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CL 76

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By email to: CommentLetters@iasb.org.uk

Re: ED3 Business Combinations

We appreciate the opportunity to comment on the International Accounting Standards Board's (Board) *ED3 Business Combinations* (the "Exposure Draft"). Goldman Sachs is a leading global investment banking, securities, and investment management firm that provides a wide range of financial services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments, and high-net-worth individuals.

We understand the Board is partnering with the Financial Accounting Standards Board (FASB) on the Boards' business combinations projects to coordinate the eventual issuance of exposure drafts and final standards on business combinations. We applaud the Boards' efforts to work together toward global convergence of accounting standards broadly, and business combinations in particular. However, to achieve true convergence of accounting standards, we believe the Board and the FASB should set the goal of jointly issuing single standards bearing both their imprimaturs. Such an approach will increase transparency in financial reporting to the benefit global issuers, auditors, and users because there will no question about differences in international and US generally accepted accounting principles. If this approach is not currently practicable for Board and FASB governance or other reasons, we suggest the final standards of both Boards contain either a statement in the Introduction indicating the standards are substantively identical or an appendix setting forth the differences.

Question 1 ¾ Scope

We agree with the Board's decision to exclude from the scope of phase 1 of the business combinations project (the Project) consideration of business combinations in which separate entities or operations of entities are brought together to form a joint venture and business combinations involving entities under common control. The formation of joint ventures presents complex issues different from those encountered in business combinations between unrelated parties. We agree the accounting for the formation of joint ventures is best addressed in a separate project devoted solely to these issues. However, we urge the Board to move expeditiously to address the accounting for the formation of joint ventures. The difficult issues that arise in this area have long vexed accounting standard setters. And with the increasing use of the joint venture form of organization resulting from globalization, the increasing complexity of business transactions, and the increased intellectual, capital, and risk demands of complex product development, we expect the joint venture form of organization to continue to be widely used. We suggest the Board assign a relatively low priority to business combinations involving entities under common control. We are not aware of significant practice problems in this area.

Another important issue, and one not proposed to be addressed in phase II of the Project, is the application of "push-down" accounting in the separate financial statements of acquired entities. This topic has been the subject of a number of Emerging Issues Task Force (EITF) consensus and U.S. Securities and Exchange Commission positions spanning many years. We believe the Board should devote resources to addressing the issues of push-down accounting prior to addressing business combinations involving entities under common control.

We agree with the definition and additional guidance for identifying business combinations involving entities (or operations of entities) under common control. Making that determination is not amendable to "bright-line" rules and we believe the judgment-based approach contained in the Exposure Draft is appropriate.

Question 2 ¾ Method of accounting for business combinations

We agree with the Board's conclusion to eliminate the pooling-of-interests method of accounting and require all business combinations to be accounted for by the purchase method. The Board correctly points out that it is only in rare circumstances a business combination is effected by a true "uniting of interests," and in those circumstances, carrying forward the pre-combination book values arguably is less representationally faithful than recognizing the fair values of the assets and liabilities of the combining entities. In the interest of global convergence of accounting principles and increased transparency of financial reporting, we believe the benefits of requiring only the purchase method of accounting for all business combinations outweighs the cost of requiring the purchase or pooling-of-interests methods, depending on the facts and circumstances, particularly when the pooling-of-interests method is expected to be applicable only in rare circumstances.

Question 3 ¾ Reverse acquisitions

We agree with the Board's decision to provide a judgmental approach to identifying the acquiring entity in a business combination. Basing the determination of the acquiring entity on the post-combination relationship between the combining entities to determine which of them has the power to govern the financial and operating policies of the other, rather than a simple quantitative measure of the relative ownership interests of the owners of the combining entities, will best reflect the economic substance of the combination.

Question 4 ¾ Identifying the acquirer when a new entity is formed to effect a business combination

We agree with the Board's conclusion that when a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination should be determined to be the acquiring entity on the basis of the evidence available.

Question 5 ¾ Provisions for terminating or reducing the activities of the acquiree

We agree with the Board that a provision for terminating or reducing the activities of an acquiree should be recognized as part of allocating the cost of a business combination only when the acquiree has, at the acquisition date, an existing liability for a restructuring initiative. We observe that the cost of an acquired entity is allocated to *its* assets and liabilities. Prior to obtaining control of an entity, the acquirer cannot impose its plans for terminating or reducing the activities of the acquiree, thereby creating a liability. Therefore, it should not be appropriate for an acquirer to allocate a portion of the purchase price to the costs of terminating or reducing the activities of the acquiree.

Question 6 ¾ Contingent liabilities

We agree with the Board that an acquirer should recognize the acquiree's contingent liabilities at the acquisition date as part of allocating the cost of a business combination provided their fair values can be measured reliably. However, we believe specifying the accounting for such liabilities subsequent to their initial recognition is beyond the scope of the business combinations project and should be considered in the broader context of a reconsideration of accounting for contingent liabilities in general.

Question 7 ¾ Measuring the identifiable assets acquired and liabilities and contingent liabilities assumed

We agree with the Board that the identifiable assets and liabilities (and minority interest) of an acquiree should be recognized at their fair values. We believe such an approach is consistent with the purpose of consolidated financial statements, which is to present the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions. A mixed measurement approach to the preparation of consolidated financial statements, showing part new basis and part predecessor cost does not properly reflect the assets the entity controls and management has stewardship over, inhibits users' ability to assess the cash-generating abilities of the net assets acquired, and does not best achieve the objective of consolidated financial statements.

Question 8 ¾ Goodwill

It is generally accepted that goodwill acquired in a business combination is an asset that should be recognized. Furthermore, we believe goodwill generally is not a wasting asset. In our view, companies tend to recreate and renew goodwill as part of maintaining and building their businesses. However, the costs of such regeneration generally are expensed as incurred. Amortizing goodwill ignores a company's ability to sustain and, in most cases, increase the value of the enterprise. We agree with the Board that goodwill should not be amortized under any circumstances; instead, goodwill should be reduced in value when it is impaired. We believe this approach will enhance the credibility and utility of financial reporting for business combinations.

Question 9¾ Excess over the cost of a business combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities

We agree with the Board that when there is an excess over the cost of a business combination of the acquirer's interest in the fair value of the acquiree's identifiable net assets, the full amount of the excess should be recognized in income immediately after reassessing the accuracy of the initial allocation of the purchase price, together with disclosure of the amount and a description of the nature of any such excess. We believe the realization of such gains will be rare and will result from unusual circumstances. Recognition of such gains should only be permitted when the fair values for all the significant identifiable assets acquired and liabilities assumed are readily observable.

Question 10¾ Completing the initial accounting for a business combination and subsequent adjustments to that accounting

We agree with the Board that twelve months from the acquisition date is sufficient time for completing the accounting for a business combination. We also agree that except for adjustments related to contingent consideration, adjustments after that period should be recognized only to correct an error.

Other comments

Paragraphs 4 and BC 32 of the Exposure Draft, which discuss identifying a transaction that is business combination, appear to conflict. Paragraph 4 states that a "transaction [business combination] may be between the shareholders of the combining entities . . .." Paragraph BC 32 states that the "Board also considered the assertion that the pooling of interest method properly portrays true mergers as a transaction between the owners of the combining entities rather than between the combining entities. The Board rejected this assertion, noting that business combinations are initiated by, and take place as a result of, a transaction between the entities themselves. It is the entities, and not their owners, that engage in the negotiations necessary to carry out the combination." We disagree with the statement in paragraph 4 and support the Board's conclusion in paragraph BC 32. We suggest the Board reconcile these two views in favor of the latter.

Paragraph 4 of the Exposure Draft states that a business combination "may involve . . . the restructuring of one or more of the combining entities." We do not understand what this phrase is intended to address and suggest the Board clarify its meaning either in the final statement itself or in the basis for conclusions.

Paragraph 26 of the Exposure Draft requires use of the published price at the date of exchange of a quoted equity instrument to determine its fair value unless the published price is an unreliable indicator of fair value. The published price is considered to be an unreliable indicator of fair value only when it is affected by the thinness of the market. Other factors also can affect the fair value of quoted equity instruments issued in business combinations such as restrictions on the transferability of the instruments, the effect of a large block of shares being placed in the market, regional timing differences in published prices, or stale prices. We suggest the Board include these factors among those that may be considered when determining if the published price at the date of exchange is an unreliable indicator of fair value. We also suggest the Board remove the discussion of how to estimate the fair value of an equity instrument when the published price is an unreliable indicator or when a published price does not exist (e.g., by reference to the proportional interest in the fair value of the acquirer or the acquiree obtained). Instead, the Board should include only the cross reference to the more comprehensive guidance for estimating the fair value of financial instruments contained in IAS 39, *Financial Instruments: Recognition and Measurement*.

We also disagree with the requirement in paragraph 26 to use the price of equity securities *at the date of exchange* as the basis for measuring the cost of a business combination. We believe the appropriate basis is the market price of the securities over a short period before and after the terms of the acquisition are agreed to and announced. The parties involved in the transaction determine the terms of a transaction based on the market price of the securities to be issued at that point in time. We believe this contemporaneous price best reflects the fair value of the assets acquired and the intended value to be given to consummate the transaction. That is, the date the terms of a business combination are agreed to and announced best reflects the economic substance of a transaction and subsequent changes in the market price of the stock should not be reflected in determining the cost of an acquired company.

Paragraph 64 of the Exposure Draft requires the subsequent realization of an unrecognized acquired deferred tax asset to be recognized in income with an offsetting reduction in goodwill recognized as expense. The Board acknowledges in paragraph BC 132 this accounting is an exception to the principle agreed by the Board that the initial accounting for a business combination should be adjusted after that accounting is complete only to correct an error. We understand the Board intends to reconsider this exception as part of the second phase of the Project. We support income recognition for the subsequent realization of an unrecognized acquired deferred tax asset of an acquired entity. However, we see no conceptual basis for recognizing an offsetting reduction in the carrying amount of goodwill as an expense or for such an inconsistency with the basic principles concerning initial accounting determined on a provisional basis contained in paragraph 60. We suggest the Board eliminate the requirement in paragraphs 64(a) and (b) to recognize the reduction in the carrying amount of goodwill as an expense in this phase of the Project rather than defer this issue to the second phase of the Project. We believe goodwill should be written down only when it is impaired, as determined in accordance with draft IAS 36, *Impairment of Assets.*

In certain circumstances an acquirer may use its unrecognized tax losses to offset future taxable profits of the acquired entity. In such cases IAS 12, *Income Taxes*, requires the acquirer to recognize a deferred tax asset and to reduce the goodwill arising from the acquisition when realization becomes probable. Paragraph B15(i) of the Exposure Draft requires acquired tax assets to be valued based on the amount of the tax benefit arising from tax losses assessed from the perspective of the combined entity. We believe this accounting is inconsistent with the logic of paragraphs 35 and 40 of the Exposure Draft that address allocating the cost of a business combination to the assets acquired. Just as costs expected to be incurred by an acquiring entity under a plan to exit an activity of an acquired entity (which may include involuntarily terminating or relocating employees) generally are not assumed liabilities (as discussed in paragraphs BC 55 through BC 66), realization of an acquirer's unrecognized tax losses are not acquired assets. Rather, realization of an acquirer's unrecognized tax losses is an event attributable to synergies realized *as a result of and subsequent to* the business combination.

Accordingly, we believe the realization of such deferred tax assets should be recorded in income when realization becomes probable.

Paragraph B15 specifies how an acquirer should determine fair value for a variety of assets and liabilities commonly acquired or assumed in a business combination, including a number of financial instruments (e.g., marketable securities, non-marketable securities, receivables, payables, short- and long-term debt). We suggest the Board remove the guidance contained in the Exposure Draft related to determining the fair values of financial instruments and, instead, provide a cross reference to the more comprehensive guidance for estimating the fair value of financial instruments contained in IAS 39.

The Exposure Draft refers throughout to business combinations involving entities or *operations of entities*. However, the Exposure Draft does not define when an operation of an entity constitutes a business. Determining when a collection of assets or *operations of an entity* constitutes a business can be difficult. If fact, the EITF of the FASB found it necessary to define what constitutes a business in EITF Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business.* We suggest the Board expand this reference to "operations of entities that constitute a business" and clarify when operations of entities constitute a business.

We suggest the description of a reverse acquisition in paragraph 21 of the Exposure Draft be moved to the defined terms in Appendix A.

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Thank you for the opportunity to provide you with our feedback. If you have any questions regarding our comments, please do not hesitate to contact me at 212-357-8437, Stephen Davies, Managing Director and European Controller in London at (20) 7774-3804, or Tom Jones, Vice President, Accounting Policy in New York at 212-357-2236.

Sincerely,

/s/Matthew L. Schroeder

Matthew L. Schroeder
Managing Director
Director of Accounting Policy