Group Accounting/Controller

bhpbilliton

BHP Billiton Limited
BHP Billiton Centre 180 Lonsdale Street
Melbourne Victoria 3000 Australia
GPO Box 86A
Melbourne Victoria 3001 Australia
Tel +61 1300 55 47 57 Fax +61 3 9609 3015
bhpbilliton.com

16 August 2004

Annette Kimmit
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

David Boymal
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West, VIC, 8007

Dear Annette and David

IASB Exposure Draft of Proposed Amendments to IFRS 3
AASB ED 133 Request for Comment on IASB ED to IFRS 3
Business Combinations – Combinations by Contract Alone or Involving Mutual Entities

The IASB has issued an Exposure Draft proposing amendments to IFRS 3 Business Combinations, and the AASB has issued ED 133 requesting comment on the IASB's Exposure Draft. BHP Billiton has chosen to respond concurrently to both ED's in this comment letter.

We reconfirm that our preferred approach to the format of the converged Australian standards is for them to adopt IFRS standard wording exactly (that is, no amendments of any kind to the original text) with separate Australian-specific material at the beginning of the standard or contained in an Appendix. For this reason, our comments on the IASB and AASB ED's have been submitted together.

Before responding to the specific questions raised in the AASB's ED 133 and the IASB's Exposure Draft, we would like to make some specific comments on the consequential accounting for dual listed company arrangements.

Consolidation by the acquirer

Adding DLC combinations to the scope of AASB 3 and IFRS 3 requires that one of the entities be identified as the acquirer, with the other entity identified as the acquired. By definition (IFRS 3.17), the acquirer is deemed to be the entity obtaining control over the acquired entity. Therefore, the acquirer becomes the parent in the DLC and the acquired a subsidiary (IAS 27.4). Through application of these definitions, IAS 27 and AASB 127 cause the parent entity to consolidate the subsidiary, and execute the purchase method of accounting for the business combination in its consolidated financial statements.

While the above accounting enables the deemed acquirer to present the effect of the DLC business combination in its consolidated financial statements, it would appear to preclude the acquired entity from reflecting the impact of the DLC in its own financial statements. Where a DLC is executed between shareholders of two entities, and as a consequence the economic interests of both shareholder groups become common in the combined economic entity, the financial statements of the acquired entity would be irrelevant and misleading unless it can present the financial position of the entire DLC.

Our reading of IAS 27 / AASB 127 and IFRS 3 / AASB 3 (as proposed to be amended) indicates that the acquired entity would not be able to consolidate the acquiring entity in its own financial statements, and would have no basis on which to measure any such consolidation. In our view, the simple solution to this problem would be to require the acquired entity to present the financial statements of the acquiring entity as its own financial statements. Accordingly, we believe IAS 27 / AASB 127 should be amended to deal specifically with the reporting of consolidated financial statements by entities that are combined in a dual listed company structure.

Differential adjustments on transition not accommodated

While DLC structures are not common, where they do exist they typically involve parent entities resident in different countries. BHP Billiton for example is a dual listed company structure comprising BHP Billiton Limited, an Australian entity, and BHP Billiton Plc, a UK entity. Where the DLC parent entities reside in different countries, their current application of national accounting standards may mean that certain assets, liabilities and equity components are recognised or measured on a different basis. Transition to IFRS (or a national equivalent such as Australian AASB's) promises the opportunity for the two parent entities to align their accounting policies and their financial statements.

The transitional procedures of IFRS 1 / AASB 1 generally provide an effective method of transition, as assets and liabilities are adjusted to the amounts that would have been determined had IFRS always been applied. However, the exceptions to this approach for business combinations, while providing pragmatic relief from an otherwise onerous task of remeasuring some or all past business combinations, does not adequately cater for dual listed company structures. As a specific example, goodwill reported under UK GAAP would be reversed on transition to IFRS against retained earnings, whereas the same amount of negative goodwill under Australian GAAP would be restated prior to transition, for example, by allocation against non-monetary assets. Accordingly, on transition to IFRS, a DLC previously reporting under UK and Australian GAAP would not be able to commence with the same IFRS balance sheet. We believe that where assets, liabilities and equity components would be recognised or measured on a different basis within a DLC structure, as above, the acquiring entity be given the option as to which of the two accounting treatments it would adopt for reporting transition to IFRS in both jurisdictions. Resolution of this problem is also possible if the deemed acquired entity in a DLC was permitted the option of adopting either the acquiring or acquired entity's accounting treatment, for example with negative goodwill, on transition to IFRS.

Pre-existing ownership interests

The exposure draft proposes to include business combinations in which separate entities or businesses are brought together to form a reporting entity by contract alone, and to apply a method of measuring the cost of the combination that is different to other forms of business combinations. As a different basis of measurement applies, it is important that the proposed revised IFRS 3 / AASB 3 is clear as to the type of transactions that would qualify for this treatment. There is no effective commentary to explain what is meant by the words "brought together.....by contract alone". In particular, the intended accounting treatment to be applied when ownership interests were acquired between the entities prior to them being brought together (e.g. minority interests previously acquired)

Ownership interests necessary to implement contractual terms

Further, it is not clear from the proposed revision what the intended accounting treatment is to be applied when the contractual arrangements require one or more of the combining entities to issue instruments to shareholders that are required by law to ensure that contractual rights are enforceable or capable of execution in a tax effective manner

Logic of expensing costs of executing the DLC

We note that the IASB proposes to insert 31B into IFRS 3 (ED 133 issued by the AASB does not acknowledge this addition). This paragraph notes that the cost of a business combination measured in accordance with 31A will exclude any costs directly attributable to the combination, such as professional fees paid to accountants and lawyers – accordingly, such costs will be recognised directly in profit and loss. While this is a consequence of the definition of business combination costs set out in 31A, there is no rationale as to why such costs are excluded. On the premise that the measurement of business combinations in accordance with 31A appears to treat them as a contribution of equity (refer our comments in response to specific questions raised by the IASB), it would appear logical that the costs of obtaining that equity contribution should be recognised as a reduction in the equity raised, consistent with the requirements of IAS32.

Response to specific questions

IASB questions

1. Is this (the proposal to include business combinations involving two or more mutual entities and business combinations in which separate entities are brought together to form a reporting entity by contract alone) an appropriate interim solution to the accounting for such transactions until the Board develops guidance on applying the purchase method to such transactions as part of a subsequent phase of its Business Combinations project?

We believe it is important that the IASB develop specific guidance for the accounting for such transactions and that the proposals contained in the exposure draft are appropriate as an interim solution. We note however that the IASB provides no commentary explaining the basis of measurement proposed. We interpret the IASB's proposal as suggesting that a business combination involving mutual entities or combinations by contract alone are akin to a contribution of equity, but with measurement of the equity contribution limited to the fair value of the identifiable net assets of the acquired entity.

2. The exposure draft proposes no amendment to the transitional and effective date requirements of IFRS 3. Is this appropriate? If not, what transitional and effective date arrangements would you recommend for such business combinations, and why?

The consequence of this is that a business combination involving mutual entities or combinations by contract alone, entered into on or after 31 March 2004, must apply the proposed revised requirements, subject to the transitional rules contained in IFRS 1 in the first year of application of IFRS. If the IFRS provided a later transition date for these proposed amendments, it would result in other methods of accounting (such as those contained in IAS 22) to continue to apply. We would see this outcome as problematic and agree that a consistent transitional and effective date applies to IFRS 3 both before and after the proposed amendments.

AASB questions

1. Whether it is appropriate to request the IASB to amend the effective date of the revised IFRS 3 to 1 January 2006, and assuming the IASB does not make such an amendment to the effective date, whether the AASB should mandate the application date of the revised AASB 3 for reporting periods beginning on or after 1 January 2005?

For the reason stated above, we do not believe the IASB should be requested to defer the commencement date of the amended IFRS 3. With respect to AASB 3, we believe the application date of the proposed amendments should be the same as that applicable to the existing AASB 3, that is, reporting periods beginning on or after 1 January 2005.

2. Any regulatory of other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to not-for-profit entities and public sector entities?

With respect to not-for-profit entities and public sector entities, we are not aware of any specific regulatory issues, however we note that we have not seen any specific analysis of the types of business combination transactions typically undertaken in the not-for-profit and public sectors and the impact the proposed amendments may have in those sectors.

With respect to DLC's currently reporting under Australian GAAP, we note that their ability to present a consolidated financial report is achieved only by application of specific ASIC relief, which recognises the combination of the two Groups comprising the DLC as a valid basis of consolidation. It is not clear whether that basis of combination remains available to DLC's that choose to exercise the transitional relief of IFRS1/AASB1 and therefore not reopen their accounting for past business combinations. We recommend that the AASB consult with both ASIC and the IASB in clarifying this matter.

3. Whether the proposals are in the best interests of the Australian economy?

We note that dual listed company structures, mutual entities and stapled security arrangements, while not exclusive to the Australian business environment, are not uncommon amongst Australian entities. We believe the proposed amendments are an important step in the completion of the accounting framework and are in the best interests of the Australian economy.

Yours sincerely,

Nigel Chadwick
Vice President Group Accounting / Controller