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DCP/CRG/TEIXEIRA-IASB

Mr. Teixeira
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

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Dear Sir

Exposure Drafts of Amendments to IFRS3: Business Combinations and IAS27: Consolidated and Separate Financial Statements

We have reviewed the above exposure drafts, issued earlier this year and have attached our answers to the questions included in the invitation to comment sections of these documents. In addition to these views, we would also make the following observations:

The proposed amendments to these standards have created concerns over a number of areas, as you will see from our responses to the invitations to comment. We do not see where the demand exists to fundamentally change a standard which was only issued recently. This seems to disregard the impact on both preparers and users who must make decisions on financial information which is not helped by frequent change. Moreover, we are also surprised that in suggesting a fundamental change, which many would suggest raises issues over consistency with the framework, the IASB proceeded to an exposure draft without first issuing a discussion paper setting out the options and reasons for change more clearly, together with an agenda for the future intended developments on business combinations, and so providing the base for a more considered review. The development of high quality standards which lead to useful and understandable financial reporting through an appropriate due process should be the prime aim of the IASB. Set out below is a summary of the principal concerns that we currently have with the Board's proposals.

In cases where the acquirer holds less than 100% of the acquiree, we agree with the views of the dissenting Board members and prefer the "parent-only" approach to goodwill rather than the "full goodwill" method. We believe that the approach favoured by the Board will lead to less reliable information being provided, in that it will prove difficult in practice to measure the goodwill that relates to the non controlling interests. The benefit of the resultant numbers in difficult to see. Group financial statements are prepared from the perspective of the parent company's equity shareholders not non-controlling interests, while the proposed approach leads to a number of changes in accounting which we do not believe improve financial reporting.

We would also refer you to our comments on the proposed changes to IAS37 and express our concern over the move to accounting results based on hypothetical exchanges rather than the probable outflow of resources. This is not a route to accounts which are reliable, understandable or relevant in a predictive or confirmatory sense.

With respect to acquisition costs, we disagree with the Board's proposal to exclude these items from the measurement process for determining goodwill. We are concerned that the Board is prepared to create differences between accounting for these costs and accounting for similar costs incurred in the acquisition of other assets. We do not understand how the Board could conclude, as stated in paragraph BC88 of the Basis for Conclusions, that the proposal will improve financial reporting.

Conclusion

We are therefore not in agreement with the proposed approach to the measurement of goodwill and the consequent amendments to the accounting for non controlling interests. Consequently we do not believe that the Board should proceed with its proposals as currently drafted.

We thank you for allowing us the opportunity of commenting on the proposed amendments and hope that you find our comments helpful.

Yours faithfully

D C POTTER Head of Finance and Accounting

British American Tobacco

AMENDMENTS TO IFRS3: BUSINESS COMBINATIONS

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 continue to believe that it is not strictly appropriate to account for all business combinations using the acquisition method. We do not agree with the presumption that it will always be possible to identify the acquirer and the acquiree in any business combination. There will be rare circumstances where no acquirer can be identified and an alternative approach to acquisition accounting would be more appropriate.

We previously agreed with the ending of "pooling of interests" accounting on pragmatic grounds and for harmonisation. However, we understand that the Board will be considering the use of "fresh start" accounting as part of its business combinations project. Such an approach, whereby the net assets of both the acquirer and acquiree are measured at fair value at the date of combination, would avoid the criticism that is made in respect of "pooling of interests" accounting. However, any use of this methodology should be limited to the rare cases of true mergers.

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 note the comments by the dissenting Board members in paragraph AV14 of the Basis for Conclusions and are unclear as to why the IASB does not regard this as a problem.

Measuring the fair value of the acquiree

Question 3 – In a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

We do not believe that the approach proposed by the Board (the "full goodwill" method) is appropriate. We share the views of the dissenting Board members, set out in paragraphs AV2 to AV7 of the Basis for Conclusions, that the "parent-only" approach to goodwill is preferable as goodwill is not like other "assets".

As noted in paragraph AV7, the full goodwill approach requires estimating the total fair value of the acquiree which is likely to be a highly subjective measurement. Using the consideration transferred to estimate this fair value will require that any control premium included in the consideration is measured and such an exercise is unlikely to be able to be performed with sufficient reliability.

The recognition of only the goodwill attributable to the parent's interest in the subsidiary is consistent with the view that the group's consolidated financial statements are intended to meet the needs of the parent company shareholders not non-controlling interests down the corporate chain. The parent only approach results in goodwill that relates to the cost of the investment and provides useful information for users on the decisions and actions taken by management.

The Board's alternative approach introduces a notional item (the element of the goodwill that relates to the non controlling interests in the subsidiary) into the balance sheet which does not improve the quality of the information provided in the financial statements. We do not see the benefit of the soft point in time "valuation" of the business being included in the balance sheet, which also seems to be another partial move to fair value without the consensus that this is the right direction for IFRS. Our concerns are reinforced by some of the consequent implications of using the "full goodwill" approach covered in these responses on IFRS3 and IAS27.

Question 4 – Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair vale of an acquiree? If not, what additional guidance is needed?

We do not agree with the basic approach given our comments on the previous question but, in any event, we believe the guidance illustrates the subjective nature of the approach taken by these proposals. We also believe that in the current regulatory and audit environment, the Board may be oversimplifying the practical issues and should not underestimate the work needed to arrive at final numbers for publication. We are concerned that, where there are substantial non-controlling interests in the acquiree, the measurement of the fair value of the acquiree as a whole will be particularly subjective.

In addition we note that the definition of fair value, set out in paragraph 3(i) of the exposure draft, is based on FASB's proposed statement for value measurements which are subject to possible amendment dependant on the publication of a final statement on this subject by the FASB. We are somewhat surprised that the Board has seen fit to issue its proposals before finalising the definition of one of its key terms. Moreover, as regards the definition in the exposure draft, we are concerned to note that it only refers to "exchange in a current transaction". This again moves us down the route of accounting for items based on hypothetical, and sometimes impractical, "exchange" transaction rather than the flows of resources that are likely to occur.

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?

We would agree that the acquisition-date fair value of the consideration transferred is likely to provide the best evidence of the fair value of the acquirer's interest in the acquiree but we assume that this is intended to be a rebuttable assumption. Also, as regards paragraph 22, we would refer you to question 10 below.

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

Our preference is to adjust the cost of the combination when necessary as currently expressed in IFRS3. Contingent consideration may well be the result of difficulties on agreeing a price for a business combination and more appropriately related to accounting for the deal than post acquisition. Moreover, the suggested revision opens up the possibilities of abuse and the reference to the measurement period in paragraph 26 while helpful is arbitrary.

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 do not agree that acquisition costs should be excluded from the measurement of the consideration transferred for the acquirer and agree with the dissenting Board members in paragraph AV18 of the Basis for Conclusions. We believe that such costs should be capitalised as part of the acquirer's investment in the acquiree. We were surprised to see that the Board disagreed with this viewpoint, as discussed in paragraph BC87 of the Basis for Conclusions. The Board's approach seems to be based on the concept that the fair value of consideration incurred by the acquirer must equal the fair value of consideration received by the acquiree which is not the case. Also the arguments in BC86 do not seem to support the change. External costs on unsuccessful acquisitions are correctly written off because they do not result in an asset. The apparent inconsistency with internal costs could just as logically be resolved by capitalising these costs.

As noted in paragraph BC88, this approach will create inconsistencies with the treatment of acquisition costs for other types of assets and we are concerned that the Board is prepared to create such inconsistencies. We would prefer that the accepted practice remains in place until the Board is able to review the treatment for all types of assets, as referred to in paragraph BC41.

We do not see any logic in distinguishing between the different costs which are incurred in making an acquisition, whether they be cash paid to the acquiree, directly associated legal fees etc.

Measuring and recognising the assets acquired and the liabilities assumed

Question 8 – Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

We do not believe that the proposed changes are appropriate. We are concerned about the removal of probability and reliability tests. Especially for some contingent liabilities, the point made on "exchange" under question 4 above is relevant. As you will see from our answers to the questions for comment with regard to the amendments to IAS37, we have severe reservations over such changes being proposed by the Board.

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 believe that the exceptions set out in paragraphs 42 to 51 of the exposure draft are appropriate.

Additional guidance for applying the acquisition method to particular types of business combinations

Question 10 – Is it appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

Whilst we agree that it is appropriate to recognise any gain or loss on previously acquired non-controlling equity investments, we would suggest that consideration is given to whether any such gain or loss should be recognised in equity rather than profit or loss.

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 are in agreement with the proposed approach in that any such gain should first be used to reduce the goodwill arising and that only any excess remaining after such goodwill has been reduced to zero be taken to profit or loss. However, the concerns set out in paragraph BC177 of the Basis for Conclusions illustrate the potential problems which arise from the basic approach in these proposals and with which we disagree as explained elsewhere in this response.

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 do not believe that the amount of an overpayment could be measured reliably at the acquisition date.

Measurement period

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

We would agree that comparative information for prior periods should be adjusted for the effects of measurement period adjustments.

Assessing what is part of the exchange for the acquiree

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?

Aside from the position over acquisition costs (see our answer to question 7 above) where we believe such costs should be included, we believe that the guidance provided for making the necessary assessment is sufficient.

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?

Whilst we do agree with the principles set out in paragraphs 71 and 75, we are concerned at the extent of the proposed disclosures.

In particular we would consider

- (a) the requirements for a full "pro forma" for all acquisitions in paragraph 74(b) to be excessive, although we accept it is currently in IFRS3.
- (b) the requirements in paragraph 73(b) to be unrealistic in practice in many cases, especially as IFRS and the regulatory environment continue to increase in complexity.
- (c) the implications for interim reporting (IAS34) need to be considered on a practical not theoretical basis.

In summary we believe the Board should give more consideration to the balance of cost/timeliness of reporting.

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 recognised 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; and
- (b) cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?

We do not believe that an identifiable intangible asset can always be measured with sufficient reliability to be recognised separately from goodwill. We believe that no changes should be made without the field trips etc. which we understood were part of the development of IFRS3.

Question 17 – Do you agree that any changes in an acquirer's deferred tax benefits 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? If not, why?

We would agree that any such changes in an acquirer's deferred tax benefits should be accounted for separately from the business combination.

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

Given that the Board is committed to the international convergence of accounting standards, it is obviously disappointing that it has not been possible to achieve complete convergence with the FASB standard. We do not believe that it is appropriate to retain disclosure differences and would hope that the Board will continue its efforts to eliminate such differences.

Style of the Exposure Draft

Question 19 – Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

We agree that the bold type-plain type style of the Exposure Draft is helpful. We are not aware of any paragraphs that should be bold type, but are in plain type, or vice versa.