Ladies and Gentlemen,

We welcome the possibility to comment on the above mentioned two exposure drafts. We outline some general comments below and we then answer the specific questions of the exposure drafts in the annexe.

We disagree with the proposals of the two exposure drafts for practical and conceptual reasons. Though the Board has indicated that IFRS 3 would be followed by a second phase and though this standard, which was established under the pressure of the 2005 stable platform might have needed to be enhanced, we doubt that major changes such as the full goodwill method and the entity concept are necessary for a better understanding of the users. Moreover we consider that these changes create an unnecessary pressure on the preparers that are still struggling with the implementation of the very complex requirements of the current IFRS 3 and of the 2004 version of IAS 36 and IAS 38 as well as all the other standards of the 2005 Stable Platform.

In the basis for conclusion § BC137 the Board considers that, since goodwill meets the definition of an asset, it should be recognised in its entirety and not just for the parent share. Paragraph 49 (a) of the framework defines an asset as "[...] a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity".
We disagree with the Board interpretation that the goodwill from the minority shareholders is an asset because it has not been acquired in a transaction that gives rise to a past event in accordance with § 49 (a) of the Framework. We agree with the dissenting Board members who consider in § AV3 that "goodwill is different from other assets, because it is a component of the value of the business as a whole, rather than having a separate existence". The justification of the majority of the Board therefore stems only from the economic entity concept, which we disagree with.

By using the economic entity concept the Board has concluded in § BC17 that "the measurement objective in accounting for business combinations should be the fair value of the acquire on the acquisition date rather than the costs incurred in the business combination". In § BC18 "[t]he Board believes that the principles underlying IFRS should strive to reflect the underlying economics of transactions and events". We believe that there is a contradiction between these two statements and we consider that measuring the full fair value of a business for recognizing 100% of the goodwill whereas minority shareholders own a share in the business does not reflect the economics of transactions and events because no transaction has been entered into with the minority shareholders.

We agree with the dissenting Board members opinion expressed in § AV 2 of the ED on IAS 27 that "non-controlling interests represent equity claims that are restricted to particular subsidiaries whereas the controlling interest are affected by the performance of the entire Group". This is particularly true in a multinational group that has subsidiaries with minority interests spread in several different countries and where minority interests can represent several different type of interests, i.e., shareholders of locally publicly listed companies or private financial investors in a given country. Those shareholders are involved only with the subsidiaries in which they own shares, they are not involved with the Group as a whole and they consequently cannot be assimilated to the shareholders of the Parent from an economic standpoint. We see no contradiction between IAS 1 § 68 (o) that requires to present minority interest in equity and our recommendation to maintain the parent entity concept. We consider the previously mentioned IAS 1 requirement as a presentation requirement that should not influence the recognition of transactions with minority shareholders.

In the revised IAS 27 the economic entity view gives rise to the recognition in equity of gains or losses on the movement of minority interest because they result in transactions with equity holders. While some may view this as a simplification, we consider that its benefits are outweighed by the loss of visibility on these transactions.

In the detailed comments of the annexe, we express our concerns about the determination of the fair value of the non controlling equity investment as per §§ 21 (b) and 56 ss. as well as the related application guidance. We agree with the dissenting Board members who state in the ED on IFRS 3 § AV8 ss. that "changes for the shareholders of the parent entity should be reported clearly in the income statement, as is permitted by current IFRSs". We consider that the determination of goodwill at 100% while no transaction has been taken place with the minority shareholders creates a doubtful asset and contradicts the requirement of a faithful presentation of the effect of the transactions and other events and conditions as stipulated in IAS 1 § 13.
To conclude, we do not believe that the EDs on IFRS 3 revised and on IAS 27 revised achieve the relevance and reliability qualitative characteristics as specified in §§ 26 and 31 of the Framework because they mix valuation with accounting.

We thank you for allowing us to comment on these exposure drafts and for your attention to our comments.

Yours very truly,

NESTLE S.A.

[Signature]

H. Wirz
Senior Vice President
Head of Group Accounting and Reporting

Enclosure: Answers to specific questions
ED ON AMENDMENTS TO IFRS 3 BUSINESS COMBINATIONS

**Question 1 - Objectives, Definitions and Scope**

As stated in our general comments we disagree with the objective of the proposed standard. In contrast we consider that the definition and the scope of a business combination is appropriate but we recommend that the Board finds rapidly a solution to the formation of joint ventures for which there is currently no guidance because they are scoped out in § 2 (a).

**Question 2 - Definition of a Business**

We generally agree with the definition of a business but we consider that the items (1) and (2) of sub-paragraphs 3 (d) are superfluous. The definition should stick to the Framework and specify: "[...] providing either future economic benefits as stated in the Framework". The notion of future economic benefits is specified § 53 of the Framework which covers all "returns to the investors", "dividends", etc. that need not to be mentioned in the future standard.

**Question 3 - Inclusion of 100% of the Fair Value of the Acquiree when the Acquirer Holds Less than 100%**

As mentioned in our general comments we consider that including 100% of the fair value of the acquiree when the acquirer holds less than 100% is neither relevant nor reliable because the measurement is based on parameters existing and the date on which control is obtained whereas the correct value will be that when the minority interest are acquired if this ever occurs. We therefore strongly recommend to maintain the requirements of the current IFRS 3 whereby the fair value of the acquiree is determined on the basis of the actual transactions having been made.

**Question 4 - Guidance for Measuring the Fair Value of the Acquiree**

We have mentioned in our general comments that we disagree with the measurement of the full fair value of the acquiree when the acquirer purchases an interest of less than 100%. The lack of reliability of this requirements appears in the example 3 of § A15 ss. Paragraph A17 mentions that the price per share paid by the acquirer "is not necessarily representative of the amount that other knowledgeable parties unrelated parties are willing to pay for [the acquiree] as a whole". Therefore the example recommends to determine the full fair value by using the price paid by the acquirer on the share that it acquires and the prices quoted on the exchange for
the remaining shares at the acquisition date. Then the example says that the acquirer should refine its valuation by using other techniques. This demonstrates that the measurement of the full fair value is difficult, highly subjective and does not appear to be relevant: why would other bidders accept to pay less than the acquirer for obtaining 100% of the interest in the acquiree? Moreover we do not believe that the market approach or the income approach are very reliable for the reasons that we mention below. We therefore recommend to stay with the requirements of the current IFRS 3 because only the costs of a transaction having actually been made are reliable and not arguable.

On the specific methods proposed in §§ A19 to A23 we consider the following:

- In § A19 the Board has taken the rule of observable prices for a business that is similar to the acquiree or multiple techniques if available. We have concerns about the reliability of information related to similar businesses and we doubt that such information would be available in practice especially in case of the acquisition non listed privately owned businesses or of State owned enterprises especially in emerging markets.

- The market approach proposed in § A20 seems also even more subjective. How could an acquirer find prices of publicly traded comparable businesses? How would such prices be representative of the metrics of the acquiree? What would be the limitations in defining "similar products and services". The adjustment by ratios as proposed in A21 also seems rather subjective.

We believe that only the income approach proposed in A22 might offer less risks of unreliability – with the exception of subjective weighing factors, but the rates used to discount the cash flows would reflect parameters widely used and spread on the financial markets. This method should be recommended for valuing the cost of acquisitions for which no consideration is paid.

**QUESTION 5 – ACQUISITION DATE FAIR VALUE OF THE INTEREST TRANSFERRED**

We have said in the general comments that we disagree with the valuation of a business at 100% when there are minority shareholders. Should the Board want to proceed with the proposals of the ED, we would consider the proposed requirements as acceptable.

**QUESTION 6 – ACCOUNTING FOR THE CONTINGENT CONSIDERATION AFTER THE ACQUISITION**

Assuming that the proposed approach of the acquisition date is retained we would agree with the proposed requirements. However, as already expressed, we have a problem with the recognition of a gain or a loss on the remeasurement of the liability for the contingent consideration and we prefer to stay with the current requirement of recognising this remeasurement under goodwill.
QUESTION 7 – COSTS INCURRED BY THE ACQUIRER

As mentioned in our general comments, we prefer the cost method under which it is logical to include the acquisition costs under the cost of the acquisition. Nevertheless even if the Board would retain the proposed acquisition method, we would disagree with the proposal to expense the costs incurred by the acquirer for the acquisition of the acquiree. The reasoning that the seller does not want to accept a lower price as a result of the acquisition cost as mentioned in § BC87 does not hold. In acquiring a business, the acquirer intends to recuperate those costs out of the future economic benefits of the transaction as it does when it acquires an item of PP&E. The costs consist of fees from business consultants, lawyers, investment bankers, etc. and cannot be assimilated to the acquisition costs of a financial instruments measured at fair value from which the proposed treatment is derived. The fact these costs are not part of the value exchanged between the buyer and the seller as mentioned in § BC85 is irrelevant because such costs are part of the amount invested in the acquiree both under cost or a fair value measurement.

QUESTION 8 – MEASURING THE RECOGNISED ASSETS AT FAIR VALUE

We generally agree with the fair value recognition with the exception of the following two points.

As mentioned in our comment letter concerning the ED on the revised IAS 37 on Non Financial Liabilities, we express our disagreement with the proposed accounting for contingencies whereby probability should be considered when measuring contingencies rather than when recognising them. Please see our comment letter on this subject for more details.

We also have concerns about the exclusion of a separate valuation allowance for uncollectible receivables. While uncollectability issues can be incorporated in the fair value of individual receivables because a willing buyer and a willing seller of a financial instrument would take those issues in consideration, the situation of portfolios of large amounts of debtors is different because, in transacting such portfolios, willing buyers and willing sellers would typically incorporate a separate valuation allowances. An individual valuation of each item of portfolios of large amounts of debtors is not practicable.

The ED on the revised IFRS 3 no longer mentions in paragraphs 28 to 31 "the reliability of measurement recognition criterion". This is justified in § 102 of the basis for conclusion because the reliability of measurement is a criterion for recognition in the Framework. Since the Framework "does not define standards for any particular measurement" (§ 2), it consequently does not have the authority of a standard and we recommend to reinstate the reliability of measurement criterion in the future revised IFRS 3 or to explicitly refer to the Framework for the sake of clarity.
**QUESTION 9 — EXCEPTION TO THE FAIR VALUE MEASUREMENT**

The proposed guidance appears acceptable subject to the following addition. Inventories of materials should be valued at replacement costs. Work in progress and finished goods that were manufactured in the acquiree's factories should be valued at the replacement costs of the materials plus the costs of conversion because this corresponds to what the acquirer would have incurred in manufacturing the goods at the acquisition date in the acquiree's facilities. It would not be reliable to assume that the acquirer would have purchased such goods from third parties at the balance sheet date.

**QUESTION 10 — GAIN OR LOSS UPON OBTAINING CONTROL**

We disagree with the proposed requirement because no transaction has actually taken place. The gains or losses only stem from the determination of the fair value of a former associate or an available for sale financial instrument. We recommend to carry these gains or losses to equity until a partial or complete divestiture takes place or until the reporting unit is impaired.

**QUESTION 11 — ACQUIRER CONSIDERATION TRANSFERRED WHICH IS LOWER THAN THE FAIR VALUE OF THE ASSETS**

We agree with the proposed treatment.

**QUESTION 12 — OVERPAYMENT**

We consider not only that an overpayment cannot be measured reliably but also that the notion of an overpayment itself is very subjective. Furthermore with the yearly testing of goodwill for impairment, any overpayment that might have occurred would be immediately detected and would give rise to an impairment loss.

**QUESTION 13 — MEASUREMENT PERIOD**

We consider that the arguments that the Board has put forward are very theoretical and are valid for isolated cases such as the case of the incomplete appraisal illustrated in the Example 11 of the appendix paragraph A84 ss.

Large multinational groups very often acquire an other group made of several entities, for which the determination of the fair value of PP&E involve thousands of items. While the appraisal should obviously be limited to the material items, those values have nevertheless to be entered into the plant register which is a time consuming process that may exceed the 12 months deadline that is fixed in § 65.
Therefore we propose to modify paragraph 65 by saying that the measurement period should be "in principle twelve months from the acquisition date" and that an entity should disclose the reasons why it cannot meet such deadline and indicate when the appraisal shall be completed. The time limit should be extended to 24 months.

Another source of concern is the retrospective application of the changes in depreciation of the items for which the appraisals has been subsequently changed. With transactional computer systems (e.g. SAP) that are currently used by large multinational groups, such an adjustment could not be made without undue cost and effort, for which reason we propose to handle such changes prospectively.

**QUESTION 14 — ASSESSING WHAT IS PART OF THE EXCHANGE WITH THE ACQUIREE**

While § A88 is referring to judgement, then the appendix is establishing very detailed rules that seem to have been written with the aim of preventing abuses. In practice the abuses are limited by anti-trust laws and regulations that prohibit an acquirer to interfere in the management of an acquiree during the review of such authorities. Therefore we would propose to limit the guidance to §§ A87 and A88 and to drop the examples that we consider as too specific to be incorporated in guidance that is an integral part of the standard.

**QUESTION 15 — DISCLOSURES**

Subject to our comment below, we generally agree with the disclosure requirements but we note that some of them are the consequence of the changes proposed in the ED which we disagree with.

The requirement of paragraph 76 (b) could cause problems when private companies are acquired. Sometimes the sellers require by contract that the terms of the agreement should not be disclosed to the public and such clauses become legally enforceable. Therefore we recommend that a waiver similar to that of IAS 37 § 92 should be included to say that in the extremely rare circumstances where the disclosure should create legal prejudice to the entity, then the entity should explain the reasons for the absence of disclosure.

**QUESTION 16 — RECOGNITION AND MEASUREMENT OF INTANGIBLE ASSETS**

We disagree with the elimination of the reliable measurement criteria for intangible assets acquired in the business combinations and with the justification that the reliable measurement is clearly expressed in § 89 of the Framework. We therefore agree with the dissenting Board member's opinion expressed in § AV19.

To answer your specific question while we agree that an intangible asset can always be sold with a business, there are examples of intangible assets whose cash flows are inextricably linked with their related business, for example a brand of mineral water that bears the name of the spring has cash flows that are inextricably linked with the cash flows of the bottling operations, which under certain jurisdictions have
to be located next to the spring. Therefore, in such and similar cases, the intangible asset cannot be separated and is embedded in the goodwill of the business.

**QUESTION 17 — DEFERRED BENEFITS THAT BECOME RECOGNISABLE BECAUSE OF THE BUSINESS COMBINATION**

This is logical under the application of the fair value approach.

**QUESTION 18 — DISCLOSURE DIFFERENCES BETWEEN IASB AND US GAAP**

This is not applicable to us.

**QUESTION 19 — STYLE OF THE ED**

Although we agree that bold type and plain type paragraphs have equal authority, we consider that the use of these two types is very useful to the readers especially for identifying the key requirements of the standards.