October 28, 2005

Dear Mr. Teixeira

Exposure Draft of Proposed Amendments to IFRS 3, Business Combinations

We very much welcome the opportunity to comment on the Board’s proposals. Our comments have been prepared in conjunction with representatives from the major Swiss industrial and commercial multinational groups amongst our members.

1. 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. There is as yet practically no support for the general adoption of fair values on the part of the former; and the AIMR’s 2003 financial reporting survey only elicited explicit support for fair value from 3% of polled members, insofar as these can be taken as representative of users, and recent contacts with members of the user community have confirmed a lack of enthusiasm for what is seen as fixing something that is not broken.

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“.

Some of our members see some practical benefits in some of the specific proposals. The accounting for step acquisitions and for small ownership changes with no change in control
would be simplified, while the suggestion on contingent consideration would avoid adjustments to goodwill possibly dragging on over an indefinite period. However, in our opinion, these are marginal, and the Board has not demonstrated any other material benefits and advantages from the proposed changes. On the other hand, 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). We do not perceive any increase in the relevance of the reported financial information as a consequence of the proposals to outweigh these disadvantages. 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.

2. Specific Questions

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?

For the reasons given in our general remarks above and under question 3 below, we are unable to support the objective as stated, because of the “acquisition method” described therein. We see no significant benefits from changing from the current “purchase method” based on cost.

Subject to the scope exceptions for joint ventures and combinations of entities under common control, we can agree with the proposed definition of a business combination in the sense of acquisitions. However, we believe that it still leaves a problem for those situations in which an acquirer cannot be identified. In practice there can be true mergers - particularly in the area of combinations involving two or more mutual entities or combinations achieved by contract alone - and we believe that, in those cases, the application of the acquisition method, involving the identification of the acquirer in all cases, will not reflect economic reality. The wording of the definition of “business combinations” appears to scope out such transactions: this leaves them unregulated specifically under IFRS. We believe that this situation would need to be clarified.

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 could accept the definition and the additional guidance.

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

It is worthwhile to add that we think it wrong to move away from accounting for actual transactions which have taken place and the generally clear “real-money” costs involved in accounting for hypothetical values based on estimates subject to a potentially wide range of outcomes, especially where no specific market data are available as 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. deferred tax), 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. Users would suffer instead the increased ‘softness’ of the numbers reported under the proposals.

In connection with the proposals on IAS 27 also, we prefer the present 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 would no longer be an indicator which can be used directly. Following example 4 in A62 and A63, we easily arrive at strange situations with only slight adjustment to the assumptions. For example, if AC pays a “fair” price of CU 170 instead of CU 160 (reflecting synergies etc.) AC’s “real” goodwill of CU 50 would be capped at CU 45, which does not properly reflect what has actually been paid. The mechanics of the consolidation in such situations are also not quite clear to us. Taking the “fair” price as CU 170 in example 4 and assuming push-down of the acquisition accounting and no impairment problem, we see the situation as follows:

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<th>AC</th>
<th>IC</th>
<th>Aggregated</th>
<th>Consolidated</th>
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<tbody>
<tr>
<td>Goodwill</td>
<td>45</td>
<td>45</td>
<td></td>
<td>45</td>
</tr>
<tr>
<td>Identified assets/liabilities</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>170</td>
<td>170</td>
<td>-170</td>
<td>0</td>
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<tr>
<td>Equity</td>
<td></td>
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<tr>
<td>- controlling interest</td>
<td>170</td>
<td>195</td>
<td>365</td>
<td>-200</td>
</tr>
<tr>
<td>- non-controlling interest*</td>
<td></td>
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<td>30</td>
<td>30</td>
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* allocated goodwill 0 + 20% of Identified assets/liabilities 30
Thus, on equity – controlling interest, we have a reduction of CU 5 (170 → 165). How is this to be shown and described in the statement of changes in equity?

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 guidance given, the measurement would reflect a high level of subjectivity, especially when unquoted businesses are acquired. Novartis’ recent offer of $40 per share for the remaining 57.8% of Chiron compared to a stock market price of $36.44 before the bid and a price of $43.13 in early trading after the bid. An 18% spread of possibilities, and that in a highly liquid market for a quoted US company! Example 3 in A15 also demonstrates some of the difficulties. The example gives the impression that what the other bidders were prepared to pay for the interest in the acquiree would be of no relevance in determining the fair value of the acquiree as a whole. We would have thought that information may well be relevant. The exercise which acquirers are being asked to carry out is clearly not as straightforward as it may at first seem. Under such circumstances we find that the historical cost of the transaction remains the appropriate value for recording the transaction as it is more transparent, more reliable and also more relevant to users of the parent's consolidated financial statements.

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, though we have doubts as to whether the fair value of the consideration transferred should logically include any previously held interest.

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 cost method of the current IFRS 3, with contingent consideration being recognised only when certain 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 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 cost method of the current IFRS 3, under which it is logical to include 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 measurement changes for identifiable assets acquired and liabilities assumed, with the following reservations:

- 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 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.

- We have in practice found the guidance in B16 of the current IFRS 3 to be very useful and would welcome similar “tips” on specific assets and liabilities in any revision. However, it is appreciated, as discussed in our general comments, that general debate on fair values must come first.

- 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.

- The draft revised IFRS 3 in paragraphs 28 to 31 no longer mentions the “reliability of measurement” recognition criterion. In BC96 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 enable the accounting principles established for certain assets and liabilities in specific standards to be applied subsequent to the business combination. As a further suggestion, however, we would favour the addition of a practical simplifying change to permit the valuation of manufactured WIP and finished goods inventories at replacement cost as a surrogate for fair value, as is already done with raw material inventories and specialised
equipment. This would be a substantial practical help in reducing the compliance costs and simplifying the accounting.

**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 realization 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 understandable in the consolidation process and in line with other IFRS (e.g. IAS 31). We agree with the two dissenting Board members on this point.

We would also like to request that, if the Board retains the ED proposal, quite clear principles – with examples – are included in the standard to explain exactly how entities are to report changes in the levels of control that are key for financial reporting purposes. Shares being acquired or disposed of leads to movements between categories (investments/associated companies/subsidiaries), and the reporting and disclosure consequences of this are somewhat opaque in the present draft.

Furthermore, under the existing IFRS 3, certain auditors are producing interpretations that the amount to be recorded in equity as a result of taking control needs to be recorded in a separate equity component account to be kept until the subsidiary is sold.

We request that any amendments to IFRS 3 clarify that separate disclosure within equity is not required, and this adjustment can form a part of consolidated retained earnings, and that this new guidance can be applied retrospectively to all transactions since the effective date of the current IFRS 3 of March 31, 2004.

**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 fair value approach, 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 difficult to measure the fair value of the acquiree reliably. Also, as mentioned in the Basis for Conclusions, the first impairment testing would catch the effects in any case. Consequently, we could accept the pragmatic solution proposed, assuming that the fair value approach is adopted.
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 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. They should stand or fall in the final version according to the final decisions on those other changes.

An additional issue concerns the disclosures of the ED on IFRS 3. Para 76 (b) requiring the disclosure of the movement of the contingent consideration during the period. Such a requirement could cause problems in case of a step acquisition of a private company. In those types of deals, especially when the steps are based on an earn-out formula, the parties agree in the contract that terms of the agreement are confidential. Therefore, business practice requires that the Board establishes a waiver to this disclosure requirement when it could cause legal prejudice to the entity as is already the case in IAS 37 § 92 (current standard).

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?

Contrary to the assertions in paragraph 29, the proposals in paragraphs 40-41 and A28-34 are inconsistent with both the Framework and IAS 38 on intangible asset recognition, as paragraphs 40 and A28 only refer to definition (IAS 38, 10-17) and not to the recognition criteria (IAS 38, 21-
22), which include reliable measurement. This clearly weakens the credibility of the proposals by seemingly seeking to ignore key items in both the Framework and IAS 38. We fully support and agree with the alternative view expressed in AV19 in this regard and look forward to the Board re-instating the reliable measurement criterion in any final standard. It 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?

Assuming the adoption of the fair value approach, this would be logical.

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. We also warmly support the suggestion to present arguments on accounting treatments in Basis for Conclusions in future exposure drafts in pro/con tabular form.

We thank you for your attention to the above.

Yours sincerely

FEDERATION OF SWISS INDUSTRIAL HOLDING COMPANIES

Dr. Peter Baumgartner
Chairman Executive Committee

Dr. Jan Atleslander
Member Executive Committee

cc - IH Committee
- IH Expert Group Accounting and Reporting