Dear Mr Teixeira

COMMENTS ON ED OF PROPOSED CHANGES TO IFRS3 and IAS27

Thank you for the opportunity to provide our comments on the Exposure Drafts and related Basis for Conclusions. This letter sets out our general comments on the proposed standards and in particular provides answers to the specific questions raised.

In summary we believe that the proposed treatment gives rise to inconsistencies with accounting principles established in existing standards. For example, expensing acquisition costs that are directly related to the business combination is not consistent with the cost measurement of inventory, plant and equipment and intangible assets (see our response to question 7). Recording transactions with non-controlling interests through equity, even though profits may have been realised, and yet recording fair value changes during a step acquisition through the income statement, even though this “profit” is largely generated by transactions with yourself, is not only difficult to comprehend, but appears inconsistent with the treatments of other assets that are held at fair value.

We feel that the move to fair value accounting outlined in this ED does not achieve the objective of enhancing the relevance and reliability of financial statements. In our view the ED introduces fair value accounting only at one point in time (see our response to Question 3). We believe that the relevance of this fair value will quickly diminish with the passage of time.

Our detailed responses to the questions raised are set out below:

IFRS3

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?

We have no specific observations in the context of this ED however we note that the accounting for transactions with parties involved in ventures excluded from the scope of this ED (as specified in paragraph 2) and transactions between commonly controlled entities are not discussed in this ED. We trust that these arrangements and the treatment...
of related transactions will be covered in separate proposals to ensure the guidance is consistent.

**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?

No specific observations.

**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 understand the aim of the IASB in proposing recognition of 100% of goodwill attributable to an acquiree however we do not agree with the method proposed for allocating goodwill between the controlling and non-controlling interest.

The method proposed results in the proportion of goodwill attributable to the acquirer not necessarily being proportionate to the equity holding. Also, it could result in situations where either the acquirer or the non-controlling interest (NCI) is allocated no goodwill - you acknowledge in BC178 that when a control premium is paid, the fair value of the business is likely to be difficult to establish. In our view, it is inappropriate to use the non-controlling interest as the “balancing” entry where it is not possible, because of a control premium or discount, to establish a true fair value.

We also note that whilst the ED appears to be moving towards fair value accounting for goodwill, the effect of the proposed treatment does not fully achieve this. Goodwill is not subsequently remeasured under the ED’s rules and so is only carried at “fair value” at the acquisition date (unless impaired at a later date). The relevance of this fair value will quickly diminish with the passage of time.

We consequently feel that the ED’s proposed treatment introduces additional complexity to the area of goodwill accounting which will detract from the relevance and reliability of the accounts.

Historically, it has been possible to reliably measure the fair value of consideration paid, and to use this to establish the goodwill attributable to an acquirer. Due to the disproportionate impact of any control premium on the amount of goodwill allocated to the non-controlling interest, we believe that it is more appropriate to continue with this measure of goodwill (and not to recognise the non-controlling interest share of goodwill).
A further consideration we do not believe is addressed in the ED is how any future impairment in goodwill would be allocated. IAS is currently silent on the topic as there is no allocation of goodwill between acquirer and non-controlling interest under existing GAAP. This lack of guidance means it is unclear how the impairment would be booked - would the parent’s share be written down first or would the impairment have to be allocated - and if so on what basis?

We also have the following observations in respect of the example given in paragraph A64:

The paragraph permits inclusion of post-acquisition synergy and cost benefits in the fair value calculations where “any likely” acquirer could achieve those synergies.

We believe that this is contrary to the concept of fair value and is also inconsistent with the treatment of other post acquisition changes, such as those outlined for deferred tax benefits (paragraph’s 42 – 51 of the ED) and post acquisition events which do not qualify as “measurement period adjustments”.

By permitting inclusion of such synergies in any fair value calculation, the definition of fair value is changed to being the value to the acquirer rather than to an independent party in an arm’s length transaction as it is not possible to state that the synergies (if it is indeed possible to reliably measure them) would be available to any purchaser. Thus the fair value of an acquired business might be different to an acquirer who already has a presence in a similar industry, to one which does not.

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 no specific observations however we raise concerns over whether the move to fair value accounting will in fact present a clearer picture of a business’ results and assets/liabilities.

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 agree with the principle that the acquisition-date fair value of the consideration transferred in exchange for the acquirer’s interest in the acquiree is the best evidence of the fair value of that interest.

Question 6: Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?
We appreciate the basis on which the IASB has reached the proposed treatment for contingent consideration.

We believe that the proposed approach is consistent with the ED’s approach of establishing the fair value of acquisition fair value at the date of acquisition, subject to changes within the remeasurement period which affect circumstances at the date of acquisition.

We also agree that it is appropriate to introduce a “cut off” period for remeasurement however we believe that the wording of paragraph 65 of the ED could be made more specific in this respect. Currently it is not clear whether the cut off is receipt of the final information in respect of an acquisition or whether there is a rebuttable presumption that all relevant information would be known within 12 months and therefore the maximum remeasurement is 1 year. We would welcome greater clarity on this.

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 disagree with this principle. Groups would not incur costs of acquisition if they are prohibitively expensive and therefore, in our view, the costs are part of the fair value of consideration paid to acquire a business and it is appropriate to include these costs in the calculation of the fair value of consideration. All costs associated with an acquisition, not just the consideration, are considered by an acquirer when evaluating a potential transaction and building a predicted returns model. We therefore believe it is unrealistic to regard these costs separately from the purchase cost.

The concept of capitalising costs related to bringing an asset in to use such that it can generate value in future is applied to both Tangible Fixed Assets and inventory (costs of assets in construction/costs incurred bringing inventory to its present location and condition) and it would therefore be consistent with IAS2 and IAS16 to allow costs of acquisition to be included in the measurement calculation.

We acknowledge that speculative costs may not be so appropriately capitalised and the Board may wish to avoid unnecessary “capitalisation” of these expenses. However where a target is identified and a deal completed the costs can be likened to development costs. In the context of research and development costs, IAS38 requires capitalisation of certain costs where specific criteria are met. In the case of acquisitions, this may be once the acquirer has a reasonable expectation that the transaction will complete.

By mandating that expenses in committed/completed business acquisitions be charged to the income statement, we believe the ED runs contrary to the guidance in IAS2, IAS16 and IAS38. We would suggest that costs are permitted to be included as part of the fair value of consideration – perhaps subject to similar criteria to those required to capitalise development costs.
We also note that the guidance in paragraph 21(a) of the ED appears inconsistent with the principle of expensing costs incurred. Para 21(a) states that the fair value of consideration transferred includes liabilities "incurred". In our view, this could be taken to include costs of acquisition.

Question 8: Do you believe that these proposed changes [relating to recognition of contingencies and receivables at fair value] 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 concur with the Board's proposal to exclude disposal groups and non-current assets held for resale from the requirement to recognise the assets and liabilities at fair value. The inclusion of such assets at the lower of carrying value and fair value less costs to sell (subject to any identified impairment) may result in significant post-acquisition profits in the consolidated results of the acquirer where the fair value is shown to be higher. This would be the case even where the fair value of those assets was accurately identified as part of the acquisition process and was included in the consideration paid to the seller.

Paragraph 43 of the ED states that acquired disposal groups should be measured in accordance with IFRS5 Paras 7 - 11. BC118 states that the Board intend disposal Groups acquired as part of a business combination to be measured at fair value less costs to sell. We therefore believe that the paragraph 43 references to paragraphs 7 - 11 in IFRS5 are incorrect as they refer to guidance on classification rather than measurement of assets. Paragraphs 15 to 19 are concerned with measurement.

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?

As noted previously, we have reservations about the wholesale move towards fair value accounting however we do not disagree with the exceptions proposed in the ED.

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 understand the basis on which the Board has proposed the treatment set out in the ED in its attempt to ensure acquisition accounting is applied in all business combinations where control is acquired. However we do not believe that the approach proposed is appropriate as long as the income statement remains in its current format.

On the date control is acquired, the change in value of the acquired company has not been realised, yet under the treatment proposed by the ED the change in value relating to the previously held interest will be recognised in the income statement. This will result in a
(potentially significant) timing difference between recognition and realisation of the change.

This treatment is also the converse of the proposed treatment of transactions with non-controlling interests, where gains and losses which have been realised by the majority shareholder upon the disposal of shares to the non-controlling interest are recognised in equity.

In our view it would therefore be more appropriate to show any change in value of a minority stake triggered by a step acquisition through equity, disclosed in the SORIE. This treatment would be consistent with that set out for revaluation in IAS39 and IAS16.

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?

Please refer to our comments in response to Question 3.

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 have no specific observations.

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 with the principle underlying this proposal but believe that there are significant practical and commercial considerations which make the ED proposals inappropriate:

- "Restating" financial information has adverse connotations to most readers of accounts and therefore should be avoided where the restatement would be a result of a requirement in an accounting standard. It would be confusing for readers to see regular restatements where, in reality the financial information was correct (to the best of a company's knowledge) at the date of publication;

- Practically there are several issues for companies in restating information: not only could groups with an active acquisition programme end up "restating" every year, but the logistics of manipulating financial records to adjust for these changes in a previous, "locked" period would be complex.

As an alternative, we would prefer that the changes are recognised in the current period and that additional disclosure items are provided in the Notes to the accounts to explain the impact of the changes on the acquisition accounting in total.
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 have no specific comments.

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 do not agree with the Board’s proposal to include extensive disclosure requirements in respect of acquisitions completed after the end of the period but prior to the date of approval of the financial statements (paragraph 71 (b)). Reporting timetables for listed companies in the UK and Europe are short, by historical standards, and we believe that the requirement to include extensive fair value disclosures for acquisitions completed after the end of the period up to the date of approval of the statements will place an unreasonable burden on financial reporters. It is our view that this is likely to lead to either delay in the issuance of financial statements, or the inclusion of information that may subsequently be found to be significantly in error. We do not believe that either of these outcomes is desirable, and are also of the opinion that the exemption for impracticality is insufficient.

We do not agree with the requirement in paragraph 74 (b) to disclose the revenue and profit or loss for the combined entity that would have resulted had the acquisition date been as of the beginning of the reporting period. We believe this requirement is demanding and complex, and should either be removed or further guidance provided. Further guidance should address questions such as:

   a. Whether the fair values should be calculated both at the acquisition date and the beginning of the period (which we would consider unnecessarily onerous);
   b. How depreciation and other similar adjustments should be made, bearing in mind the answer to (a);
   c. How synergies and similar benefits that would have resulted if the acquisition had been made as at the beginning of the period should be reflected;
   d. How significant events should be treated if they occurred before the actual acquisition date but after the beginning of the period i.e. should they be treated as pre- or post-acquisition events?

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 agree with the assertion in principle however, we draw your attention to our concerns on the impact of a shift to fair value accounting on the relevance and reliability of financial statements.

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 proposed treatment based on the definition of “fair value” being the value of an acquiree in an arms length transaction with a third party, and therefore concur that, for the purposes of calculating goodwill attributable to the business as a whole, deferred tax benefits arising after acquisition should be excluded from the calculation.

However we would note that an acquirer may attribute fair value to the benefits arising as a result of the acquisition and this may therefore be incorporated into the consideration paid. On the proposed allocation of goodwill calculation in the ED, this would impact the allocation of goodwill between acquirer and non-controlling interest.

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?

We have no specific comments.

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 do not recommend any changes to the current formatting – which is consistent with that applied in all previous accounting standards.

We do however like to take this opportunity to observe that an increasing amount of information critical to the correct understanding and application of accounting standards appears to be presented outside the main body of the recently issued IFRS and EDs.

We would prefer that the main body of the Standards contained a greater level of detail and information in the appropriate sections rather than cross-referring to Appendices, Examples and Basis of conclusions paragraphs.

IAS 27

Question 1: Draft paragraph 30A proposes that changes in the parent’s ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders. As a
result, no gain or loss on such changes would be recognised in profit or loss (see paragraph BC4 of the Basis for Conclusions). Do you agree? If not, why not and what alternative would you propose?

See our response to IFRS3 ED Question 10. We believe that it is inconsistent to treat transactions with minority shareholders as equity transactions whilst step acquisition transactions result in a gain or loss in the income statement. In our opinion these transactions result in a realised gain or loss to the Group and should therefore be recognised in the income statement. We believe that where a transaction with other shareholders results in a realised gain or loss, that gain or loss should be recognised in the income statement. Conversely, where a gain or loss is unrealised, it should be held in equity until the time it becomes realised (similar to the treatment of cashflow hedges under IAS39).

Furthermore, we note that the proposed treatment for transactions with non-controlling interests conflicts with the accounting treatment for ‘deemed disposals’, where an entity’s stake in a subsidiary is diluted due to the issue of shares by that subsidiary to a third party. In such cases, any gain or loss on the ‘deemed disposal is recognised through the income statement.

Question 2: Paragraph 30D proposes that on loss of control of a subsidiary any non-controlling equity investment remaining in the former subsidiary should be remeasured to its fair value in the consolidated financial statements at the date control is lost. Paragraph 30C proposes that the gain or loss on such remeasurement be included in the determination of the gain or loss arising on loss of control (see paragraph BC7 of the Basis for Conclusions). Do you agree that the remaining non-controlling equity investment should be remeasured to fair value in these circumstances? If not, why not and what alternative would you propose? Do you agree with the proposal to include any gain or loss resulting from such remeasurement in the calculation of the gain or loss arising on loss of control? If not, why not, and what alternative would you propose?

No specific comments.

Question 3: As explained in Question 1, the Exposure Draft proposes that changes in a parent’s ownership interest in a subsidiary that do not result in a loss of control should be treated as transactions with equity holders in their capacity as equity holders. Therefore, no gain or loss would be recognised in profit or loss. However, a decrease in the parent’s ownership interest resulting in the loss of control of a subsidiary would result in any gain or loss being recognised in profit or loss for the period. The Board is aware that differences in accounting that depend on whether a change in control occurs could create opportunities for entities to structure transactions to achieve a particular accounting result. To reduce this risk, the Exposure Draft proposes that if one or more of the indicators in paragraph 30F are present, it is presumed that two or more disposal transactions or arrangements that result in a loss of control should be accounted for as a single transaction or arrangement. This presumption can be overcome if the entity can demonstrate clearly that such accounting would be inappropriate (see paragraphs BC9-
Do you agree that it is appropriate to presume that multiple arrangements that result in a loss of control should be accounted for as a single arrangement when the indicators in paragraph 30E are present? Are the proposed factors suitable indicators? If not, what alternative indicators would you propose?

No specific comments.

Question 4: Paragraph 35 proposes that losses applicable to the non-controlling interest in a subsidiary should be allocated to the non-controlling interest even if such losses exceed the non-controlling interest in the subsidiary’s equity. Non-controlling interests are part of the equity of the group and, therefore, participate proportionally in the risks and rewards of investment in the subsidiary. Do you agree with the proposed loss allocation? Do you agree that any guarantees or other support arrangements from the controlling and non-controlling interests should be accounted for separately? If not, why not, and what alternative treatment would you propose?

We agree with the proposed treatment.

Question 5: The transitional provisions in the Exposure Draft propose that all of its requirements should apply retrospectively, except in limited circumstances in which the Board believes that retrospective application is likely to be impracticable. Do you agree that proposed paragraphs 30A, 30C and 30D should apply on a prospective basis in the cases set out in paragraph 43B? Do you believe that retrospective application is inappropriate for any other proposals addressed by the Exposure Draft? If so, what other proposals do you believe should be applied prospectively and why?

We agree with the prospective application outlined in paragraph 43B. We would however add paragraph 30E to this prospective application as it relates to equity items to be “recycled” on loss of control which would not exist until application of paragraph 30C.

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We thank you for considering our comments in developing this standard.

Kind regards

Juliet Wall
Head of Corporate Accounting and Planning
Anglo American plc