Letter of Comment No: 178
File Reference: 1204-001

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Sir David Tweedie
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October 28, 2005

Business Combinations Project (Phase II)

Dear Sir David,

We appreciate the opportunity to comment on ED IFRS 3 "Business Combinations" and ED IAS 27amend "Consolidated and Separate Financial Statements".

RWE is a firm believer in the need for a single set of high quality accounting standards that are applied throughout the world. We therefore welcome the efforts made to achieve convergence on accounting for business combinations. The joint development of a single standard by IASB and FASB is generally speaking an important step forward towards international convergence.

However, we have general concerns about the business combinations project. We consider it unfortunate that the exact scope of the overall business combinations project and the exact timing for completion is not explained. Furthermore, from an preparer's point of view, it is less than satisfactory that decisions made in Phase I of the project (for example the definition of a business combination or the approach taken in recognizing contingent assets and liabilities) are revised only two years later in Phase II, thereby changing a standard that has already been established and put into practice. This argument seems to be all the more important as there are references in the proposals for later stages of the project (for example, fresh start accounting), which reveal that further changes in accounting for business combinations are intended.

In reviewing the proposed amendments, we have identified the following issues that we would like to comment on:

- Although we appreciate the theoretical consistency of the proposed amendments, as IASB and FASB have managed to align requirements for business combinations with the entity theory as well as the fair value approach, we regret that both concepts have not been discussed previously on a more conceptual basis. Neither has a fundamental discussion on measurement taken place yet, nor have the advantages of the entity view or the parent-only approach been discussed with users and preparers. Hence, before it has been demonstrated that the entity theory leads to more relevant and reliable information for users of consolidated financial statements than the parent-only ap-

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proach, we cannot not agree with these proposals. Moreover, we believe usage of fair value should be restricted to items that have reliable market values.

- Under the proposals, all equity interests in a group should be treated as being homogenous. As a result, transactions between controlling and non-controlling interests are thus regarded as transfers within the total equity interest and consequently no gain or loss is recognised on such transactions. This approach is in accordance with the entity theory, but will, in our opinion, confuse users of financial statements. We believe that consolidated financial statements should report performance from the perspective of the controlling interest, and therefore the consequences of changes in controlling interests in subsidiaries after control is established should be reported clearly in the income statement.
- ED IFRS 3 proposes that, in a business combination achieved in stages (step acquisition), the acquirer has to remeasure its non-controlling equity investment in the acquiree at fair value as of the acquisition date and recognise any gain or loss in profit or loss. We understand that the purpose of this approach is to determine the fair value of the full consideration transferred by the acquirer. However, we do not agree with the proposal since this accounting treatment would create opportunities for entities to structure transactions to achieve a particular accounting result.
- We also do not agree with the proposed treatment of costs that the acquirer incurs in connection with a business combination as we believe that such costs are part of the consideration transferred. Furthermore, the proposed principle is inconsistent with the treatment of direct acquisition related costs in other standards where these costs form part of the carrying amount of the asset acquired.

We would be pleased to answer any questions that you may have concerning our arguments or discuss any aspect of this letter.

Sincerely yours,

RWE Aktiengesellschaft

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