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**Exposure draft of proposed amendments to IFRS 3 Business Combinations  
Exposure draft of proposed amendments to IAS 27 Consolidated and Separate Financial  
Instruments**

Dear Mr Texeira,

The IASB has issued for consultation *Exposure Drafts of Proposed Amendments to IFRS 3 Business Combinations* and *IAS 27 Consolidated and Separate Financial Statements*. We welcome the opportunity to comment on the drafts.

**General comments**

The exposure draft of amendments to IFRS 3 is the first joint draft to be published by the IASB and FASB and thus lays the groundwork for convergence between the IFRS and US GAAP rules on accounting for business combinations. The convergence of IFRS and US GAAP is highly important for the international capital markets. Uniform rules on the accounting treatment of business combinations will significantly improve the comparability of financial statements and make it easier for international undertakings to prepare their group accounts. We therefore strongly support the convergence project.

Though we welcome efforts to create the greatest possible convergence, we would point out that convergence should not be a one-way street leading to a relatively uncritical blanket adoption of US GAAP rules. It should always be the rule which makes most economic sense that is included in a globally accepted set of standards.

The exposure draft IFRS 3 proposes that the cost of an acquisition should no longer be allocated to the individual assets acquired and liabilities assumed. Instead, the fair value of the acquired entity

should be used as the basis of accounting for a business combination. This is an example of the IASB's growing leaning towards fair value as a measurement basis. The IASB argues that increased use of fair values will enhance the relevance and reliability of financial statements. This view has not yet been substantiated by any concrete impact assessment, however. Yet the recently revised Constitution explicitly provides for field tests to be carried out in such cases (para. 31(f)). A critical look also needs to be taken at whether such a fundamental decision on introducing a valuation concept of this kind should not be taken as part of a debate on basic principles – in the context of amending the Framework, for example. A prerequisite for a principle-based set of standards like IFRSs is that the principles which must be respected when developing and applying individual standards are decided upon in advance. And any decision concerning basic accounting and valuation principles must be preceded by extensive consultations.

The implied potential of the fair value concept to improve the quality of financial statements is particularly called into doubt when it comes to the full goodwill method. If less than 100% of a company is acquired, we foresee considerable problems calculating the goodwill allocated to the minority shareholders. This is due to the special nature of goodwill. Unlike other assets, this is a residual amount that cannot be measured directly. The prescribed valuation techniques are largely based on subjective assessments. The alleged information gain will be at the expense of a further loss in the reliability of financial statements.

It is regrettable that the IASB did not publish a discussion paper when embarking on this project. A discussion paper would have given market participants the opportunity to analyse in depth the proposed conceptual changes at an early stage. A consultation period of 120 days is too short for a thorough analysis of such complex exposure drafts. What is more, we consider the lack of a discussion paper to be a violation of the Constitution, which was revised only in July 2005. This envisages that a discussion paper should be published whenever a major project is involved; any decision to refrain from doing so must be justified by the Board (para. 31(b) and (g) of the Constitution).

The exposure drafts are the outcome of the second phase of the business combinations project. Though some basic rules from the first phase of the project have been retained, important changes have been made to the version of IFRS 3 which was published only one-and-a-half years ago, in March 2004. Moreover, the IASB has indicated that these drafts by no means represent the final rules and that further changes are planned (cf. ED IFRS 3 BC 32, BC 42). This gives the impression that accounting for business combinations is an area which is likely to be in a never-ending state of flux. When changes are made to standards in quick succession, companies have to

invest heavily to keep up with the new rules without any discernable added value for users necessarily resulting. Furthermore, the acceptance of the standards is undermined. We would therefore welcome the adoption of a comprehensive and stable set of rules on accounting for business combinations that will not be subject to incessant changes.

Our comments on specific aspects of the exposure drafts are as follows:

### **Proposed amendments to IFRS 3 Business Combinations**

#### **Costs incurred in connection with a business combination (ED IFRS 3.27 and BC 84-89)**

The costs incurred in connection with a business combination (acquisition-related costs) include legal, valuation, advisory, accounting, auditors' and finders' fees. Under the existing version of IFRS, directly attributable acquisition-related costs are included and recognised in the acquisition cost allocated to acquired assets and liabilities assumed. Costs indirectly associated with the acquisition are booked as an expense. The draft, on the other hand, envisages that all, including direct, acquisition-related costs should immediately be booked as expenses.

We do not agree with this proposal. Given the basic assumption of a balance between the consideration transferred and the acquirer's interest in the acquiree, it is perfectly true that it would appear reasonable not to recognise costs incurred in connection with a business combination. If a balance is to be ensured between acquisition costs and the (proportionate) value of the acquired entity, the directly attributable related costs should not be included in the cost of the acquisition. Nevertheless, the proposed change would result in discrepancies in the treatment of acquisition-related costs between business combinations and other types of purchase. When plant, property and equipment (IAS 16.16), intangible assets (IAS 38.27) and financial instruments (IAS 39.43) are acquired, directly attributable related costs are included in the cost of acquisition. It would make little sense, in our view, to treat acquisition-related costs in connection with a business combination any differently. We therefore advocate retaining the existing procedure, which is consistent with other IAS/IFRS and will ensure that the set of standards form a coherent whole.

#### **Business combinations achieved in stages (ED IFRS 3.55-57 and BC 151-153)**

If a business combination is achieved in stages, control of the acquired entity is obtained in several steps. Under the existing standard, the acquirer treats each transaction separately (IFRS 3.58). At each individual step, the goodwill is determined by comparing the transaction cost with the acquired interest in the fair values of the assets acquired and liabilities assumed. The exposure

draft, on the other hand, proposes that when the transaction giving the acquirer control of the acquired entity is executed, the interests acquired in previous transactions should be remeasured at their current fair value and included in the acquisition cost.

The goodwill which is then recognised is consequently no longer determined on the basis of the amounts paid over the individual stages, but solely on the basis of the amount paid in the transaction giving the acquirer control over the acquired entity. If the acquisition price paid in this final stage is above that paid in the previous stages, this will result in a correspondingly high valuation of the goodwill and in income being reported in the P&L that is the result of remeasuring interests already held. The profit shown is thus based on an “appreciation” of the goodwill of the acquired entity. This can have a significant impact on a company’s results.

Very often, however, even a step acquisition is actually only a single transaction from an economic point of view. If the acquirer’s intention from the outset is to obtain a majority interest and this is achieved only in stages due to prevailing circumstances, this is not a step acquisition. A true step acquisition will exist only in very rare cases – if, for example, a company holds an interest for many years before increasing it to a majority holding. Only in such exceptional circumstances would the rule envisaged in the exposure draft make economic sense. In consequence, the proposed rule should be applied only in narrowly defined situations and should be restricted to exceptional circumstances in which a step acquisition can be deemed to exist from an economic point of view (e.g. it can be demonstrated that the acquisition of a controlling interest was not originally intended). In all other cases – and in line with the economic background to the transaction – the draft’s general rules for acquired interests should apply, including those for bargain purchases, which do not require existing holdings to be remeasured and recognised in profit or loss, but use the actual purchase price as the basis for initial consolidation.

Should you require any further information, please do not hesitate to contact us.

Yours sincerely,



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