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Dear Mr Teixeira

Amendments to IFRS 3 – Business Combinations

The Group of 100 (G100) welcomes the opportunity to provide comments on the Exposure Draft. The G100 is a body representing the interests of the CFOs of Australia's major business enterprises.

The G100 supports the retention of the present ownership interest and cost allocation approach to accounting for business combinations. We consider that it is important to give entities the freedom and time to implement the 'stable platform' before frontier approaches to accounting issues are embraced. While the G100 recognises the theoretical attractions and logical consistency of the proposed approach, for example, the recognition of goodwill and the treatment of transactions with minority interests, we do not believe that the changes should be introduced at this time and that extensive debate is necessary before changes of this magnitude are introduced.

The objective of applying the entity concept is theoretically justifiable but in view of the entrenched current practice which emphasises an ownership interest approach we believe that an extensive education and information program should precede the introduction of proposals of this nature. We are concerned about the timing and process adopted in respect of this and related exposure drafts. A further concern is that the proposals represent a significant departure from the Framework without any discussion of the Framework itself including the replacement of a cost allocation basis of accounting with a fair value basis of accounting.

We strongly believe that changing the concepts dealt with in the Framework should be resolved before those changes are reflected in proposed amendments to IFRSs. In this regard the present project dealing with measurement is a more appropriate vehicle to ventilate these issues.

The G100 considers a major defect of the proposals is that they do not deal with entities under common control and combinations by contract alone. In Australia entities with stapled securities comprise a significant part of the listed entities and the appropriate method of accounting is not clear under IFRSs.

The G100 believes that development of standards relevant to these types of entities is more likely to result in improvements in the quality of financial reporting in the current environment than the pursuit of the current proposals. For example, the IASB's previous Exposure Draft Proposed Amendments to IFRS 3 Business Combinations – Combinations by Contract alone or involving mutual entities (June 2004), in respect of combinations by contract alone would have been an appropriate starting point.

Our response focuses on the following questions:

- Q7 *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?*

The G100 strongly disagrees with the exclusion of transaction costs from the measurement of the consideration paid by the acquirer in a business combination.

The proposed approach is inconsistent with the treatment of other transaction costs incurred in origination or acquiring financial instruments under IAS 18 'Revenue' and IAS 39 'Financial Instruments: Recognition & Measurement' and with such costs incurred in the acquisition of property, plant and equipment under IAS 16 'Property, Plant & Equipment'. The proposed approach results in inconsistent treatment for transactions which, in principle, are similar. For example, acquisition of a business is similar to the acquisition of plant and equipment.

- Q8 *Do you believe that these proposed changes to the accounting for assets acquired and liabilities assumed in a business combination are appropriate? If not, which changes do you believe are appropriate, why, and what alternatives do you propose?*

The G100 agrees, in principle, that contingent assets acquired and contingent liabilities assumed should be recognised at their fair values at the acquisition date. However, the reliability of measurement will, in the vast majority of cases, be uncertain and extensive and additional guidance is necessary for the requirements to be operational.

- Q16 *Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognized separately from goodwill? 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 generated are inextricably linked with the cash flows that the business generates as a whole?*

The G100 believes that intangible assets, whether acquired or internally developed, that satisfy the definition of an asset and the recognition criteria for an asset should be recognised.

However, reliability of measurement is a fundamental requirement and in a business acquisition it is imperative that the reliability of measurement criterion be preserved.

The G100 does not believe that an identifiable intangible asset can always be measured with sufficient reliability to be recognised separately from goodwill. For example, we strongly disagree with the recognition of non-contractual customer relationships as intangible assets when such relationships cannot be measured reliably.

For example, the experience of one of our members, the Commonwealth Bank of Australia, which illustrates this point, is outlined in Appendix 1.

A major concern of the G100 in this context is the change from the requirements of IFRS 3 which we consider to be a realistic and practical approach in respect of business combinations which minimises reliance on subjective approaches and the provision of potentially unreliable information.

The G100 does not support replacing this approach with one which mandates that recognition is mandatory and that if an asset can be identified it must be capable of reliable measurement. The G100 strongly disagrees with this as the basis of the proposed approach.

Q19 Do you find stating the principles in bold type helpful? If not, why? Are there are paragraphs you believe should be in bold type, but are in plain type, or vice versa.

The G100 believes that while the bold/plain emphasis in the standard is useful to readers, the fact that they are equally applicable should be emphasised.

Yours sincerely

Tom Honan
National President

c.c. Mr David Boymal, AASB

APPENDIX 1

"The application of the proposed revisions to IFRS 3 would be likely to result in a material increase in the amount of identifiable intangible assets recognised in respect of the Commonwealth Bank of Australia acquisition of Colonial Limited (with a corresponding reduction in goodwill) were it to occur under these proposals.

The identifiable intangible assets would be expected to include the value of contractual and non-contractual customer relationships and there would be significant uncertainty around the measurement of these assets, which would give rise to the recognition of such customer relationships that cannot be reliably measured.

It is conceivable that longer term loan and debt contracts could be valued based on profit projections and discounted cash flow methodology. However, the value of non contractual customer relationships is likely to be uncertain and subject to significant variables, for example, customer loyalty, economic factors, pricing decisions, competition etc. In this context whether such customer relationships can be reliably measured is a major concern. On this basis the G100 believes it more appropriate to err on the side of conservatism and not recognise such 'intangible' assets separately from goodwill because their value cannot be determined reliably.

Further, the useful life of such non-contractual customer relationships is considered to be indeterminant. Unless one can readily assess a useful life, then it is not appropriate that a company is required to decree an amortisation period for such an asset.

In view of the uncertainties involved in identifying, calculating and amortising such non-contractual customer relationship 'intangible' assets, the G100 believes that they should be recognised as part of the goodwill on acquisition.

In the acquisition of Colonial, the Bank recognised \$2,548 million in intangible assets, being excess of net market value over net assets of life insurance controlled entities, and \$5,662 million in goodwill.

In essence the excess of net market value over net assets of life insurance controlled entities represents the value of in-force and future new life insurance and funds management business over and above the net assets of that business. This, in part, is the value of contractual and non-contractual customer relationships in the life insurance and funds management business acquired.

The State Bank of New South Wales was acquired as part of the Colonial acquisition. This bank included many contractual and non-contractual customer relationships. Housing and business loans are contractual arrangements which have a profit stream which is capable of valuation.

At the end of the contractual relationships with the customer at the repayment of these loans (maybe after 2 or 3 years), there is generally a much longer non-contractual relationship which could run for another 20 years, for example, a renegotiated loan, a new loan, a credit card, an investment in a managed fund.

Appendix (Contd)

The question that arises: is this more in the nature of goodwill than a non-contractual relationship that should be identified and valued as an intangible asset? The guidance provided by IFRS 3 is not clear.

Additionally, there are non-contractual relationships with the depositor base which is said to have an intangible value. This core deposit base was assessed to have a value of \$149 million for US GAAP purposes.

The other material intangible asset that could be recognised is the brand name value of Colonial First State (Australia's largest funds management business).

The anomaly that arises in recognising most identifiable intangible assets is a requirement to amortise them over an arbitrarily determined useful life, while the residual goodwill recognised is not amortised, while at the same time the fair value of the total business acquired is more likely to be increasing in value.

The valuation of additional identifiable intangible assets will present a major implementation issue in a banking environment. Given the potential size of the intangible assets to be identified (contractual, non-contractual, core deposits, brand names), it is likely the Bank would engage independent valuation resources.

It is not clear from the guidance provided, as to which intangible assets should be valued in the banking environment. Are the future earnings streams to be valued for each of the customer/product groups? Contractually most business loans would be re-negotiated every 2 – 3 years, but many of these customers would be expected to remain customers of the Bank for several years into the future. It is unlikely in this instance that the value of a contractual rate loan for an average 3 year term will vary significantly from its face value, but the non-contractual relationship, that is the future value of the customer to the Bank will be reasonably significant. It appears that this non-contractual relationship with the customer base if considered as a whole is akin to 'goodwill' and in the normal course events would be expected to grow in value."