Dear Sir David

Re: Exposure Drafts of Proposed: Amendments to IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements

We appreciate the opportunity to comment on the Exposure Drafts mentioned above and would like to submit our comments as follows:

General Remarks

We note that the Board’s decision to follow the entity theory of consolidation in phase I of the business combination project has been upheld in drafting the current amendments to IFRS 3. We had expected the Board to have discussed the issue of whether the pure entity theory of consolidation or alternatively, the parent company theory is more appropriate to fulfil the user needs and, therefore, should form the basis for IFRS 3.

If adopted, the proposed amendments to IFRS 3 would have a substantial impact on the accounting treatment of business combinations. Therefore we consider that it would have been appropriate for the Board to publish an initial discussion paper as the first part of the due process. The Board should have also pointed out why the amended IFRS 3 as currently proposed will lead to an increase in the usefulness of consolidated financial statements for user’s decision-making purposes in comparison with consolidated financial statements prepared in accordance with the current IFRS 3. We are also of the opinion that the Board should have undertaken field tests before publishing the Exposure Draft.
The entity theory leads to a presentation of all the assets (including full goodwill) and liabilities that are controlled by the parent company. In contrast to this the parent company theory provides information on the participation of the shareholders of the parent company in the net assets of the group. Hence, consolidated financial statements prepared pursuant to the entity theory constitute a response to the question: 'Which assets and liabilities are controlled by the parent company?'. Whereas consolidated financial statements prepared according to the parent company theory respond the question: 'How far do net assets provide economic benefits to the shareholders of the parent company?'. The application of the pure parent company theory would imply proportionate consolidation of all assets and liabilities.

Assuming usefulness to users as a primary prerequisite, we firstly propose that - following the entity theory in this regard - there should be a requirement for all the assets and liabilities controlled by the parent company to be presented in consolidated financial statements. However, taking both reliability and cost-benefit considerations into account (discussed below), we do not consider that full recognition of goodwill is appropriate. In addition, any lack of reliability necessarily impairs the usefulness of the information provided for decision-making purposes. Thus, in our opinion, it would be preferable for goodwill to be accounted for on a cost basis. We would therefore like to suggest that the acquirer shall measure the cost of a business combination as the aggregate of the fair value of the consideration transferred by the acquirer in exchange for control of the acquiree plus costs directly attributable to the business combination. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets and liabilities shall be accounted for as goodwill.

Secondly we would like to propose that any non-controlling interest expressly not be presented within equity since the parent company shareholders do not participate in the benefits deriving from that non-controlling interest. In our opinion, changes in a parent's controlling interest in an entity that do not result in a loss of control should not be treated as transactions with equity holders. In so far we prefer the parent company theory, so that in the end the consolidated financial statements will be based on an appropriate combination of both, entity theory and parent company theory aiming relevant information to be provided on a reliable basis.
Exposure Draft of Proposed: Amendments to IFRS 3 Business Combinations

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 1 – 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?

We do not agree that the objective and the definition of a business combination are appropriate for accounting for all business combinations. The IASB is proposing changing the definition of business combinations. Adopting the proposed amendments to IFRS 3 would result in a business combination being defined as a transaction or other event in which an acquirer obtains control of one or more businesses. The acquisition method of ED IFRS 3 would therefore not be applicable in the case of a combination of businesses in which none of the parties is able to obtain control of the other combining entity (e.g. merger of equals). In this respect, the scope of ED IFRS 3 appears restricted in comparison with the current IFRS 3.

We also note that the Basis for Conclusions stipulates in BC32 that all business combinations included in the scope of the current IFRS 3 are also within the scope of the proposed ED IFRS 3, despite the fact that the new definition focuses on obtaining control. We interpret this as meaning that, even in the exceptional case of a combination of businesses in which none of the combining entities does obtain control of the other combining entity, the application of the acquisition method is required. In our view, it is not appropriate that the requirements in respect of application of the acquisition method are stated only in the Basis for Conclusions, rather this issue should be dealt with in the body of the Standard.

As we have previously discussed in our comment letter dated 30 July 2004 on the Exposure Draft of Proposed Amendments to IFRS 3 'Combinations by Contract Alone or Involving Mutual Entities' if no actual acquirer can be identified, i.e. in case of a true merger, applying the acquisition method might lead to misleading results. In cases of combinations of mutual entities in particular, we doubt that this type of combination always results in one of the mutual entities obtaining control. We therefore recognise a need for a broad discussion as to whether the pooling of interests method or the fresh start method would be best applied in such cases.

In our view, the Board should clarify whether it intends the principles of ED IFRS 3 also to apply in respect of shell companies formed to acquire an entity.
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 2 – 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?

ED IFRS 3.3 (d) proposes to define a business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return to investors or dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants. The proposed definition of a business has been changed for convergence reasons. We agree with the proposed definition.

However, we would like to suggest that the Board clarify the difference between ‘providing a return to investors’ and ‘providing dividends’. We would also like to recommend that the Board provide more guidance on the distinction between ‘single assets or groups of assets’ and ‘businesses’ to avoid potentially fostering creative accounting.

Furthermore, it is not clear to us whether the acquisition of a subgroup containing several businesses is to be accounted for as a single transaction or, alternatively, whether each business acquired is to be treated as a separate transaction. The latter could lead to a good- or badwill for each separate transaction.

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 3 – 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?

According to the IASB proposal the acquirer should measure and recognise 100 per cent of the fair value of the acquiree as of the acquisition date in a business combination. This even applies in business combinations in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at that date. Pursuant to ED IFRS 3.49 the acquirer should measure and recognise goodwill as the excess of the fair value of the acquiree, as a whole, over the net amount of the recognised identifiable assets acquired and liabilities assumed.

We share the concerns of the five dissenting Board Members as mentioned in ED IFRS 3.AV 2 – 7. We disagree that goodwill should be accounted for on a similar basis to any other of the acquiree’s assets. Goodwill cannot be identified and measured at fair value separately because it is a component of the value of the business as a whole. Thus, goodwill is only a residual amount. Measuring goodwill requires determining the value of the acquiree as a whole as well as the fair value of the assets and liabilities of the acquiree.

Measurement of the value of the acquiree as a whole is especially problematical when the acquirer purchases less than 100 per cent of the acquiree because synergies affecting the consideration paid by the acquirer do not necessarily affect the income of the non-controlling interests. Hence, the consideration transferred by the acquirer for its interest often does not constitute an appropriate basis for measuring the fair value of the acquiree as a whole. This problem is compounded by the fact that the process of measuring goodwill also involves highly subjective estimations. We, therefore, doubt that a reliable measurement of the full goodwill is possible. From our point of view, adopting the full goodwill method will lead to a reduction in the reliability of the financial statements, and results in the capitalisation of goodwill not adequately evidenced by a transaction. Hence, we are of the opinion that the cost basis of accounting should be applied and the Board should reject full goodwill accounting.
We would like to emphasise that we have serious doubts that the usefulness of financial information would be improved by implementing the full goodwill method for the reasons discussed above. In our opinion, ED IFRS 3 should continue to be based on the parent-only, cost-based approach, i.e. the aggregate of the fair value of the consideration transferred by the acquirer in exchange for control of the acquiree plus costs directly attributable to the business combination, of the current IFRS 3. Any difference between the cost of the business combination and the acquirer’s interest in the net fair value of the identifiable assets and liabilities shall be accounted for as goodwill.

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 4 – 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?

In our view ED IFRS 3 does not provide sufficient guidance on measuring the fair value of an acquiree. The Board presumes that the exchange price paid by the acquirer on the acquisition date is, in principle, the best evidence of the acquisition-date fair value of the acquirer’s interest in the acquiree. This is not always a valid assumption, since it ignores the fact that the exchange price usually contains a control premium reflecting expected synergies when less than 100 per cent of the equity interests of an acquiree are purchased. Therefore, the consideration transferred usually cannot be taken into account alone measuring the fair value of an acquiree. It will also be necessary to take further information that has a significant effect on the estimation of the fair value of the acquiree into account.
Quoted market prices as used in Appendix E measuring the fair value of the acquiree will not be available in most cases. In such circumstances entity inputs in the form of information derived from an entity’s own internal estimates and assumptions will replace market inputs and have a significant influence on the determination of the fair value of the acquiree. In comparison to fair values derived from market inputs recourse to internal information will undoubtedly reduce the reliability of the measurement. Furthermore, considering cost-benefit aspects, we are of the opinion that such an approach is unreasonable.

In our view, the examples provided are helpful. However, they do not address the more complex cases that are often relevant in practice.

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 5 – 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?

As outlined above we do not agree that the acquisition-date fair value of the consideration transferred in exchange for the acquirer’s interest in the acquiree is necessarily the best evidence of the fair value of that interest. As mentioned above, the fair value of the consideration transferred usually includes a control premium reflecting the impact of anticipated synergies realisable only as a result of the combination of the particular acquirer and the acquiree. The fair value of the interest in the acquiree defined as the price at which that interest could be exchanged in a current transaction between knowledgeable, unrelated, willing parties, however, will not contain such a premium for synergy effects. Therefore, the fair value of the consideration transferred will usually differ from the fair value of the interest in the acquiree.
As already stated, we consider the cost basis accounting preferable for measuring the value of the acquiree. In this case, the fair value of the consideration transferred in exchange for the acquirer’s interest will be considered as the purchase price of the acquiree. Adopting this approach would remove the need to determine the fair value of the acquirer’s interest in the acquiree.

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

We are in doubt whether the proposed accounting for contingent consideration after the acquisition date is appropriate. Contingent considerations are often arranged if the acquirer and the seller are unable to reach an agreement about the fair value of the acquiree. If e.g. a contingent consideration is agreed on that basis, i.e. to reflect solely any uncertainty about the appropriate fair values, an adjustment of the consideration should be recognised as an adjustment to acquisition accounting.

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 7 – 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 do not agree that the costs incurred by the acquirer in connection with a business combination should be excluded from the measurement of the consideration transferred for the acquiree because recognising acquisition-related costs as expenses is neither in line with the cost basis of accounting nor consistent with accounting for purchases of assets (AV18). In BC88 the Board states that the treatment of acquisition-related costs should be similar for acquisitions of an individual asset, a group of assets and a business. In our opinion, acquisition-related costs are an unavoidable cost directly resulting from, and attributable to, the investment in a business and, as such, should be capitalised as part of the total investment in the business. Furthermore, the acquirer will only purchase the acquiree if the value of the acquiree from the acquirers' perspective will at least equal the sum of the consideration transferred and any related costs that the acquirer incurs in connection with the business combination.

In our view, costs that the acquirer incurs in connection with a business combination constitute part of the purchase consideration of the acquired business for the acquirer and should, therefore, be included in measuring the consideration transferred for the acquiree.

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 8 – 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 an identifiable asset or liability (contingency) should be measured and recognised 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 if the amounts to be recognised are limited to the values reflected in the purchase price consideration.

However in our opinion, on account of the resulting practicality considerations when the probability of the occurrence or non-occurrence of one or more uncertain future events is very remote, a liability should not be recognised.

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 9 – 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 agree that these exceptions to the fair value measurement principle are appropriate.

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 10 – 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 do not agree that it is 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. The proposed accounting will result in a realisation of built-in gains, although there has been no corresponding transfer of the previously acquired non-controlling equity investment. When significant minority interests have existed for a long period of time, such treatment might have a substantial impact on reported profit. In our view, it is not appropriate to remeasure non-controlling interests, since such treatment contradicts the cost basis of accounting.

Should the Board however proceed with its proposal revaluation, we are of the opinion that gains or losses should not be recognised in profit or loss but in equity.

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 11 – 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?

As an alternative to the proposed treatment we would prefer a re-introduction of the treatment of negative goodwill pursuant to IAS 22. Expectations of future losses cannot always be allocated to the assets of the acquiree, since by definition the fair values do not encompass the expected future losses of an entity as a whole.
Therefore, although future anticipated losses may be included in negative goodwill, it would not be reasonable to recognise such a negative goodwill as gain immediately.

However, should the Board proceed with its proposal, we agree with the proposed accounting for those business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest as it leads to a mitigation of the potential for inappropriate gain recognition due to measurement errors. The Board should bear in mind, as stated in BC177, that placing limits on gain recognition is not in line with the fair value measurement principle of ED IFRS 3. The Board seems to be in doubt as to the practicality and reliability of the proposed fair value accounting. We wonder, why the Board is proposing a pragmatic approach regarding the accounting of 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 but apparently deviating from this approach in developing the full goodwill approach.

It would be helpful if the Board could expand the example in A67 in respect of goodwill attributable to the non-controlling interest that would tentatively be recognised pursuant to paragraph 49.

Question 12 – 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?

An overpayment may occur as a result of misinformation at the acquisition date or be attributable to irrational behaviour on the part of the acquirer's management. In our view, it will be difficult to measure such an overpayment reliably. Should it prove true, that the fair value of the acquiree cannot be determined reliably in case of overpayments, we question the Board's assumption regarding the full goodwill concept as there appears to be an inconsistency in this respect.

ED IFRS 3 does not contain an explicit requirement regarding the accounting treatment of an overpayment. According to BC178 an overpayment has to be addressed through subsequent impairment testing instead of an immediate impairment. The Board should explain, why management would be able to identify an overpayment that cannot be identified at the acquisition date by means of a subsequent impairment test.
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 13 – 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 agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments.

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 14 – 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 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.

According to A93 a pre-existing relationship may be a contract between acquirer and acquiree in which the acquirer had previously granted the acquiree the right to use the acquirer’s recognised or unrecognised intangible assets. We doubt that it is reasonable to require the acquirer to recognise an intangible asset for that right separately from goodwill as part of the business combination accounting, since the acquirer would thereby be required to present a right to use its own intangible assets.
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 15 – 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?

Many of the disclosures would not be applicable if our proposals for accounting for business combination stated in the general remarks of this letter were adopted.

In our opinion providing the disclosures required for each material business combination would be too burdensome from a cost-benefit perspective.

According to ED IFRS 3.74 (b) the revenue and profit or loss of the combined entity for the current reporting period should be disclosed as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. In our view, the new business structure starts at the acquisition date and, therefore, this kind of pro-forma information is not truly relevant and, hence, not needed.

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 16 – 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?
IFRS 3 requires that an intangible asset acquired in a business combination shall be reliably measurable for it to be recognised. According to BC99 the Board concluded that sufficient information should exist to measure reliably the fair value of an intangible asset and, therefore, decided not to include a reliability of measurement criterion equivalent statement in ED IFRS 3. Reliability is a criterion for recognition in the Framework. In our opinion, it is not reasonable to presume for business combinations that it is always possible to determine the fair value of an intangible asset reliably. Hence, we would prefer to explicitly retain the reliability of measurement recognition criterion and reintroduce it in ED IFRS 3. We would also like to suggest that the Board provide guidance on how to measure the fair value of those intangible assets stated as examples of intangible assets that are identifiable in paragraphs A35-A61.

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 17 – 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?

In our view, 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 those benefits were not part of the purchase consideration.

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 18 – 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 are disappointed that some divergences between ED IFRS 3 and FASB standards still remain despite the agreed objective being to achieve full convergence. This unfortunately means that, in any subsequent full convergence project, further changes to IFRS will be necessary. We would prefer to see convergence of standards in all respects to the maximum degree possible rather than this step-by-step approach, because, as we have repeatedly pointed out, each Standard must be sufficiently robust so as to remain valid for an extended period so that subsequent changes are kept to an absolute minimum.

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 19 – 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 find the bold type-plain type style of the Exposure Draft helpful. We have not identified any paragraphs that should be changed from one typeface to another.

Yours sincerely

Klaus-Peter Naumann
Chief Executive Officer

Norbert Breker
Technical Director
Accounting and Auditing