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Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations

Dear Mr Teixeira

We welcome very much the opportunity to comment on the draft amendments to IFRS 3 Business Combinations as follows:

General comments

We continue to support convergence of IFRS and US-GAAP to permit a level playing-field in financial reporting. This is particularly necessary in reporting business combinations which, in the past, gave rise to major reconciling differences for dual-reporting groups. However, with the present IFRS 3, which has only just been implemented, convergence was already largely achieved in this area. Although published under the convergence banner, the proposed changes appear rather to target the introduction or extension of fundamental new conceptual bases which have not themselves been exposed to public debate and can by no means claim widespread acceptance among the primary players in financial reporting, the preparers and the users alike. Without a prior debate on this, and the other fundamental issues of the probability criterion for recognition and the full economic entity concept, with continuing contraventions of the existing Framework and with its constant apparent confusion of financial reporting with valuation, the IASB will find it difficult to gain wholehearted acceptance of its proposals among key constituents. The debate must take place before any specific proposals like the present ones can be properly considered. **We are therefore unable to support the current proposals for amending IFRS 3.** Furthermore, we very much share the doubts expressed by the five dissenting members of the Board as expressed in the "Alternative Views".

In our view, the Board has not demonstrated any material benefits and advantages from the proposed changes. On the contrary, we see significant overall disadvantages, which lead us to reject the proposals. As well as having the objections on conceptual aspects mentioned above, we cannot subscribe to the Board's assertions of increased transparency; **indeed, the reporting of hypothetical values in the financial statements, rather than actual transaction values, will make it even more difficult for users to derive data to help them form a judgment on sustainable future cash flows, which are key to their**

considerations. Moreover, the proposals would result in many cases in a significant reduction in the reliability of reported financial information, especially where values are determined in situations where no market information is available (e.g. acquisition of control of private companies). Thus, there would be **no significant enhancement of relevance but an unacceptable sacrifice in reliability, to which IASB unfortunately seems to be according less weight than relevance in contrast to the Framework's equal weighting.** These views are expanded in our responses to your specific questions below.

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 agree with the proposed *definition* of a business combination.

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 agree with the definition and the additional guidance provided.

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?

Apart from our general objections given on pages 1 - 2 of this letter, we believe that the proposed approach is not appropriate for the reasons set out by the dissenting Board members in the Proposed Amendments to IFRS 3, AV2-7. In our view, the treatment of acquisitions should continue to be based on the parent-oriented approach of the current IFRS 3.

It is worthwhile to add that we think it completely wrong to move away from **accounting for actual transactions which have taken place to accounting for hypothetical values based on estimates subject to a potentially wide range of outcomes**, especially where no specific market data are available especially in the case of acquisitions of control of privately owned businesses. Neither can we identify any concrete benefits in doing so. While full (100%) fair values for individual identifiable acquired assets and liabilities are more meaningful (as under the present IFRS 3) and thus aid transparency, goodwill is not like any other asset. Users of financial statements do not generally think it has the same level of information content as the other asset numbers, and accounting treatments that produce very useful information when applied to other assets do not necessarily generate any benefit when applied to goodwill, which is – and should remain – purely a difference arising out of the particular transaction. It should be borne in mind that, since there would be exceptions to fair value as a basis for the identifiable assets and liabilities (e.g. defined benefit assets and liabilities), goodwill would not in any case be a 'clean' fair value but would include differences from fair value on such exceptional items. It is not, and under the proposals would still not be, a very useful number. For that reason it is particularly important in this case to consider the costs and benefits of what is being proposed, and we are not convinced that the Board has identified worthwhile benefits arising from the proposals.

In connection with the proposals on IAS 27 also, we prefer the present parent entity approach to the full economic entity concept. Users of a group's financial statements are interested in the earnings and net assets attributable to the parent company's shareholders: *minority shareholders will refer to the financial statements of the company in which they have their interest for information.*

Finally, we are concerned that the proposals would substantially increase the complexity of tracking and calculating minority interests. With the proposed goodwill allocation method, the percentage of ownership interest would no longer be an indicator which can be used directly to measure a non-controlling interest in a non-wholly owned subsidiary.

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

We have already explained above why we find the proposed "acquisition method" unacceptable. Expanding on our previous comments, we emphasise that, even with the fair value guidance given, the measurement would reflect a high level of subjectivity, especially when unquoted businesses are acquired.

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 have already explained above why we find the proposed "acquisition method" unacceptable. If the Board were nonetheless to insist on implementing the proposal, we could broadly agree with this presumption.

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

Assuming that the proposed approach of acquisition date fair value measurement of the acquiree is the method adopted, the accounting for contingent consideration after the acquisition date is appropriate. However, as already expressed, we have difficulties with the proposed general approach and prefer the current method in IFRS 3, with contingent consideration being recognised only when certain additional criteria are met. Further, we believe that the proposed approach bears the risk that in practice entities may be tempted to increase the use of contingent considerations and as a consequence benefit later from higher equity numbers.

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 have already explained above why we find the proposed "acquisition method" unacceptable and prefer the current purchase method in IFRS 3, under which it is logical to include in the cost of acquisition the direct incidental costs of the transaction in line with other asset acquisitions. Even if the Board were nonetheless to insist on implementing the proposed acquisition method, we believe that it would still be appropriate to include these costs: whether they are paid to the seller or to a third party (e.g. legal consultants), they are still part of the fair value of consideration for the transaction. The arguments in BC86 do not hold up as a successful acquisition cannot be regarded in the same light as an abortive one.

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 can broadly accept the initial recognition and subsequent measurement changes for identifiable assets acquired and liabilities assumed, with the following reservations:

a) As a matter of practicality, we suggest that a global valuation allowance for uncollectible receivables should be permitted as an alternative to a separate valuation of each item, which can be very cumbersome when an acquisition includes a large portfolio of debtors.

b) Contingencies: Probability is a key asset and liability recognition criterion according to the Framework. The proposals contradict the Framework by treating probability as a measurement attribute and are for this reason unacceptable. See our general comments above as well as our comments on the draft amendments to IAS 37. Removing the recognition criterion will result in forecast outcomes (using the expected cash flow approach) *which are improbable* being used to *support amounts* recorded in the financial statements, which we find highly undesirable in respect of both relevance and reliability.

c) The draft revised IFRS 3 in paragraphs 28 to 31 no longer mentions the "reliability of measurement" recognition criterion. In BC98 of draft revised IFRS 3 the Board explains that it decided to drop the notion because an equivalent statement is already part of the recognition criteria in the Framework (paragraph 86 – 88). Based on our understanding that the Framework *cannot supersede* a standard and to prevent uncertainty, we recommend the Board to **reinstate this recognition criterion in the revised IFRS 3** or - as a minimum – include a direct reference to the Framework paragraph.

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?

If the Board were to proceed with the proposed acquisition method, we agree that the exceptions would be appropriate and therefore enable the accounting principles established for certain assets and liabilities in specific standards to be applied subsequent to the business combination.

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?

We believe that this approach is inappropriate. No realisation has taken place, and nothing leaves the group. The valuation adjustment – *if made at all* – should be held in equity until a disposal takes place, which would also be more cogent in the consolidation process and in line with other IFRSs (e.g. IAS 39). We agree with the two dissenting Board members on this point.

We would also like to request that if the Board decides to retain this proposal, clear principles – together with detailed examples – should be provided in order to explain exactly how entities are to apply this accounting treatment in practice.

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?

Assuming the adoption of the acquisition method, we agree with this as a pragmatic solution. What is unclear, however, is the Board's criterion for deciding when, as here, to permit practical solutions which are inconsistent with the principles adopted.

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 believe that it would be extremely difficult to measure an overpayment objectively and reliably, but that is because we take the view – as expressed earlier – that it is often very difficult to measure the fair value of the acquiree as a whole reliably. Also, as mentioned in the Basis for Conclusions, the first impairment testing would catch the effects of any overpayment in any case. Consequently, the proposed IFRS should not permit the acquirer to recognize an immediate loss on acquisition in respect of an overpayment as we believe it cannot be reliably measured.

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 that comparative information should be adjusted for effects of measurement period adjustments.

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?

A clear principle would far better achieve the objective than detailed guidance. That provided is quite detailed and lengthy and gives the impression that it is drafted mainly to prevent abuse. In any case preparers would in practice need to use their judgement to make this assessment.

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?

The changes in the disclosure requirements follow logically from the other changes proposed. Consequently, they should stand or fall in the final version according to the final decisions on those other changes.

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 it is always possible to measure an identifiable intangible asset with sufficient reliability and therefore fully agree with the alternative view as expressed in AV19 and look forward to the Board re-instating the reliable measurement criterion in any final standard. This is particularly relevant in an area like intangible assets where an active market giving reliable data is the exception rather than the rule.

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 agree with the proposal.

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?

Especially on joint projects, the Boards have not done their job unless all divergences have been removed, so we are disappointed at their failure to do so here. We hope that the remaining divergences are not used as an excuse by regulatory authorities to continue to require reconciliations and/or additional disclosures. Although the Boards cannot control this, the possibility should alert them to the need to ensure that divergences are eliminated.

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 principally agree with the bold type/plain type distinction and find it helpful. We have not (yet) identified any paragraphs which should be changed from one typeface to another.

Thanking you for the opportunity to submit our contribution to your due process.

If you would like further clarification of the points raised in this letter, either of the undersigned would be happy to discuss these further with you.

Christoph Haller
Head Corporate Controlling

Raymond Meile
Corporate Controller