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## COMMENTS ON FASB EXPOSURE DRAFT "BUSINESS COMBINATIONS - A REPLACEMENT OF FASB STATEMENT No. 141"

## Respondent's name and affiliation

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## General comments

We are grateful for the opportunity to comment on the Board's proposals. We have the following general comments which are reflected in our response to the specific questions raised.

- A. We fully support the concept of converging IFRS and US GAAP in this and other areas (see D below). However the proposals go beyond what is necessary for convergence and introduce fundamental changes in the reporting of business combinations, in particular they provide a further step towards fair value accounting as the prime measurement basis. We do not see there is a problem here to be fixed and therefore cannot see a need, nor believe there is a demand from users of financial statements, for such changes. We would therefore prefer to see convergence around the principles of the existing IFRS 3.
- B. We would urge the Board to put on hold the expansion of the use of fair value accounting until there is a re-think about how information is presented in financial statements; this means concentrating on the performance reporting project. Otherwise we consider that the understandability, and therefore the usefulness, of financial statements will be compromised by additional use of fair values, which bring with them less reliability and more measurement uncertainty. We do believe for example that realisation remains a key factor.
- C. The proposals extend further the principle that consolidated financial statements focus on the enterprise as a whole ("economic entity" concept) rather than on the parent's interest, i.e. the "non-controlling" (minority) interest is simply a component of equity. (This is a more significant change for US GAAP than for IFRS.) We do not believe that this reflects how management and users of financial statements operate.
- D. We would urge both Boards to ensure that whatever standards emerge after their respective re-deliberations are converged.

## Specific questions asked

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 disagree with the objective which would require the entire acquired business to be fair valued, irrespective of the percentage interest required. This may add unnecessary measurement uncertainty to financial statements information and complexity to allocations for goodwill impairment testing, without notable benefit to preparers or users.

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?

The definition of a Business appears considerably wider than that given in the current IFRS 3 Appendix A and without clear limits.

Paragraph A2 of the Exposure Draft states that a Business comprises Inputs (for example long-lived assets), Processes (such as strategic, operational and resource management) and Outputs (returns to investors or other economic benefits).

However Paragraph A3 states that a Business sale need not transfer all inputs and processes to the buyer, if the buyer is capable of filling the gaps through integration with its own inputs and processes. This could be read as requiring most asset sales to be accounted for as a Business provided that they are not so large or different from the buyer's existing business as to require development of new processes to manage them.

We therefore suggest the inclusion of clear examples to give further guidance on exactly where the boundary lies between the definition of a Business and that of an asset or asset group.

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?

See answer to Q1 above. We would support retention of the existing requirements of IFRS 3 whereby only the fair value of the acquired share is recognised.

Question 4: Do paragraphs A8-A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

We believe that A8-A26 do provide sufficient guidance.

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 support the proposal in the exposure draft.

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

We do have some concerns that, where contingent consideration forms a significant part of acquisition date fair value, for a major acquisition the proposal to report any future adjustments within profit or loss could significantly impact income. We believe that allowing a period for such adjustment, similar to that proposed for adjusting the fair values of individual assets and liabilities, would be reasonable and alleviate this potential distortion (and without a requirement to restate prior periods financial statements).

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 with the proposal: in our view costs directly attributable to the combination are of a long-term, capital nature rather than being incurred as part of current year operating activity. They should therefore continue to be included in the measurement of the business combination when calculating goodwill.

Paragraph B97 in the exposure draft states "The Board found no persuasive evidence indicating that the seller of a business is willing to accept less than fair value as consideration for its business merely because a particular buyer may or may not incur more (or less) acquisition-related costs than other potential buyers for that business". We suggest however that, irrespective of what the seller would like, no buyer is prepared to pay a seller more than fair value less acquisition costs. For example, the successful bidder in an auction will have paid in total what he/she considers to be fair value. However the seller may receive only 85% of this amount, with the buyer paying 15% commission to the auctioneer.

Whilst paragraph B95 states that the change resolves inconsistent treatments of certain business combination costs, we do not believe that expensing all such costs is the best way to achieve this. Paragraph B98 notes the resulting inconsistency with the treatment of similar costs incurred when an asset is purchased directly. We disagree with the Board's view in this paragraph that, overall, there is a net improvement in financial reporting.

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 consider these changes to be appropriate.

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 agree that these (existing) exceptions should remain.

Question 10: Is it appropriate for the acquirer to recognise in income 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 applying fair value is especially inappropriate when a previously acquired investment has been accounted for under the equity method prior to control being obtained. Whilst the method produces only a one-line "Investment in associate" value, this must nevertheless be calculated for by applying the investor's accounting policies to the associate's individual assets and liabilities. Consequently, whilst obtaining control may be (per paragraph B156) "a significant change in the nature of and economic circumstances surrounding the investment," it is much less significant from an accounting policy viewpoint.

Applying the proposals to existing equity-accounted investments may lead to gain or loss recognition that would not have been permitted under the uniform set of accounting policies applied until control was obtained, for example:

- Reversal of previous impairments
- Upward revaluation of fixed assets above cost
- Valuation of stock at market value less costs to sell
- Capitalisation of research expenditure previously expensed

We therefore suggest that acquisitions resulting in a change from equity-method accounting to consolidation should not trigger a fair value exercise, and do not consider that recognising an unrealized gain or loss in income on an acquisition will improve the usefulness of financial statements. We would instead propose the first application of equity-method accounting as a more appropriate triggering event.

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 do not agree with the presumption that the earnings process (or the related fair value difference from the consideration given) can be measured with enough confidence to display to the readers that income has been realised (please see also our general comment

B). We do not understand why an arms-length transaction would be consummated by two arms-length parties at less than fair value.

We also disagree with the lack of symmetry in the proposed approach, i.e. that a bargain purchase can necessarily be measured any more reliably or is any more likely than a potential overpayment. (paragraph B183 refers).

Question 12: Do you agree 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 are not aware of such circumstances.

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 consider that the potential cost to preparers in presenting adjusted comparative data could considerably outweigh the benefit to users. We would support retention of the existing measurement period with any adjustment to prior periods being reflected in the current period results. Disclosure should be made if such adjustments are significant.

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?

We believe that the guidance is sufficient.

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?

We broadly agree with the objectives but if changes are made to the accounting proposals (as outlined in our answers above) then disclosure requirements can be reduced.

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

We do believe that generally an identifiable intangible asset can be measured with sufficient reliability to be recognised separately from goodwill.

Question 17: Do you agree that any changes in an acquirer's deferred tax benefits that become recognizable 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 support this proposal i.e. to converge FAS 109 with the existing IAS 12 requirement.

Question 18: Do you believe it is appropriate for the LASB 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?

Whilst there may be some differences which arise for broader reasons, we believe that the Boards will miss an opportunity to assist both preparers and users unless they fully converge all other disclosures.

Question 19: Do you find stating the principles in bold type helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

We find it useful that the key issues are highlighted.