised as a loss (instead a distribution to parent or investment in subsidiary). However, the agenda decision implies notional re-setting of all non-arms-length pricing, for example, even if the purchase price is an undervalue that reduces but does not eliminate the IAS 28.32(a) goodwill, the pricing is grossed-up to fair value and the undervalue is

accounted for as an owner's transaction (distribution or contribution received). It is that every-time, notional re-pricing principle that we do not agree with.

We are not aware of any grounds in current IFRS standards for such a principle. Further, we note that neither IAS 28 nor IAS 24 have any requirements in such respects – in fact IAS 24 is based on the premise of disclosing transactions, not re-measuring them, because they might not be at arms-length. Yet paragraphs 23 and 24 of the related Agenda Paper (Agenda Paper 8) consider that such a principle can be read into the concept of cost. We do not agree. Cost is not defined by IFRS as the price that would have been paid at arms-length.

The suggested treatment would have further, far-reaching consequences. If this were a principle inherent in IFRS and in cost, then any transaction between related parties would require its cost to be so remeasured if it was not exchanged at fair value – e.g. transfers of PPE or inventory or the provision of services. That would, at a stroke, mandate pervasive re-measurement of intra-group transactions in the financial statements of many group entities. It would also strongly suggest that, as there must be two parties to an owners' transaction, the same re-pricing applies in the seller's financial statements.

Concepts underlying procedures – a fundamental problem with IAS 28

The tentative agenda decision indicates that the requirements in IAS 28.26[1] should not be used as a basis to apply the common control exemption of IFRS 3.2(c). However, we have concerns, because the notions of concepts and procedures referred to in IAS 28.26 are significantly unclear and subject to different interpretations. One of the different interpretations is over the applicability of the exemption in IFRS 3.2(c), for the transfer of a subsidiary between entities under common control and hence a "concept used in accounting for the acquisition of a subsidiary", to a transfer of an associate between entities under common control. Further analysis is needed to determine principles for precisely what is and is not covered by IAS 28.26.

Anomalous outcomes will occur

Although the IFRIC Paper provides some analysis and concludes that there would be no anomalous outcomes, we are concerned that this is not the case. For example, a parent company M controls two entities S1 and S2, S1 is the parent company of a subgroup which comprises two controlled trading entities X and Y as well as an associate Z. In this situation, if the entire subgroup S1 is transferred to S2, the transferee S2 would have to apply a different accounting treatment in its consolidated financial statements for the recognition of the associate Z from that for the recognition

[1] IAS 28.26 states that an entity adopts the concepts underlying the procedures used in accounting for the acquisition of a subsidiary in accounting for the acquisition of an investment in an associate or joint venture.

of the rest of the sub group. The business-combination accounting with fair values would have to be applied to the associate Z but not to the assets and liabilities of the other entities S1, X and Y.

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We therefore consider that the need for further analysis, in respect of the above mentioned concerns, requires these issues to be addressed as part of the International Accounting Standards Board's (IASB's) ongoing projects on business combinations under common control and equity accounting. The agenda decision on its own appears to pre-empt the discussions that the Board should be having while conducting those two projects.

Please contact Mark Vaessen +44 (0)20 7694 8871 or Mike Metcalf +44 (0)20 7694 8081 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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