Comments on Exposure Draft of proposed Amendments to IFRS 3 Business Combinations  
IAS 27 Consolidated and Separate Financial Statements

Dear Mr. Teixeira,

We welcome the opportunity to comment on the above Exposure Drafts, which propose significant changes to the current accounting for business combinations.

We generally support the IASB’s intention to achieve convergence in the accounting for business combinations and non-controlling interests. However, we are fundamentally opposed to the fair value approach taken by the IASB and the FASB in their Exposure Drafts. We are concerned that such an approach will significantly impair the reliability, understandability and neutrality of financial reporting.

We strongly believe the IASB should maintain a cost allocation model for the initial recognition of a business combination and find an appropriate solution to the accounting for the acquisition of non-controlling interests after control has been obtained. **Cost is the amount paid, liabilities and transaction costs incurred in connection with an acquisition, and that is the relevant amount that should be accounted for.** We also believe that financial reporting is primarily addressed to the parent company shareholders, and therefore should be based on a parent entity concept, rather than an economic entity concept. The recognition of a “fictional” portion of goodwill attributable to the minority shareholders of an acquired subsidiary is neither reflecting economic reality nor of any particular interest to the parent entity’s shareholders.

We therefore propose that the Board adopt a converged model based on the **current IFRS 3, Business Combinations**, with improvements to address certain issues associated with its application in practice.
1. Comments on the proposed amendments to IFRS 3

Questions 1 & 2 – Objective, definition and scope

Are the objectives 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?

We support the IASB’s objectives of improving the relevance and comparability of financial information about business combinations and to achieve convergence with US GAAP. However, we disagree with the economic entity approach taken by the Exposure Draft. Specifically, we disagree with the resulting consequences on the proposals of the Exposure Draft, including the acquirer recognising (1) a non-controlling interest at its estimated fair value, including allocating goodwill to the non-controlling interests (the full fair value approach), (2) a gain or loss for any investments held in the acquiree before the business combination (i.e., in a step acquisition), and (3) no gain or loss on the disposal of ownership interest without loss of control. We believe that the parent entity approach provides more relevant information to users of the consolidated financial statements because users of the consolidated financial statements are able to understand the investment of the parent company in the acquired entity.

We agree with the proposed definition of a business combination as a transaction or event in which an acquirer obtains control of one or more businesses, which is much clearer than the definition currently included in IFRS 3. We also agree with the proposed definition of a business and the additional guidance provided.

As noted above, we propose that the Board adopt, jointly with the FASB, a converged model based on the current IFRS 3, with certain improvements to address existing practice issues associated with its application. We believe this approach will meet the key objectives of the Board to improve financial reporting for business combinations and achieve convergence.

Question 3 – Measuring the Fair Value of the Acquiree

In a business combination in which the acquirer holds less than 100 percent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognize 100 percent of the acquisition-date fair value of the acquiree, including 100 percent 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?

We do not support the use of the economic entity model and the resulting recognition of 100 percent of the acquisition-date fair value of the acquiree in a business combination in which the acquirer holds less than 100 percent of the equity interests of the acquiree. Goodwill represents the excess of the consideration paid over the fair value of the identifiable net assets acquired, and should be recognised only for the portion of the business acquired. The minority shareholders do not participate in the transaction, and therefore, there is no “residual” attributable to the non-controlling interests because that portion of the entity has not been acquired. Accordingly, we propose that the Board adopt a model based on the current IFRS 3 model, adding guidance on how to determine goodwill on further acquisitions of ownership interests after control has been obtained.
Question 4 - Measuring the Fair Value of the Acquiree (continued)

Do paragraphs A8–A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

As noted above, we do not support the model proposed by the Board and therefore do not address this question in detail. We do not believe the full fair value method will result in reliable and comparable information. We specifically believe there are significant obstacles to a consistent and neutral application of the full fair value model in practice, including the identification and measurement of control premiums and buyer-specific synergies that arise in business combinations, and when the acquirer should adopt methods other than “grossed up” consideration paid to measure the fair value of the acquired entity.

Question 5 - Measuring the Fair Value of the Acquiree (continued)

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?

We generally agree with the Board’s conclusion that the acquisition-date fair value of the consideration transferred is the best evidence of the interest acquired in a business combination. Further, we agree that the fair value of contingent consideration based on security prices can be reliably measured on the acquisition date and should be recognised at fair value on that date. Such consideration should subsequently be accounted for in accordance with IAS 39.

However, we believe that contingent consideration based on the acquiree’s earnings levels or other performance measures (performance-based contingent consideration) should be included in the acquisition price on the date of acquisition only if payment of is probable at acquisition.

We believe that performance-based contingent consideration generally is not reliably measurable at the acquisition date. In our experience, such contingent consideration is often agreed to because the buyer and seller were unable to reach an agreement as to the fair value of the entity. As a consequence, we question the ability to reliably measure the fair value of such contingent consideration at the acquisition date in most cases. Rather, we believe that such amounts should be recognized as an adjustment to acquisition accounting when the amounts are probable of being paid.

We agree with the Board’s conclusion that the consideration paid should be measured at the acquisition date since that is the date when the transaction is being recognised in the financial statements.
Question 6 – Measuring the Fair Value of the Acquiree (continued)

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

As mentioned in our response to Question 5, we believe that performance-based contingent consideration and security price-based contingent consideration should be accounted for differently at the acquisition date and, as a result, the accounting after the acquisition date also should be different.

For security price-based contingent consideration, we agree that (1) equity-classified contingent consideration should not be remeasured and (2) liability-classified contingent consideration should be subsequently accounted for under IAS 39.

We believe that performance-based contingent consideration should be recognised as an adjustment to acquisition accounting when payment is probable and it can be measured reliably. We are concerned about the reliability of a fair value measurement of such obligations from the date of acquisition, and its impact on future earnings, and therefore we believe that it is not appropriate for the acquirer to recognise changes in the estimated fair value of performance-based contingent consideration in earnings.

Question 7 – Measuring the Fair Value of the Acquiree (continued)

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?

We believe that the accounting for business combinations should continue to be based on a “cost accumulation” approach. Transaction costs are directly related to the acquisition of the acquiree’s net assets and should therefore be part of the acquisition costs to be recognised, which is consistent with the acquisition of other assets such as PP&E.

Question 8 – Measuring and Recognising the Assets Acquired and the Liabilities Assumed

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?

We agree that receivables (including loans) acquired in a business combination should be recognised at fair value and that no separate valuation allowance should be recognised for uncollectible amounts.

We do not agree that contingent assets and liabilities should be recognised at fair value in a business combination, since this results in inconsistencies, i.e., two different methods to account for contingent assets and liabilities, depending whether they are acquired / incurred in a business combination or directly (please note that we do not support the proposed amendments to IAS 37 that would lead to the recognition of all contingent liabilities at fair value). We believe that the probability and reliability criteria should be maintained as a basis for recognising (contingent) assets and (contingent) liabilities, and the current IFRS 3 should be amended accordingly. This would also ensure consistency with the Framework. A buyer pays less goodwill because of the contingent risks assumed, and this is reflected by not recognising the contingent obligation on the balance sheet. We do not see the need or the benefit of contingent, improbable, liabilities being recognised on the balance sheet and subsequently, when the risk is eliminated, being released to income.
Question 9 - Measuring and Recognising the Assets Acquired and the Liabilities Assumed (cont.)

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?

We generally believe the exceptions to the fair value measurement principle listed in paragraphs 42 through 51 of the proposed Standard are appropriate.

Question 10 — Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations

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?

We disagree with the Board’s conclusion that unrealised gains and losses on remeasurement of previously acquired non-controlling interests should be recognised in earnings at the date on which control is obtained. Users of financial statements will not understand how a profit or loss can arise from acquiring an additional ownership interest. Gain or loss on ownership interests should in our opinion only be recognised in the income statement when such ownership interests are sold (except for those accounted for under IAS 39 at fair value through profit or loss).

Question 11 — Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations (continued)

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?

We agree that goodwill should be reduced to zero 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, and that any remaining excess should be recognised in income on the acquisition date.

Question 12 — Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations (continued)

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?

We agree that overpayments cannot be measured reliably. However, this is equally true for goodwill portions to be attributed to the non-controlling interest under the Exposure Draft, and the related use of the full fair value method.
Question 13 – Measurement Period

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?

We disagree that comparative information for prior periods presented in financial statements should be restated as a result of measurement period adjustments. We believe that measurement period adjustments should be reported in the period in which those adjustments are made, consistent with the accounting for a change in estimate.

Question 14 - Assessing What is Part of the Exchange for the Acquiree

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?

We agree with the guidance and the underlying principle.

Question 15 - Disclosures

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?

We agree with the Exposure Draft’s overall disclosure objectives, which are consistent with the current provisions in IFRS 3.

We also agree with the IASB’s decision to remove the disclosures currently required by IFRS 3 for the carrying amounts for each class of the acquiree’s assets and liabilities determined in accordance with IFRSs immediately before the combination. We believe that this disclosure is neither relevant nor useful.

We disagree with the disclosures that are directly related to the full fair value method, particularly with §72(e) and §72(j). We further object to §74(b), already required by the current IFRS 3, requiring disclosure of pro forma information that is very costly to prepare and should not be part of audited financial statements (the Board may want to address such pro forma disclosures as part of its MD&A project).
Question 16 - The IASB’s and the FASB’s Convergence Decisions

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?

In our opinion both the probability criterion (which has already been removed by the current IFRS 3) and the reliability criterion should be retained. They form the fundamental preconditions stated in the Framework for recognising assets and liabilities. We believe that it is possible to reliably allocate the cost of a business combination to the net assets, including intangible assets, acquired. However, we believe a cap for recognising intangible assets only to the extent that they do not create or increase negative goodwill, as previously included in IAS 22, should be re-introduced. From our experience in practice there is a wide range of possible fair value estimates, and recognising gains in the income statement merely due to the separate recognition of intangible assets such as in-process R&D and other intangibles with unknown future economic benefits is simply misleading and not verifiable through independent audit procedures.

We agree that an assembled workforce acquired in a business combination should not be recognised as an intangible asset separately from goodwill.

Question 17 - The IASB’s and the FASB’s Convergence Decisions (continued)

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?

We agree that the acquirer’s deferred tax assets that become recognisable as a result of the business combination are not part of the fair value of the acquiree and, therefore, should be accounted for separately from the business combination.

Question 18 - The IASB’s and the FASB’s Convergence Decisions (continued)

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?

We believe the Boards should strive to eliminate as many differences in disclosure requirements as possible. However, we generally believe that the proposed disclosures are extensive and should not be further expanded for the sake of convergence.

Question 19— Style of This Exposure Draft

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?

We support the use of the bold type-plain type style of the presentation in the Exposure Draft. We believe that the distinction between principles (bold-letter paragraphs) and explanations and/or additional guidance (grey-letter paragraphs) is useful and facilitates understanding of the standards.
2. Comments on the proposed amendments to IAS 27

**Question 1 - Changes in Ownership Interests in a Subsidiary**

*Do you agree that changes in ownership interests in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as equity transactions? If not, what alternative do you propose and why?*

We do not believe that an economic entity approach is an appropriate basis for preparing the consolidated financial statements of the parent company. The non-controlling interests are not equity holders in the parent entity, and therefore transactions with the non-controlling interest should not be treated as transactions between equity holders.

We propose a model that is consistent with current practice in the US whereby transactions that result in a reduction of the parent company’s ownership interest while retaining control should be recognised in earnings. Further, additional direct or indirect investments in a consolidated subsidiary should be treated as additional acquisitions (and similarly presented in the cash flow statement as investing activities). Under IFRS 3, diversity in practice currently exists on the accounting for these additional investments in subsidiaries (e.g., any difference between the acquisition price and the carrying amount of the non-controlling interest obtained is treated as 1) an adjustment to goodwill; 2) a revaluation of identifiable assets and liabilities and the residual as additional goodwill; or 3) a debit or credit to equity). There is clearly a need to resolve this issue in order to achieve comparability.

**Question 2 - Loss of Control of Subsidiaries**

*Do you agree that any gain or loss resulting from the remeasurement of a retained investment in a former subsidiary should be recognised in income of the period? If not, what alternative do you propose and why?*

We disagree with the Board’s proposal that loss of control should give rise to a remeasurement of the remaining investment at fair value with the adjustment recognised in profit or loss. We believe that upon the loss of control, gains and losses should be recognised for the portion of the investment that is sold. Any remaining investment would retain its carrying amount at that date and would be accounted for subsequently in accordance with the appropriate Standard (i.e., IAS 28 for equity method investment, IAS 39 for either available-for-sale security or trading security).

We agree that loss of control of a subsidiary is a significant economic event. However, we do not see why such an event, in itself, justifies the recognition of revaluation gains and losses on the retained investment in income, unless a loss arises due to an impairment.
Question 3 – Multiple Arrangements

Do you agree with the proposed guidance for determining whether multiple arrangements that result in a loss of control should be accounted for as a single arrangement? If not, what alternative do you propose and why?

We believe an entity should recognise gains and losses on the portion of a subsidiary that is sold, regardless of whether control is retained or not. Accordingly, we consider such guidance would not be needed under our proposed model.

Question 4 – Allocating Losses to the Non-controlling Interests

Do you agree with the proposed requirement for attributing losses to the non-controlling interest even if such losses exceeded the non-controlling interest? Do you agree that any guarantees or other support arrangements from the controlling and non-controlling interests should be accounted for separately? If not, what alternative treatment do you propose and why?

We agree that losses attributed to the non-controlling interests should be attributed even if those losses exceeded the non-controlling interest in the subsidiary’s equity. We also agree that guarantees or other support arrangements between the controlling and non-controlling interests should be accounted for separately.

Question 5 – Transitional Provisions

Do you agree with the proposed transition requirements? If not, what alternative do you propose and why?

We agree with the proposed transitional provisions.

Yours sincerely,

Swiss Institute of Certified Accountants and Tax Consultants
Accounting and Auditing Practices Committee

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