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Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Re Exposure Draft of proposed amendments to IFRS 3 Business Combinations (ED)

Dear Sir, I have the following comments on the ED in response to the questions you have raised. Please refer to my general comments on my submission to the exposure draft on IAS 27 concerning my preference for parent entity reporting and my concern that no justification has been made for the review of the standards. I do not believe the current time is appropriate for these standards to be reviewed with such fundamental changes in their approach, without clear evidence of a problem existing and without clear support from the business community for the new approaches.

Question 3

I do not agree with the proposal that an acquirer should recognised 100% of the goodwill, including goodwill attributable to minority shareholders. I do not believe that this can ever be determined and it should not be calculated by reference to the purchase price paid by the majority shareholder.

I believe that the value of the business to the minority shareholder, including their share of the goodwill, can ever only be known by that minority shareholder. We are not doing the accounting for the minority shareholders and we should not pretend that the values we have recognised for the acquisition are the only correct numbers and that the minority shareholders would agree with them.

I consider this to be an attempt to make accountancy more of a science than an art and I have concerns that it is giving it more creditability than it deserves.

I agree that we should prepare group accounts but these must surely be from the viewpoint of the parent company's shareholders and should not pretend to represent the view of all shareholders in the group.

A group does not normally have legal form. Entities within the group are registered companies. A group of companies, associates, joint ventures and partnerships is only an accounting convention. Sometimes a group of companies will form a guaranteeing group for debt purposes. Australia has a class order regime where by companies that enter into a deed of cross guarantee are exempt from preparing individual statutory accounts and only the statutory accounts of that group are required to be filed. In both cases the companies involved would normally be wholly owned subsidiaries.

I also have concerns with the proposal that once the value of the total goodwill has been determined that this would never change for any step acquisitions. This just does not concur with my understanding of commercial reality.

Question 7

I do not support the ED's view that acquisition costs should be expensed in the earnings statement rather than being included as part of the total acquisition cost. The ED doesn't say this but this is what it means. I consider this to be commercially naïve. The fair value of a business is not some thing that you can get right or wrong, it is simply the cost you had to pay to acquire the business and this should include all the direct costs you incurred to do this.

The ED seems to be driven by an extremely academic view of fair value as if there is one right answer. The price paid for an acquisition can easily vary for many different factors, or by different bidders. Does this means that all of them, apart from the one version of the truth, are wrong? In the pursuit of technical purity I believe that we have lost sight of common sense.

I believe that you have asked a leading question in the ED, i.e. do I believe that the costs incurred in connection with a business combination are not assets. By themselves any cost is unlikely to be an asset, i.e. who would ever say that a legal bill has provided a benefit. These costs are only incurred in order to complete the acquisition and then to integrate the acquired company within the group.

One of the costs frequently incurred in acquisitions is paying external valuers to value the land, buildings, plant and machinery, fixtures and equipment, stock, brands and other intangibles etc. These costs have got nothing to do with the operations of the acquiring company and they have only been incurred in order to bring the acquired company to the condition necessary for inclusion in the group accounts. Without incurring this cost you have not completed the fair value exercise. You don't know what the assets are worth and you don't know what profit the acquired company has made since acquisition.

IAS 16 Property, Plant and Equipment provides that the cost of a fixed asset includes its purchase price as well as any cost directly attributable to bring the

asset to the location and condition necessary for it to be capable of operating in the manner intended by management. I believe that this same principle should apply to acquisitions.

I consider that external costs such as finder's fees, advisory, legal, accounting, valuation and other professional or consulting fees should be capitalised into the cost of an acquisition. The cost of issuing debt should be capitalised and amortised over the period of the loan and the cost of raising equity should be charged against the equity raised. I would also expense internal costs such as an acquisition department.

Question 8 and 9

I agree with the concept of assigning the fair value to the individual assets and liabilities when completing the fair value exercise. However I believe that the ED has gone too far. Completing a fair value exercise is a major task of any acquisition and I consider that the ED is not commercially realistic. Any company which has been acquired will be going through significant changes involved in the integration of the company to the new group, such as a change in directors and management, learning the culture and requirements of the new owner, restructurings, redundancies, plant closures etc.

To complete a fair value exercise based on this ED will involve a huge amount of time when it can be least afforded, for no practical benefit.

Receivables

For example, the ED requires receivables to be measured at their fair value and no separate valuation allowance is allowed for uncollectible amounts.

I cannot honestly believe that you are suggesting this. If you think about what is involved the acquired company will still be recording the receivables and provision for specific and doubtful debts in their own statutory accounts. They will then have to do a separate exercise to determine the "fair value". They would then have to account for the receivables in two different sets of books, one theirs and one for the new owner.

Does this make sense? No! It is far more practical to account for receivables at book value. You are probably going to come to the same answer anyway, for a lot less work. Speaking as a group that has done three major acquisitions in the past three years we are quite happy to accept book value. If we believe that the debtors are overvalued and won't be collected, we will then do an exercise to review the situation and to ensure that the value assigned, net of a provision, is fair.

In your pursuit of the technical purity of fair value you seem to have overlooked the cost benefit ratio of what you are requiring.

I would be quite happy for working capital items to generally be recorded at book value.

Stock

This would also include stock. Some jurisdictions in the world permit this to be recognised at book value and some at fair value. The argument for valuing it at fair value is that all assets should be recorded at their fair value and the acquiring company should not be rewarded for selling finished stock that it did not produce.

Alternatively stock should be continued to be carried at book value. Arguments in support of this are that it is a very time consuming exercise to revalue the stock to its market value, less an allowance for the costs of disposal and an allowance for a reasonable profit margin for the act of selling the stock.

My experience of acquisitions is that when acquiring a company we assume that they are a going concern. We know that they have stock which will be sold for a profit and we do not directly value this. The value of the company is based upon discounted cash flow models valuing the company as a whole.

It doesn't make commercial sense for the acquired entity to be reporting the stock in its statutory accounts at book value and reporting \$XXX profit on the sale of the stock, but to value the stock at a higher value in the group accounts and only report a profit of \$x.

Given the high profile to most acquisitions, which usually are fully valued it makes no sense to report to the market that we paid this large price for the acquired company, but it has only made a profit of \$x since acquisition. This is just commercially naïve. The acquired company actually made a profit of \$XXX, but due to an accounting standard we can't report that. How does this give a true and fair view to the shareholders of the parent company?

For acquisitions of manufacturing companies the carrying of stock at book value or fair value may not be that significant to the balance sheet, but I believe that it can be significant to the profit that is reported in the first period of ownership. I believe that it does give a true and fair view to carry the stock at book value as this will reflect the profit the acquired company actually makes.

I agree that there will be acquisitions where stock will be more or less significant. Perhaps you should allow companies the right to carry stock at either book value or fair value, but require them to disclose which option they have followed.

Contingencies

I do not support your treatment of contingencies, particularly after reviewing the exposure draft on IAS 37. I believe that liabilities should be recorded and for contingent liabilities, a liability recognised based on assessment of the likelihood of the liability crystalling. Given that there is a measurement period of one year this would seem to be a reasonable period to make an informed assessment. I do not support the view that we should book a liability based on its fair value of what we would rationally pay to settle the present obligation. I believe you can rest assured that most acquirers will want to fully value liabilities to avoid taking a loss to earnings, but I do not support recognising liabilities that are contingent on the occurrence or non occurrence of one or more uncertain future events.

Intangible assets

I have reservations concerning your treatment of intangible assets. I believe that intangible assets should be recognised at their fair value if they are identifiable and separable. I believe that most intangible assets are not separable from the business of the acquired company and therefore consider that they are part of goodwill and should not be separately identified and valued. I have some reservations as to the extent that you have gone to in identifying intangible assets which you believe should be recognised. I disagree with recognising internet domain names, customer lists, customer relationships, order or production backlogs.

Question 10

I do not believe that an entity should remeasure its non controlling equity investment to fair value and record a gain in the profit and loss account, upon acquiring a controlling interest. Instead this should just form part of the cost base of the investment.

Question 13

I do not agree that comparative information for prior periods should be restated for the effects of measurement period adjustments. I believe that any such adjustments should be made against the current balance sheet and the current period's results.

Question 15

I agree with providing relevant, timely information to the users of financial statements, but I have serious concerns about the level of information required to be disclosed. The Fletcher Building annual report has increased by 72%, from 61 pages in 2001 to 105 pages in 2005. I consider that the disclosure requirements are too extensive and so complex that readers of the financial statements are not reading them any more. I am not convinced that the business community reads and understands them anymore, let alone the public.

Specifically I disagree with the requirements to disclose the primary reason for the business combination, as required by paragraph 72 (d). I consider that the reasons for the acquisition are best stated in a press release or the sections of an annual report dealing with the chairman's or managing director's comments or an MD&A section, but not in the financial statements.

I also do not understand the requirement to include a description of the factors that contributed to the recognition of goodwill. What does this mean? I still believe that goodwill is simply the balance between the purchase consideration (including costs) and the fair value of the identifiable assets and liabilities.

I disagree with the requirement to disclose the costs expensed in paragraph 72 (I), as I do not believe that they should be expensed in the first place.

I disagree with the requirement in paragraph 74 (b) (1) to disclose proforma type information showing the revenue and profit of the group for the year as if all acquisitions had been effected from the beginning of the year. This is simply more disclosure for the sake of it. If a company felt that this information would be useful or relevant, the appropriate place to disclose it would be the MD&A section of an annual report, but not in the financial statements.

I disagree with the requirement in paragraph 76 (b), as I do not believe that contingent liabilities should be accounted for this way in the first place.

I disagree with the requirements of paragraph 77 through to 80:

I consider that the amount of the goodwill recognised will be disclosed already with the other asset and liability classes as required by paragraph 72 (g).

If the goodwill is deductible for tax purposes then the deferred tax asset in relation to this would surely be disclosed under IAS 12 when showing the composition of a deferred tax asset by asset category, i.e. provisions, fixed assets, tax losses etc.

I am unsure of the requirements of paragraph 79. I consider it inevitable that a company will not know the amount of goodwill for a material acquisition completed after balance date and before the financial statements are authorised for issue. Why would you require only the amount of the goodwill to be disclosed? Surely the important fact to disclose is details of the acquisition, including the acquisition cost in the subsequent events note.

I disagree with the requirements of paragraph 80 and consider that the disclosure of the roll forward of goodwill should be covered by other standards.

Question 16

I do not agree that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill.

Question 17

I agree that changes in an acquirers deferred tax base that become recognisable 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. I believe that it is a case of taking the good and the bad. A lot of acquisitions would involve restructurings, redundancies, plant closures, etc to realise the synergy benefits that can drive an acquisition and the purchase price paid. Under the ED these will be accounted for through earnings.

If you have any queries in respect to this submission please feel free to contact me. The comments that I have made are my own opinion and not necessarily those of Fletcher Building.

Yours sincerely,

John Hames
Group Controller
Fletcher Building Limited