International Accounting Standards Board

Alan Teixeira – Senior Projekt Manager
Henry Rees – Projekt Manager

30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Mr. Teixeira,
Dear Mr. Rees,

Amendments to IFRS 3 „Business Combinations“, IAS 37 “Non-financial Liabilities” and IAS 27 “consolidated and separate Financial Statements”

We are pleased to have the opportunity to comment on the International Accounting Standards Board’s proposed amendments to IFRS 3, IAS 27 and IAS 37. The Exposure Drafts envisage significant and far-reaching amendments to prior regulations in certain sections. These concern, for example, fundamental questions of definition in connection with the framework project.

From the Board’s point of view, these amendments constitute the logical continuation of fair-value measurement and of the consistent implementation of the one-entity theory in the consolidated financial statement. However, the approach taken means that individual standards will be amended before fundamental questions have been discussed. It would therefore be appropriate to first discuss these extensive conceptual changes on the basis of a discussion paper, without reference to specific standards.

Of particular importance in this connection is the question of recognition and measurement of assets and liabilities. The decision regarding the level at which occurrence probability is to be considered is a fundamental issue. From the Board’s point of view, the procedure selected in the Exposure Drafts is consistent with the framework. However, the dissenting views expressed by one Board member and by EFRAG show that this is by no means conclusive.

We would therefore welcome it if approval of the Exposure Drafts could be put back until these conceptual questions have been clarified.
IFRS 3 “Business Combinations”

General remarks

The Exposure Draft contains a number of changes which may still need to be amended at short notice.

For example, one problem appears to be the idea of stipulating a guideline for the fair-value hierarchy at this present time when it is already clear that the definition could still be amended on the basis of the final FASB statement on fair-value measurement. It would therefore be appropriate to wait for final approval of this statement in order to avoid the risk that companies have to undertake costly adjustments which might prove to be obsolete after a short while.

Similarly, a final position should be found regarding the method to be used in the future and above all in the long term for defining special forms of business combinations. It does not appear appropriate at this stage to extend use of the acquisition method while at the same time realising that the possible use of the fresh start method for specific business combinations still needs to be discussed. This might also lead to lengthy and costly adjustments at companies which would again have to be conducted at short notice.

Question 1—Objective, definition and scope

The proposed objective of the Exposure Draft is:

... that all business combinations be accounted for by applying the acquisition method. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). In accordance with the acquisition method, the acquirer measures and recognises the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date. [paragraph 1]

The objective provides the basic elements of the acquisition method of accounting for a business combination (formerly called the purchase method) by describing:

(a) what is to be measured and recognised. An acquiring entity would measure and recognise the acquired business at its fair value, regardless of the percentage of the equity interests of the acquiree it holds at the acquisition date. That objective also provides the foundation for determining whether specific assets acquired or liabilities assumed are part of an acquiree and would be accounted for as part of the business combination.

(b) when to measure and recognise the acquiree. Recognition and measurement of a business combination would be as of the acquisition date, which is the date the acquirer obtains control of the acquiree.

(c) the measurement attribute as fair value, rather than as cost accumulation and allocation. The acquiree and the assets acquired and liabilities assumed would be measured at fair value as of the acquisition date, with limited exceptions. Consequently, the consideration
transferred in exchange for the acquiree, including contingent consideration, would also be measured at fair value as of the acquisition date.

The objective and definition of a business combination would apply to all business combinations in the scope of the proposed IFRS, including business combinations:

(a) involving only mutual entities
(b) achieved by contract alone
(c) achieved in stages (commonly called step acquisitions)
(d) in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date.

(See paragraphs 52-58 and paragraphs BC42-BC46 of the Basis for Conclusions.)

**Question:** Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

**Answer:** The definition of a business combination is not clear, for example, on whether IFRS 3 will also apply to true mergers in the future, and if it does not apply, how such mergers should be treated. We therefore request clarification of the types of business combinations that now fall within the Standard’s scope of application compared with the previous definition.

**Question 2—Definition of a business**

The Exposure Draft proposes to define a business as follows:

A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:

1. a return to investors, or
2. dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants. [paragraph 3(d)]

Paragraphs A2-A7 of Appendix A provide additional guidance for applying this definition. The proposed IFRS would amend the definition of a business in IFRS 3. (See paragraphs BC34-BC41.)

**Question:** Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

**Answer:**
Questions 3-7—Measuring the fair value of the acquiree

The Exposure Draft proposes that in a business combination that is an exchange of equal values, the acquirer should measure and recognise 100 per cent of the fair value of the acquiree as of the acquisition date. This applies even in business combinations in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at that date. In those business combinations, the acquirer would measure and recognise the non-controlling interest as the sum of the non-controlling interest’s proportional interest in the acquisition-date values of the identifiable assets acquired and liabilities assumed plus the goodwill attributable to the non-controlling interest. (See paragraphs 19, 58 and BC52-BC54.)

Question: In a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

Answer: Implementation of the full goodwill approach is consistent with the one-entity theory. However, there are considerable problems involved in the practical application of this method if less than 100% of the shares are acquired. The Board itself ascertains that the costs of a company acquisition with the existence of minority interests, for example due to paid controlling premiums, cannot be added to the overall value of a company. The examples listed of how one arrives at this value only cover certain cases. However, it is to be expected that the calculation in practice will not be quite as straightforward in all cases.

Even if the overall company value can be calculated, we also doubt that the distribution of goodwill between majority and minority shareholders is possible fairly and without inconsistencies if the first value has to be determined on the basis of assumptions.

In general, we question whether the goodwill can be entirely equated with other assets or whether this is not more of an asset with special character, even if the IFRS essentially do not recognise such “partial items” – unlike the German Commercial Code.

Against this background, we believe the objective of greater transparency cannot be achieved with the full goodwill approach. It actually opens up significant scope for discretionary latitude.

The Exposure Draft proposes that a business combination is usually an arm’s length transaction in which knowledgeable, unrelated willing parties are presumed to exchange equal values. In such transactions, the fair value of the consideration transferred by the acquirer on the acquisition date is the best evidence of the fair value of the acquirer’s interest in the acquiree, in the absence of evidence to the contrary. Accordingly, in most business combinations, the fair value of the consideration transferred by the acquirer would
be used as the basis for measuring the acquisition-date fair value of the acquirer’s interest in the acquiree. However, in some business combinations, either no consideration is transferred on the acquisition date or the evidence indicates that the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer’s interest in the acquiree. In those business combinations, the acquirer would measure the acquisition-date fair value of its interest in the acquiree and the acquisition-date fair value of the acquiree using other valuation techniques. (See paragraphs 19, 20 and A8-A26, Appendix E and paragraphs BC52-BC89.)

**Question:** Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

**Answer:** In item 3(i) and the accompanying footnote of the Exposure Draft it says:

“For the purposes of this [draft] IFRS, fair value is the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties.” (IFRS 3.3 (i) amend); “The definition of fair value is based on the definition in the FASB’s Proposed Statement Fair Value Measurements. The FASB plans to issue a final statement on fair-value measurements in the fourth quarter of 2005. The definition of fair value may change in that final Statement.”

As already mentioned in our general remarks, it does not appear appropriate if regulations are adopted while at the same time stating that there might well be foreseeable and short-notice amendments to these regulations.

The Exposure Draft proposes a presumption that the best evidence of the fair value of the acquirer’s interest in the acquiree would be the fair values of all items of consideration transferred by the acquirer in exchange for that interest measured as of the acquisition date, including:

(a) contingent consideration;
(b) equity interests issued by the acquirer; and
(c) any non-controlling equity investment in the acquiree that the acquirer owned immediately before the acquisition date.
(See paragraphs 20-25 and BC55-BC58.)

**Question:** Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer’s interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

**Answer:** We agree with the assumption that “the consideration transferred” is the best indicator of the fair value of the company acquired.
The Exposure Draft proposes that after initial recognition, contingent consideration classified as:

(a) equity would not be remeasured.
(b) liabilities would be remeasured with changes in fair value recognised in profit or loss unless those liabilities are in the scope of IAS 39 Financial Instruments: Recognition and Measurement or (draft) IAS 37 Non-financial Liabilities. Those liabilities would be accounted for after the acquisition date in accordance with those IFRSs. (See paragraphs 26 and BC64-BC89.)

**Question:** Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

**Answer:** No, in our opinion the accounting for contingent consideration after the acquisition date is not appropriate.

In practical terms, the differentiation of the contingent consideration as equity or as a liability appears problematical and harbours the risk of an arbitrary allocation when using the discretionary latitude available.

The Exposure Draft proposes that the costs that the acquirer incurs in connection with a business combination (also called acquisition-related costs) should be excluded from the measurement of the consideration transferred for the acquiree because those costs are not part of the fair value of the acquiree and are not assets. Such costs include finder’s fees; advisory, legal, accounting, valuation and other professional or consulting fees; the cost of issuing debt and equity instruments; and general administrative costs, including the costs of maintaining an internal acquisitions department. The acquirer would account for those costs separately from the business combination accounting. (See paragraphs 27 and BC84-BC89.)

**Question:** 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?

**Answer:** We do not agree with the regulation that costs connected with a company acquisition should be immediately booked as an expense. With the exception of financial assets and liabilities held for trading, the overriding principle in the IFRS has so far been that incidental acquisition costs have to be considered for the initial recognition. As this also applies to “available for sale” financial instruments, the immediate booking of these costs as an expense cannot be justified by the fair-value approach. We reject the idea that the recognition of the costs of the acquisition process should now be specially prohibited for a single standard.
Questions 8 and 9—Measuring and recognising the assets acquired and the liabilities assumed

The Exposure Draft proposes that an acquirer measure and recognise as of the acquisition date the fair value of the assets acquired and liabilities assumed as part of the business combination, with limited exceptions. (See paragraphs 28-41 and BC111-BC116.) That requirement would result in the following significant changes to accounting for business combinations:

(a) Receivables (including loans) acquired in a business combination would be measured at fair value. Therefore, the acquirer would not recognise a separate valuation allowance for uncollectible amounts as of the acquisition date.

(b) An identifiable asset or liability (contingency) would be measured and recognised at fair value at the acquisition date even if the amount of the future economic benefits embodied in the asset or required to settle the liability are contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events. After initial recognition, such an asset would be accounted for in accordance with IAS 38 Intangible Assets or IAS 39 Financial Instruments: Recognition and Measurement, as appropriate, and such a liability would be accounted for in accordance with [draft] IAS 37 or other IFRSs as appropriate.

**Question:** Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

**Answer:** Analogous to our comments on IAS 37, the definition of when an "unconditional or conditional obligation" exists is not clear. In this respect, we refer to our comments on IAS 37 amend.

The Exposure Draft proposes limited exceptions to the fair value measurement principle. Therefore, some assets acquired and liabilities assumed (for example, those related to deferred taxes, assets held for sale, or employee benefits) would continue to be measured and recognised in accordance with other IFRSs rather than at fair value. (See paragraphs 42-51 and BC117-BC150.)

**Question:** Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

**Answer:** /.

Questions 10-12—Additional guidance for applying the acquisition method to particular types of business combinations

The Exposure Draft proposes that, for the purposes of applying the acquisition method, the fair value of the consideration transferred by the acquirer would include the fair value of the acquirer's non-controlling equity investment in the acquiree at acquisition date that the acquirer owned immediately before the acquisition date. Accordingly, in a business combination achieved in stages (step acquisition) the acquirer would remeasure its non-controlling equity investment in the acquiree at fair value as of the acquisition date and recognise any gain or loss in profit or loss. If, before the business combination, the acquirer recognised changes in the value of its non-controlling equity investment directly in equity (for example, the investment was designated as available for sale), the amount that was recognised directly in equity would be reclassified and included in the calculation of any gain or loss as of the acquisition date. (See paragraphs 55, 56 and BC151-BC153.)

Question: Is it appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

Answer: We refer to our comments on IAS 27 amend.

The Exposure Draft proposes that in a business combination in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest (referred to as a bargain purchase) any excess of the fair value of the acquirer's interest in the acquiree over the fair value of the consideration transferred for that interest would reduce goodwill until the goodwill related to that business combination is reduced to zero, and any remaining excess would be recognised in profit or loss on the acquisition date. (See paragraphs 59-61 and paragraphs BC164-BC177.) However, the proposed IFRS would not permit the acquirer to recognise a loss at the acquisition date if the acquirer is able to determine that a portion of the consideration transferred represents an overpayment for the acquiree. The boards acknowledge that an acquirer might overpay to acquire a business, but they concluded that it is not possible to measure such an overpayment reliably at the acquisition date. (See paragraph BC178.)

Question: Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

Answer: /.

Question: Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

Answer: /.
Question 13—Measurement period

The Exposure Draft proposes that an acquirer should recognise adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements would be adjusted, including any change in depreciation, amortisation or other profit or loss effect recognised as a result of completing the initial accounting. (See paragraphs 62-68 and BC161-BC163.)

Question: Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

Answer: /. 

Question 14—Assessing what is part of the exchange for the acquiree

The Exposure Draft proposes that an acquirer assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred by the acquirer and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree would be included in the business combination accounting. (See paragraphs 69, 70, A87-A109 and BC154-BC160.)

Question: Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

Answer: We agree with the proposed regulation

Question 15—Disclosures

The Exposure Draft proposes broad disclosure objectives that are intended to ensure that users of financial statements are provided with adequate information to enable them to evaluate the nature and financial effects of business combinations. Those objectives are supplemented by specific minimum disclosure requirements. In most instances, the objectives would be met by the minimum disclosure requirements that follow each of the broad objectives. However, in some circumstances, an acquirer might be required to disclose additional information necessary to meet the disclosure objectives. (See paragraphs 71-81 and BC200-BC203.)

Question: Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?
Answer: The disclosure requirements have been extended further from the already considerable requirements stipulated in the current version of IFRS 3. The additional benefit this generates for the readers of financial statements — assuming there is any benefit — is out of all proportion to the additional expenditure involved for the companies.

Questions 16-18—The IASB’s and the FASB’s convergence decisions

The Exposure Draft is the result of the boards’ projects to improve the accounting for business combinations. The first phase of those projects led to the issue of IFRS 3 and FASB Statement No. 141. In 2002, the FASB and the IASB agreed to reconsider jointly their guidance for applying the purchase method of accounting, which the Exposure Draft calls the acquisition method, for business combinations. An objective of the joint effort is to develop a common and comprehensive standard for the accounting for business combinations that could be used for both domestic and cross-border financial reporting.

Although the boards reached the same conclusions on the fundamental issues addressed in the Exposure Draft, they reached different conclusions on a few limited matters. Therefore, the IASB’s version and the FASB’s version of the Exposure Draft provide different guidance on those limited matters. A comparison, by paragraph, of the different guidance provided by each board accompanies the draft IFRS. Most of the differences arise because each board decided to provide business combinations guidance that is consistent with its other standards. Even though those differences are candidates for future convergence projects, the boards do not plan to eliminate those differences before final standards on business combinations are issued.

The joint Exposure Draft proposes to resolve a difference between IFRS 3 and SFAS 141 relating to the criteria for recognising an intangible asset separately from goodwill. Both boards concluded that an intangible asset must be identifiable (arising from contractual-legal rights or separable) to be recognised separately from goodwill. In its deliberations that led to SFAS 141, the FASB concluded that, when acquired in a business combination, all intangible assets (except for an assembled workforce) that are identifiable can be measured with sufficient reliability to warrant recognition separately from goodwill. In addition to the identifiability criterion, IFRS 3 and IAS 38 required that an intangible asset acquired in a business combination be reliably measurable to be recognised separately from goodwill. Paragraphs 35-41 of IAS 38 provide guidance for determining whether an intangible asset acquired in a business combination is reliably measurable. IAS 38 presumes that the fair value of an intangible asset with a finite useful life can be measured reliably. Therefore, a difference between IFRS 3 and SFAS 141 would arise only if the intangible asset has an indefinite life. The IASB decided to converge with the FASB in the Exposure Draft by:

(a) eliminating the requirement that an intangible asset be reliably measurable to be recognised separately from goodwill; and

(b) precluding the recognition of an assembled workforce acquired in a business combination as an intangible asset separately from goodwill. (See paragraphs 40 and BC100-BC102.)
Question: Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill? If not, why? 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 generates are inextricably linked with the cash flows that the business generates as a whole?

Answer: The convergence sought between IFRS and US GAAP which forms the basis of the regulation is to be welcomed. However, we doubt that intangible assets can be measured accurately at all times.

For the joint Exposure Draft, the boards considered the provisions of IAS 12 Income Taxes and FASB Statement No. 109 Accounting for Income Taxes, relating to an acquirer's deferred tax benefits that become recognisable because of a business combination. IAS 12 requires the acquirer to recognise separately from the business combination accounting any changes in its deferred tax assets that become recognisable because of the business combination. Such changes are recognised in post-combination profit or loss, or equity. On the other hand, SFAS 109 requires any recognition of an acquirer's deferred tax benefits (through the reduction of the acquirer's valuation allowance) that results from a business combination to be accounted for as part of the business combination, generally as a reduction of goodwill. The FASB decided to amend SFAS 109 to require the recognition of any changes in the acquirer's deferred tax benefits (through a change in the acquirer's previously recognised valuation allowance) as a transaction separately from the business combination. As amended, SFAS 109 would require such changes in deferred tax benefits to be recognised either in income from continuing operations in the period of the combination or directly to contributed capital, depending on the circumstances. Both boards decided to require disclosure of the amount of such acquisition-date changes in the acquirer's deferred tax benefits in the notes to the financial statements. (See paragraphs D4 and BC119-BC129.)

Question: Do you agree that any changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

Answer: /.

The boards reconsidered disclosure requirements in IFRS 3 and SFAS 141 for the purposes of convergence. For some of the disclosures, the boards decided to converge. However, divergence continues to exist for some disclosures as described in the accompanying note Differences between the Exposure Drafts published by the IASB and the FASB. The boards
concluded that some of this divergence stems from differences that are broader than the Business Combinations project.

**Question:** Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

**Answer:** It is understandable that the convergence project (especially in view of existing dependencies between individual standards) between IASB and FASB cannot rectify all discrepancies at once. However, with projects requiring significant amendments in particular, such as these Exposure Drafts, there should be as much agreement as possible between the regulations of IASB and FASB.

**Question 19—Style of the Exposure Draft**

The Exposure Draft was prepared in a style similar to the style used by the IASB in its standards in which paragraphs in **bold type** state the main principles. All paragraphs have equal authority.

**Question:** Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

**Answer:** /.
IAS 37 “Non-financial Liabilities”

General remarks
The submitted amendments to IAS 37 are very extensive and have a significant impact on the disclosure of liabilities and assets in the balance sheet. In this respect, it raises the question of whether such extensive amendments would not have necessitated a completely new standard and not merely amendments to the current version of IAS 37.

The changes strongly impact the fundamental concept for measurement and recognition of assets and liabilities and in particular change these for individual standards. Even if the amendments correspond to the procedure of the IASB, a fundamental decision should first be made on such questions, which would then be applied to all financial statement items as an overriding regulation. However, detailed discussion is needed to achieve this. The procedure now selected involves the risk of there being no basic concept within the IFRS.

Question 1 – Scope of IAS 37 and terminology
The Exposure Draft proposes to clarify that IAS 37, except in specified cases, should be applied in accounting for all non-financial liabilities that are not within the scope of other Standards (see paragraph 2). To emphasise this point, the Exposure Draft does not use ‘provision’ as a defined term to describe liabilities within its scope. Instead, it uses the term ‘non-financial liability’ (see paragraph 10). However, the Exposure Draft explains that an entity may describe some classes of non-financial liabilities as provisions in their financial statements (see paragraph 9).

Question (a): Do you agree that IAS 37 should be applied in accounting for all non-financial liabilities that are not within the scope of other Standards? If not, for which type of liabilities do you regard its requirements as inappropriate and why?

Answer: Essentially, we agree that IAS 37 should apply for all non-financial liabilities which are not within the scope of another standard. However, see b) below.

Question(b): Do you agree with not using ‘provision’ as a defined term? If not, why not?

Answer: According to item 9 of the Exposure Draft, it will be deemed admissible if companies recognise certain non-financial liabilities as “provisions” in the future as well. In principle, we welcome the possibility, especially where the term “provisions” has been in use so far, to link these with circumstances with clearly defined content. These are quite clearly separate from the liabilities. However, it appears problematical in terms of comparability of financial statements that in future the criteria for the definition of non-financial liabilities and provisions are no longer clear.
Question 2 – Contingent liabilities
The Exposure Draft proposes to eliminate the term 'contingent liability'. The Basis for Conclusions on the proposals in the Exposure Draft explains that liabilities arise only from unconditional (or non-contingent) obligations (see paragraph BC11). Hence, it highlights that something that is a liability (an unconditional obligation) cannot be contingent or conditional, and that an obligation that is contingent or conditional on the occurrence or non-occurrence of a future event does not by itself give rise to a liability (see paragraph BC30).

The Basis for Conclusions also explains that many items previously described as contingent liabilities satisfy the definition of a liability in the Framework. This is because the contingency does not relate to whether an unconditional obligation exists. Rather it relates to one or more uncertain future events that affect the amount that will be required to settle the unconditional obligation (see paragraph BC23).

The Basis for Conclusions highlights that many items previously described as contingent liabilities can be analysed into two obligations: an unconditional obligation and a conditional obligation. The unconditional obligation establishes the liability and the conditional obligation affects the amount that will be required to settle the liability (see paragraph BC24).

The Exposure Draft proposes that when the amount that will be required to settle a liability (unconditional obligation) is contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events, the liability is recognised independently of the probability that the uncertain future event(s) will occur (or fail to occur). Uncertainty about the future event(s) is reflected in the measurement of the liability recognised (see paragraph 23).

Question (a): Do you agree with eliminating the term ‘contingent liability’? If not, why not?

Answer: Fundamentally, we agree that the term “contingent liability” should no longer be used in the future. However see also b).

Question (b): Do you agree that when the amount that will be required to settle a liability (unconditional obligation) is contingent on the occurrence or non-occurrence of one or more uncertain future events, the liability should be recognised independently of the probability that the uncertain future event(s) will occur (or fail to occur)? If not, why not?

Answer: For practical concerns, the definition of when an "unconditional or conditional obligation" exists is not clear. The examples given are vastly simplified and insufficient for practical use. There is therefore a significant risk of arbitrary and inconsistent application of the regulations.

We have reservations as to whether all cases to be subsumed in the future under "contingencies" only affect those which can be classified as a general business risk and which do not need to be reported. Much more worrying is that on the one hand liabilities involving significant uncertainties will have to be included in the balance sheet and on the other hand reporting requirements are eliminated which constitute an important part of the investors' assessment of a financial statement.
Question 3 – Contingent assets
The Exposure Draft proposes to eliminate the term 'contingent asset'. As with contingent liabilities, the Basis for Conclusions explains that assets arise only from unconditional (or non-contingent) rights (see paragraph BC11). Hence, an asset (an unconditional right) cannot be contingent or conditional, and a right that is contingent or conditional on the occurrence or non-occurrence of a future event does not by itself give rise to an asset (see paragraph BC17).

The Basis for Conclusions also explains that many items previously described as contingent assets satisfy the definition of an asset in the Framework. This is because the contingency does not relate to whether an unconditional right exists. Rather, it relates to one or more uncertain future events that affect the amount of the future economic benefits embodied in the asset (see paragraph BC17).

The Exposure Draft proposes that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38 Intangible Assets rather than IAS 37 (except for rights to reimbursement, which remain within the scope of IAS 37). This is because such items are non-monetary assets without physical substance and, subject to meeting the identifiability criterion in IAS 38, are intangible assets (see paragraph A22 in the Appendix).

The Exposure Draft does not propose any amendments to the recognition requirements of IAS 38.

Question (a): Do you agree with eliminating the term 'contingent asset'? If not, why not?

Answer: We agree that the term "contingent asset" should no longer be used in the future. However, see b).

Question (b): Do you agree that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38? If not, why not?

Answer: In practical terms, the definition of when an "unconditional or conditional right" exists is not clear. The information given for the recognition of unconditional rights is thus inadequate.

We agree that such cases which have so far been seen as contingent assets but which meet the definition of an asset – and thus have to be recognised in the future – are within the scope of IAS 38.

Question 4 – Constructive obligations
The Exposure Draft proposes amending the definition of a constructive obligation to emphasise that an entity has a constructive obligation only if its actions result in other parties having a valid expectation on which they can reasonably rely that the entity will perform (see paragraph 10). The Exposure Draft also provides additional guidance for determining whether an entity has incurred a constructive obligation (see paragraph 15).
Question (a): Do you agree with the proposed amendment to the definition of a constructive obligation? If not, why not? How would you define one and why?

Answer: On the basis of the Exposure Draft, the practical implications of the amendment to the definition of constructive obligations are not clear. The Basis of Conclusions states that no changes are expected in most practical applications. Only such constructive obligations whose fulfilment lies at the discretion of the company do not need to be included in the balance sheet in future.

Furthermore, the Basis of Conclusions makes it clear that the first objective of the Exposure Draft was to eliminate the existing differences vis-à-vis US GAAP. However, this has not happened, as the Board's discussions came to the conclusion that fundamental questions on the recognition of liabilities would have to be clarified first.

Given this background, it is difficult to understand why a rather puzzling amendment to the definition of constructive obligations has been made at this stage when it is clear at the same time that this definition would have to be reassessed in connection with the recognition of liabilities. Such step-by-step amendments to definitions do very little to aid understanding and comparability of financial statements.

Question (b): Is the additional guidance for determining whether an entity has incurred a constructive obligation appropriate and helpful? If not, why not? Is it sufficient? If not, what other guidance should be provided?

Answer: In light of our comments under a), there should at least be examples listed of such circumstances which currently constitute a constructive obligation, although no longer when the Exposure Draft has been adopted.

Question 5 – Probability recognition criterion
The Exposure Draft proposes omitting the probability recognition criterion (currently in paragraph 14(b)) from the Standard because, in all cases, an unconditional obligation satisfies the criterion. Therefore, items that satisfy the definition of a liability are recognised unless they cannot be measured reliably.

The Basis for Conclusions emphasises that the probability recognition criterion is used in the Framework to determine whether it is probable that settlement of an item that has previously been determined to be a liability will require an outflow of economic benefits from the entity. In other words, the Framework requires an entity to determine whether a liability exists before considering whether that liability should be recognised. The Basis notes that in many cases, although there may be uncertainty about the amount and timing of the resources that will be required to settle a liability, there is little or no uncertainty that settlement will require some outflow of resources. An example is an entity that has an obligation to decommission plant or to restore previously contaminated land.
The Basis also outlines the Board’s conclusion that in cases previously described as contingent liabilities in which the entity has an unconditional obligation and a conditional obligation, the probability recognition criterion should be applied to the unconditional obligation (ie the liability) rather than the conditional obligation. So, for example, in the case of a product warranty, the question is not whether it is probable that the entity will be required to repair or replace the product. Rather, the question is whether the entity’s unconditional obligation to provide warranty coverage for the duration of the warranty (ie to stand ready to honour warranty claims) will probably result in an outflow of economic benefits (see paragraphs BC37-BC41).

The Basis for Conclusions highlights that the Framework articulates the probability recognition criterion in terms of an outflow of economic benefits, not just direct cash flows. This includes the provision of services. An entity’s unconditional obligation to stand ready to honour a conditional obligation if an uncertain future event occurs (or fails to occur) is a type of service obligation. Therefore, any liability that incorporates an unconditional obligation satisfies the probability recognition criterion. For example, the issuer of a product warranty has a certain (not just probable) outflow of economic benefits because it is providing a service for the duration of the contract, ie it is standing ready to honour warranty claims (see paragraphs BC42-BC47).

Question: Do you agree with the analysis of the probability recognition criterion and, therefore, with the reasons for omitting it from the Standard? If not, how would you apply the probability recognition criterion to examples such as product warranties, written options and other unconditional obligations that incorporate conditional obligations?

Answer: The proposed recognition criterion means that every identified liability has to be posted on the liabilities side of the balance sheet, even if its occurrence probability is very low. On the other hand, a contingent obligation, which is very likely to lead to a drain on resources, does not fulfil the definition of a liability and therefore does not have to be treated as such in the balance sheet.

It is questionable whether the pricing for the acquisition of a company actually considers unconditional obligations with a very low occurrence probability while conditional obligations with a very high occurrence probability are not considered.

While both the previous and current concepts are clearly not without their problems and the question of a consistent regulation across all IFRS for the recognition and measurement of liabilities still requires final discussion, it does not appear appropriate to the objectives at this current time to introduce a new regulation for two separate standards (IFRS 3 and IAS 37). This should be done as part of a general new regulation and by means of a suitable amendment to the framework.

This assessment is confirmed to the extent that, according to BC 26 on the Exposure Draft, the Board realises that the identification of conditional and unconditional rights and obligations can be highly complex.
From our point of view, moreover, the Board's detailed statement in the Basis of Conclusions that removing the probability criterion does not contradict the framework does somewhat defy logic for us. BC 112 in the Basis of Conclusions on the current IFRS 3 also points out that the overall idea of the probability concept of the framework needs to be rediscussed. (...However, the Board agreed that the role of probability in the Framework should be considered more generally as part of a forthcoming Concepts project. ...) The fact that a Board member rejected the removal of the probability criterion highlights the problems involved with this definition. This should therefore be discussed in detail in a discussion paper prior to publication of a draft on the amendments to the framework or publication of an Exposure Draft.

Question 6 – Measurement
The Exposure Draft proposes that an entity should measure a non-financial liability at the amount that it would rationally pay to settle the present obligation or to transfer it to a third party on the balance sheet date (see paragraph 29). The Exposure Draft explains that an expected cash flow approach is an appropriate basis for measuring a non-financial liability for both a class of similar obligations and a single obligation. It highlights that measuring a single obligation at the most likely outcome would not necessarily be consistent with the Standard’s measurement objective (see paragraph 31).

Question: Do you agree with the proposed amendments to the measurement requirements? If not, why not? What measurement would you propose and why?

Answer: The proposed changes to the measurement of liabilities must be seen in the context of the changed regulations on their recognition, and in this respect we refer to our comments on question 5. These amendments constitute a further step by the IASB towards “full fair-value accounting” in that all non-financial liabilities within the scope of IAS 37 amend. are to be valued at their fair values. The basis for the measurement will be the expected cash flows of non-financial liabilities. It is correct that the previous “best-estimate approach” does not necessarily result in an appropriate measurement. However, the method now selected does not constitute an improvement in our eyes, especially as this approach permits a high degree of discretionary latitude. The consideration of future events in particular for the valuation of liabilities presents the risk of inconsistencies. Both involve the risk of “pseudo accuracy” in establishing values which is counterproductive in terms of decision relevance.
Question 7 – Reimbursements
The Exposure Draft proposes that when an entity has a right to reimbursement for some or all of the economic benefits that will be required to settle a non-financial liability, it recognises the reimbursement right as an asset if the reimbursement right can be measured reliably (see paragraph 46).

Question: Do you agree with the proposed amendment to the recognition requirements for reimbursements? If not, why not? What recognition requirements would you propose and why?

Answer: We agree with the proposed change.

Question 8 – Onerous contracts
The Exposure Draft proposes that if a contract will become onerous as a result of an entity’s own action, the liability should not be recognised until the entity takes that action. Hence, in the case of a property held under an operating lease that becomes onerous as a result of the entity’s actions (for example, as a result of a restructuring) the liability is recognised when the entity ceases to use the property (see paragraphs 55 and 57). In addition, the Exposure Draft proposes that, if the onerous contract is an operating lease, the unavoidable cost of the contract is the remaining lease commitment reduced by the estimated sublease rentals that the entity could reasonably obtain, regardless of whether the entity intends to enter into a sublease (see paragraph 58).

Question (a): Do you agree with the proposed amendment that a liability for a contract that becomes onerous as a result of the entity’s own actions should be recognised only when the entity has taken that action? If not, when should it be recognised and why?

Answer: It is not clear when the “entity’s own action” can be assumed in an individual case. Further explanation would be required here.

Question (b): Do you agree with the additional guidance for clarifying the measurement of a liability for an onerous operating lease? If not, why not? How would you measure the liability?

Answer: /.

Question (c): If you do not agree, would you be prepared to accept the amendments to achieve convergence?

Answer: /.
Question 9 – Restructuring provisions
The Exposure Draft proposes that non-financial liabilities for costs associated with a restructuring should be recognised on the same basis as if they arose independently of a restructuring, namely when the entity has a liability for those costs (see paragraphs 61 and 62).

The Exposure Draft proposes guidance (or provides cross-references to other Standards) for applying this principle to two types of costs that are often associated with a restructuring: termination benefits and contract termination costs (see paragraphs 63 and 64).

Question (a): Do you agree that a liability for each cost associated with a restructuring should be recognised when the entity has a liability for that cost, in contrast to the current approach of recognising at a specified point a single liability for all of the costs associated with the restructuring? If not, why not?

Answer: .

Question (b): Is the guidance for applying the Standard’s principles to costs associated with a restructuring appropriate? If not, why not? Is it sufficient? If not, what other guidance should be added?

Answer: .
IAS 27 “Consolidated and separate financial statements”

General remarks
The proposed changes in IAS 27 are the result of the amendments to IFRS 3. They were carried out in order to ensure consistency between the standards. For this reason, we refer to the general remarks given under IFRS 3.

Question 1
Draft paragraph 30A proposes that changes in the parent’s ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes would be recognised in profit or loss (see paragraph BC4 of the Basis for Conclusions).

Question: Do you agree? If not, why not and what alternative would you propose?

Answer: We welcome the fact that the IASB seeks to close a gap in regulations. The proposed amendment certainly makes sense from the point of view of the one-entity theory. However, such a point of view is not compelling. The consolidated financial statement provides a source of information for the owners of the parent company. Although minority interests have to be recognised in the future within the equity, in our view these have the character of liabilities. Therefore the step already taken of disclosing minority interests in the equity does not justify the solution proposed here. In view of our misgivings expressed in our comments on IFRS 3, we are also in favour of a postponement in the amendment and in a solution until after the framework has been finalised.

Question 2
Paragraph 30D proposes that on loss of control of a subsidiary any non-controlling equity investment remaining in the former subsidiary should be remeasured to its fair value in the consolidated financial statements at the date control is lost. Paragraph 30C proposes that the gain or loss on such remeasurement be included in the determination of the gain or loss arising on loss of control (see paragraph BC7 of the Basis for Conclusions).

Question: Do you agree that the remaining non-controlling equity investment should be remeasured to fair value in these circumstances? If not, why not and what alternative would you propose?
Do you agree with the proposal to include any gain or loss resulting from such remeasurement in the calculation of the gain or loss arising on loss of control? If not, why not, and what alternative would you propose?
Question 3
As explained in Question 1, the Exposure Draft proposes that changes in a parent’s ownership interest in a subsidiary that do not result in a loss of control should be treated as transactions with equity holders in their capacity as equity holders. Therefore, no gain or loss would be recognised in profit or loss. However, a decrease in the parent’s ownership interest resulting in the loss of control of a subsidiary would result in any gain or loss being recognised in profit or loss for the period. The Board is aware that differences in accounting that depend on whether a change in control occurs could create opportunities for entities to structure transactions to achieve a particular accounting result. To reduce this risk, the Exposure Draft proposes that if one or more of the indicators in paragraph 30F are present, it is presumed that two or more disposal transactions or arrangements that result in a loss of control should be accounted for as a single transaction or arrangement. This presumption can be overcome if the entity can demonstrate clearly that such accounting would be inappropriate (see paragraphs BC9-BC13 of the Basis for Conclusions).

Answer: We basically agree with the IASB’s comments that a change in the investment with a loss of control should dissolve the parent-subsidiary relationship and a new investment relationship should be established. However, this would produce different effects for participations in which a controlling interest never existed and for cases where one did exist. In our opinion, this situation should be clarified only in connection with the controversial points in IFRS 3 and once the stipulations in the framework have been clarified.

Question 4
Do you agree that it is appropriate to presume that multiple arrangements that result in a loss of control should be accounted for as a single arrangement when the indicators in paragraph 30F are present? Are the proposed factors suitable indicators? If not, what alternative indicators would you propose?

Answer: The need of additional regulations in order to avoid that entities have the possibility to structure transactions to achieve a particular accounting result in our view is an indication of the practical weaknesses of a perhaps theoretically sound procedure (see general remarks and the answers to questions 1 and 2).

Question 4
Paragraph 35 proposes that losses applicable to the non-controlling interest in a subsidiary should be allocated to the non-controlling interest even if such losses exceed the non-controlling interest in the subsidiary’s equity. Non-controlling interests are part of the equity of the group and, therefore, participate proportionally in the risks and rewards of investment in the subsidiary.
Question: Do you agree with the proposed loss allocation? Do you agree that any guarantees or other support arrangements from the controlling and non-controlling interests should be accounted for separately? If not, why not, and what alternative treatment would you propose?

Answer: This proposal is justified from a one-entity point of view. However, we question this point of view and refer to the answers to questions 1 and 2.

Question 5
The transitional provisions in the Exposure Draft propose that all of its requirements should apply retrospectively, except in limited circumstances in which the Board believes that retrospective application is likely to be impracticable.

Question: Do you agree that proposed paragraphs 30A, 30C and 30D should apply on a prospective basis in the cases set out in paragraph 43B? Do you believe that retrospective application is inappropriate for any other proposals addressed by the Exposure Draft? If so, what other proposals do you believe should be applied prospectively and why?

Answer: We reject the idea of retrospective application due to reasons of practicability and cost. We therefore welcome the fact that the Board has already permitted exceptions, which we feel are absolutely necessary.

Yours sincerely,

Münchener Rückversicherungs-Gesellschaft

Isabella Pfaller

Walter Hörmann