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German Accounting Standards Committee e. V.
Der Standardisierungsrat

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Sir David Tweedie
Chairman of the
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Berlin, 27. Oktober 2005

Dear David

Business Combinations Project (Phase II) of the IASB

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on IASB's Phase II of the Business Combinations Project (i.e. ED IFRS 3amend *Business Combinations* and ED IAS 27amend *Consolidated and Separate Financial Statements*). We appreciate the opportunity to comment on the proposals.

The GASB supports the efforts to establish uniform international accounting requirements and welcomes the first attempt by IASB and FASB to jointly develop a single standard on accounting for business combinations. However, we do not agree with some fundamental principles laid out in the objective of ED IFRS 3amend and have major concerns about the main features of this draft.

GASB holds other views regarding:

- the application of IFRS 3 to business combinations involving solely mutual entities and business combinations achieved by contract alone (cf. ED IFRS 3amend / Question 1),
- the recognition of the acquisition-date fair value of the acquiree including the goodwill attributable to the non-controlling interest (cf. ED IFRS 3amend / Question 3),
- the treatment of acquisition-related costs as expenses (cf. ED IFRS 3amend / Question 7) and
- the accounting for business combinations achieved in stages (cf. ED IFRS 3amend / Question 10).

Consequently we also do not share IASB's views relating to

- the accounting for changes in ownership interests without loss of control (cf. ED IAS 27amend / Question 1) and
- the treatment of remaining non-controlling equity investments in the former subsidiary (cf. ED IAS 27amend / Question 2).

As to the project schedule in general, we consider it unfortunate that the basic concepts - fair value approach and entity theory - have not been properly discussed beforehand by means of a Discussion Paper issued by the Board**.** It seems that the Exposure Draft is a further step on the way to introduce the full Fair Value model without having a proper discussion of the future accounting model in general. We understand that the FASB has agreed upon the full fair value model as the relevant future model. The IASB, however, has not (yet) and has delayed this discussion since 2001, nevertheless the IASB follows this route.
We doubt whether the further expansion of the fair value model was truly demanded by the IASB's constituents including investors and financial analysts and whether information usefulness is truly improved. We also believe that the new standards when adopted in this form will place significant burden on the preparers, e.g. fair value valuation of the acquiree, increased complexity in carrying out impairment testings, recognition of unlikely unconditional contingencies as well as extended note disclosures. In light of the foregoing we wonder whether an appropriate cost/benefit analysis has been actually carried out. At least we would have expected that the IASB should have carried out sufficient field tests with its own constituents to obtain better insight of the implications of its major changes. We understand that just the FASB has carried out a limited enquiry.

Furthermore we miss clear guidelines on the upcoming contents and the timeframe; it is not clear how many phases the project "business combinations" comprises and to what extent further changes are foreseen. Additionally, we do not appreciate delaying further the research on the following issues of the project "Business Combinations II": the possible application for fresh start accounting and the accounting for business combinations involving entities under common control. Continuous amendments to the accounting of business combinations result in undue cost for preparers as well as users of financial statements.

In the following GASB submits its comments. An overview of the main issues is given in section A. Our responses to the particular questions raised in the ED IFRS 3amend *Business Combinations* follow in section B. Our comments on the questions to ED IAS 27amend *Consolidated and Separate Financial Statements* are set out in section C.

If you would like any clarification of these comments, please contact me.

Yours sincerely,

Prof. Dr. Klaus Pohle
President

Section A
Summary of main issues of GASB's comments on ED IFRS 3amend and ED IAS 27amend

Scope of ED IFRS 3amend

As to the definition of a business combination, GASB appreciates that the new definition focuses on control. The term „acquirer obtains control" is in line with the control concept, which forms the basis of the standard. Nevertheless, we see the new definition as being inconsistent with IASB's intention to include all business combinations in the scope of IFRS 3 within the scope of ED IFRS 3amend, because the definition does not seem to include true mergers.

The need for a wider definition in order to include mergers as well as acquisitions shows that the acquisition method might not be appropriate for mergers. Mergers occur especially in the area of combinations involving solely mutual entities and combinations by contract alone. Therefore, we doubt that the inclusion of these combinations in the scope of ED IFRS 3amend is justified.

Recognition of the acquisition-date fair value of the acquiree and implementation of the full goodwill method

GASB noted that these proposed amendments are in line with the fair value approach as well as the entity theory the IASB pursues. But unfortunately these concepts have not been discussed on a more conceptual basis beforehand. From our point of view it is not obvious that the proposed changes are in the interest of investors and investment analysts. Therefore we are in doubt about the improvement of the information usefulness. We suggest giving more reasons (e.g. based on field studies) in this regard.

Particularly we refer to the special character of goodwill. It is not identifiable and includes synergies. Synergies are regularly entity specific and therefore contradictory to the intended recognition of a business combination at an objective fair value of the acquiree. Furthermore we identified application problems which arise from the special character of the goodwill.

Concerning these matters IASB's argumentation to treat goodwill in the same way as other assets does not seem to be a sufficient reasoning for the implementation of the full goodwill method. In our opinion a different treatment of goodwill in comparison to other assets is justifiable because of its special character mentioned above. The IASB also considers this in its proposed treatment of a bargain purchase (cf. question 11). In this regard IASB's proposals seem inconsistent. Also, IASB's proposed treatment of an overpayment does not seem to be consistent with the intended recognition of a business combination at the fair value of the acquiree as a whole.

Acquisition-related costs

As mentioned above we do not agree that the total amount to be recognised for the acquiree should be the fair value of the acquiree as a whole and prefer the current recognition of a business combination at its cost instead. Consequently we also disagree with the proposal to account for acquisition-related costs separately from the business combination accounting.

Business Combination achieved in stages / remeasurement of a non-controlling equity investment remaining in the former subsidiary

We agree that obtaining control for the first time changes the character of the prior non-controlling investment. But with regard to the pre-existing interests there is no exchange between market participants which warrants to remeasure the non-controlling equity investment at its acquisition-date fair value and to recognise any unrealised gains or losses in income. Rather there is the creation of the controlling interest by the entity's combination of several non-controlling investments. Therefore we prefer the current cost-based treatment under IFRS 3.58-60.

Consequently we also disagree with the proposed remeasurement of a non-controlling equity investment remaining in the former subsidiary.

Recognition of intangible assets

We share the view of the IASB that an appropriate distinction between identifiable intangible assets and goodwill enhances the information usefulness of financial statements. Therefore we are of the opinion that in a business combination the criterion "identifiable" should be the decisive factor to recognise assets and liabilities separately.

Nevertheless, we believe that the proposed wording of ED IFRS3amend D11.35 ("…information always exists to measure reliably the fair value…") is too strict. Hence we prefer a rebuttable presumption as in the current version of IAS 38.35.

Changes in parent's ownership interest in a subsidiary after control is obtained

The proposal to account for changes in ownership interest without loss of control as transactions between equity holders is in line with the IASB's concept. However we would like to point out that in the case of increasing market values an increase in ownership interest after control is obtained reduces the carrying amount of equity in the consolidated balance sheet. We are not sure if this treatment meets the information needs of the investors.

In addition we noted that the prospective application of the full goodwill method enhances this effect since the carrying amount of non-controlling interest under the current IFRS 3 is less than under the proposed full goodwill method.

In view of the fact that the usefulness of information is doubtful and our reservations about the full goodwill method we prefer the alternative approach of accounting such transactions as purchase and disposal respectively.

Loss allocation to non-controlling interests

We acknowledge that this proposed amendment is also in line with the entity theory and appreciate the consistency of the provisions of the Exposure Drafts. However, from our point of view misleading information may result from the aggregation of several positive and negative non-controlling interests. Therefore we prefer the current treatment under IAS 27.35 or recommend requiring additional disclosure of the negative amount of non-controlling interests insofar as there are no binding obligations to make an additional capital contribution to cover these losses.

Further Issues

Additionally we would like to point to two consequential amendments:

- **IAS 33**: the determination of Earnings per Share needs to be adapted as the current version is based on the parent company theory. IAS 33.12 refers to a profit or loss attributable to the parent entity; under the ED the result of the year no longer distinguishes in the same way between the parent company and other shareholders.
- **IAS 36**: In contrast to the current treatment, the proposed full goodwill method will require any goodwill impairment losses to be allocated to the controlling and non-controlling interests. In the case of high level cash-generating units including at least two partly-owned subsidiaries this will require first the allocation of impairment losses to the components of the cash-generating unit (i.e. to the partly-owned subsidiaries) which will also increase the complexity of carrying out impairment testings.

  However, the IASB concludes in BC 155 to IAS 36 that "the proposed level of the impairment test would mean that goodwill could not be identified or associated with an asset group at a level lower than the cash-generating unit to which the goodwill is allocated, except arbitrarily". We think that this conclusion implies that goodwill impairment losses could not be allocated to the lower level components of the cash-generating without arbitrariness. Therefore we are concerned that the proposed full goodwill method might be inconsistent with IAS 36.

  Additionally, we would like to point out that the proposed treatment in ED IFRS 3amendD10.C.10 does not seem to be appropriate since in later reporting periods the initial proportion of the individual purchased goodwill amounts attributable to the partially-owned subsidiaries to the aggregated goodwill attributed to the cash generating unit might change.

  Moreover we noted that in the case of a discontinued operation IAS 36.86 requires the inclusion of goodwill "…on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained…". Consequently the goodwill associated with the operation disposed of will not to be measured on the basis of the purchased goodwill less allocated impairment. This treatment increases our concerns of an inconsistency between the ED and IAS 36.

GASB´s comments on ED IFRS 3amend

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.

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?

As already mentioned, GASB does not agree with some fundamental principles laid out in the objective of ED IFRS 3amend. We doubt that the full goodwill method improves the information usefulness (cf. ED IFRS 3amend / Question 3) and that it is workable (cf. ED IFRS 3amend / Question 4). Therefore, we have reservations about recognising the acquired business at the fair value of the acquiree as a whole regardless of the percentage of the equity interest which the acquirer holds at the acquisition date and prefer the retention of the current recognition of a business combination at its costs, i.e. purchase consideration plus transaction costs.

As to the definition of a business combination, GASB appreciates that the new definition focuses on control. The term „acquirer obtains control" is in line with the control concept, which forms the basis of the standard. Nevertheless, we see the new definition as being inconsistent with IASB's intention to include all business combinations in the scope of IFRS 3 within the scope of ED IFRS 3amend, because the definition does not seem to include true mergers.

The need for a wider definition in order to include mergers as well as acquisitions shows that the acquisition method might not to be appropriate for mergers. Mergers occur especially in the area of combinations involving solely mutual entities and combinations by contract alone. Therefore, we doubt that the inclusion of these combinations in the scope of ED IFRS 3amend is justified.

We would find it inappropriate to delay the research of alternative accounting methods – such as the fresh start method – until another phase of the Business Combinations project. Further research might show that another accounting method is preferable compared to the proposed treatment. Consequently further amendments seem possible in the near future. From our point of view frequent amendments result in undue cost for preparers as well as users of financial statements.

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?

GASB welcomes the development of a converged definition of a business as well as the related guidance. Nevertheless, we find the dividing line between business combinations and acquisitions of asset groups is not sufficiently clear. Especially the wording in IFRS 3amendA3 ("However, a business need not to include all of the inputs and procedures that the seller used in operating that business if a willing party is capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with its own inputs and processes) seems to be misleading. Furthermore, we find that the guidance does not give an obvious answer whether the acquisition of a group of employees is a business combination. Therefore we would appreciate a clarification of the guidance.

In addition in order to avoid inappropriate financial structuring we recommend eliminating the different accounting treatment for a business combination and a purchase of an asset group as soon as possible if the characteristics of the transactions are alike.

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?

GASB noted that these proposed amendments are in line with the fair value approach as well as the entity theory the IASB pursues. But unfortunately these concepts have not been discussed on a more conceptual basis beforehand. From our point of view it is not obvious that the proposed changes are in the interest of investors and investment analysts. Therefore we are in doubt about the improvement of the information usefulness. We suggest giving more reasons (e.g. based on field studies) in this regard.

Particularly we refer to the special character of goodwill. It is not identifiable and includes synergies. Synergies are regularly entity specific and therefore contradictory to the intended recognition of a business combination at an objective fair value of the acquiree.

Furthermore we identified application problems which arise from the special character of the goodwill. Since it is a residual amount its measurement requires determining the value of the acquiree as a whole. But an objective measurement of the value of the acquired entity as a whole in business combinations in which the acquirer acquires less than 100 per cent of the equity interests raises problems. This is due to the fact that the consideration transferred by the acquirer for its interest is often not an appropriate basis for measuring the fair value of the acquiree as a whole because of paid control premiums and entity specific synergies (cf. question 4). Moreover, these may interfere with the allocation of goodwill to the controlling and non-controlling interests. Also we believe the full goodwill method will cause considerable costs.

Concerning these matters IASB's argumentation to treat goodwill consistently with other assets does not seem to be a sufficient reasoning for the implementation of the full goodwill method. In our opinion a different treatment of goodwill in comparison to other assets is justifiable because of its special character mentioned above. The IASB also considers this in its proposed treatment of a bargain purchase (cf. question 11). In this regard IASB's proposals seem inconsistent.

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?

GASB believes that ED IFRS 3amend does not sufficiently clarify what the main principles are for the measurement of the fair value of the acquiree. The first impression is that the consideration transferred is the primary basis for measuring the fair value of the acquiree. But this does not hold true for purchases of less than 100 per cent of the equity interests of an acquiree.

In these cases the main problem is the valuation of a control premium. Hence also other information shall be used to estimate the fair value of the acquiree. Even though the consideration transferred might be considered the influence of other information affects the estimation of the fair value of the acquiree substantially.

In addition we recognised that quoted marked prices - which are mentioned in the guidance for measuring the fair value of the acquiree using the consideration transferred - do not exist in many cases. Therefore entity inputs will play a decisive role and affect the reliability adversely.

Furthermore we think that observable prices for a business similar to the acquiree are very rare. Consequently valuation techniques are the alternative if the control premium cannot be measured otherwise. This leaves a lot of room for judgement.

In addition we would like to point out that entity specific synergies are problematic. They are considered differently dependent on the chosen measurement method. For instance they are included in the measurement of the fair value of the acquiree when using the consideration transferred and excluded when using the market approach.

GASB also thinks that it is not sufficiently clear to what extent the preparer is obliged to prove that the consideration transferred is the best basis for measuring the fair value of the acquirer's interest and for the fair value of the acquiree as a whole. Taken into account that example 3 requires: "AC should refine its initial estimate of the fair value using other relevant valuation techniques." this requirement seems to be too broad and might cause excessive efforts and burden respectively. But this contradicts IASB's intention to use the consideration transferred not only for the reason of obtaining a more reliable measurement but also to mitigate the costs.
From GASB's point of view the reasons given above show that the application guidance does not achieve the intended objective measurement of the fair value of the acquiree. It rather demonstrates that the fair value model is not workable.

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?

We generally support this assumption. However, as laid out under question 3 we doubt that recognising the fair value of the acquiree as a whole improves the information usefulness. Furthermore, we doubt that the consideration transferred will be the main basis for the measurement of the fair value of the acquiree as a whole in most cases (cf. question 4). Therefore this assumption does not ensure the intended objective measurement of the fair value of the acquiree or the reduction of costs of this measurement.

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?

GASB agrees with the proposed accounting for contingent considerations after the acquisition date. The decision not to remeasure contingent considerations classified as equity is consistent with other standards (cf. IAS 32.22 and IFRS 2).

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?

As GASB prefers the recognition of a business combination at its cost we disagree with the proposed treatment of the acquisition related costs.

Nevertheless, recognising the costs that the acquirer incurs in connection with a business combination as an expense is in line with the fair value approach chosen by the IASB. But for a consistent application further amendments to other IASs / IFRSs - for instance IAS 39.43. - are necessary. In this regard we repeatedly criticise that the fair value approach was not discussed in the required extent.

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 support the IASB's objective to eliminate inconsistencies between IFRS 3 and IAS 37 as well as the framework. Furthermore we appreciate that the ED proposes to treat former contingent liabilities arising from business combinations consistently with former contingent asset arising from the business combination. Nevertheless, inconsistencies further exist. The proposals results in a different treatment of contingent assets in separate and consolidated financial statements. Moreover the recognition criteria set down in IAS 38 differ from those set down in ED 37amend.

As to analysing contingencies by introducing the separation of an unconditional element from the conditional element we are concerned that this concept lead to a recognition of contingencies that in our opinion do not (yet) meet all Framework criteria. Additional we find the obligating event for the unconditional right / obligation not always sufficiently clear. Details to these concerns are contained in our comments to IAS 37amend.

With regard to the proposed measurement we recognise that establishing the fair value approach as the measurement basis for all contingencies will require preparers to make highly subjective assumptions because there are only seldom observable market transactions or other market-based measures for such contingencies. As there is no agreement on appropriate valuation techniques for contingencies diversity in practice will be the result.

Reliability is also affected whenever singular events and small probabilities are involved and this strengthens our doubts whether decision usefulness is improved by recognising unlikely contingencies.

Besides the measurement of unlikely unconditional obligations accompanied by a conditional obligation is a very extensive and therefore extremely costly procedure.

Furthermore, we would like to point out that additional guidance on subsequent measurement of unconditional rights accompanying conditional rights needs to be incorporated in IAS 38.

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?

Generally these exceptions are inconsistent with the main principle to measure the assets acquired and liabilities assumed at fair value. Nevertheless, GASB accepts that practicability concerns have to be taken into account. Therefore GASB agrees with the proposed exceptions.

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 agree that obtaining control for the first time changes the character of the prior non-controlling investment. But with regard to the pre-existing interests there is no exchange between market participants which warrants to remeasure the non-controlling equity investment at its acquisition-date fair value and to recognise any unrealised gains or losses in income. Rather there is the creation of the controlling interest by the entity's combination of several non-controlling investments. Therefore we prefer the current cost-based treatment under IFRS 3.58-60.
Consequently we also disagree with the proposed remeasurement of a non-controlling equity investment remaining in the former subsidiary.

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?

The proposed treatment results in a different treatment of goodwill and other assets / liabilities. Considering the special character of goodwill this seems reasonable to ensure objectivity. Therefore GASB supports limiting gain recognition by reducing goodwill.

However, we noted that this treatment is not in line with IASB's intention to treat goodwill consistently with other assets. Furthermore it is not in line with the fair value approach taken by the IASB, whereby the total amount to be recognised by the acquirer is the full fair value of the acquiree at the acquisition date. IASB's reference to difficulties in practice does not seem to be a convincing argument as IASB does not consider practical issues by its proposed recognition of a business combination at the fair value of the acquiree as a whole and the proposed implementation of the full goodwill method.

In addition we would like to point out that GASB is not of the opinion that a business combination in which the consideration for the acquirer's interest is less than the fair value of that interest and which is not a forced transaction but negotiated at arms' length between unrelated parties, is an event that should give rise to income. The excess may relate in many cases to uncertainties in the measurement of assets and liabilities.

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?

GASB believes that there are cases where an overpayment is identifiable. For example an acquirer receives information after the agreement date but before the acquisition date which shows that expected synergies or income potentials do not exist.

Nevertheless, GASB shares the opinion that in most cases a reliable measurement of an overpayment is difficult or impossible. But IASB generally assumes that the fair value of the acquiree can be measured reliably. Hence IASB's arguments are not consistent and therefore not convincing.

Furthermore GASB does not believe that the accounting for an overpayment is best addressed through subsequent impairment testing. Our concerns are based on the fact that a correction would not be made, if the overpayment is allocated to cash generation units with a relatively high amount of self-generated goodwill (not recognised).

In addition, GASB deems the intended treatment of an overpayment not sufficiently succinct. This is due to the fact that the definition of goodwill refers to the fair value of the acquiree and not to the consideration transferred.

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?

GASB agrees, but only in the case of material items concerned.

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?

GASB has not identified problems regarding this issue and therefore believes 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.

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?

GASB agrees with the disclosure objectives. We are aware that the chosen fair value approach and the intricacy of ED IFRS 3amend require far-reaching disclosures. Nevertheless, we find the minimum disclosure requirements quite extensive. Paragraph 76d seems dispensable to us. Since FASB does not require this disclosure the deletion would also enhance the convergence. Furthermore we believe the exception "impracticable" in paragraph 73b and 79b will be the rule in most cases. Hence we find a general requirement in IAS 10 more appropriate. But we would only support this procedure if the reduction of disclosure requirements does not affect the convergence substantially.

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?

We share the view of the IASB that an appropriate distinction between identifiable intangible assets and goodwill enhances the information usefulness of financial statements. Therefore we are of the opinion that in a business combination the criterion "identifiable" should be the decisive factor to recognise assets and liabilities separately.

Nevertheless, we believe that the proposed wording of ED IFRS3amend D11.35 ("…information always exists to measure reliably the fair value…") is too strict. Hence we prefer a rebuttable presumption as in the current version of IAS 38.35.

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?

GASB agrees with IASB's opinion that the acquirer's deferred tax benefits - that become recognisable because of the business combination - are an attribute of the acquirer rather than the acquiree.

However, we recognise that these company-specific synergies of the acquirer are taken into account for the determination of the consideration transferred by the acquirer. Consequently acquirer's deferred tax benefits affect the measurement of a business combination at its costs as well as the proposed measurement at the fair value of the acquiree since ED IFRS 3amend requires using the consideration transferred to measure the fair value of the acquiree. But

usually not the full amount of the acquirer's deferred tax benefits is included in the consideration transferred. Therefore GASB suggests the inclusion of acquirer's deferred tax benefits in the amount included in 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?

GASB prefers a convergence as far as possible. Therefore, we suggest the deletion of paragraph 76d (cf. Question 15). Furthermore we urge the IASB and FASB to reconsider the disclosure requirements particularly as IASB itself explains above that only some of the divergences result from differences that are broader than the Business Combinations project.

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?

Yes, GASB finds the bold type-plain type style helpful. So far it has not identified any necessary modifications.

OTHER COMMENTS

Additionally we would like to point to two consequential amendments of IAS 33 and IAS 36.

IAS 33

The determination of Earnings per Share needs to be adapted as the current version is based on the parent company theory. IAS 33.12 refers to a profit or loss attributable to the parent entity; under the ED the result of the year no longer distinguishes in the same way between the parent company and other shareholders.

IAS 36

In contrast to the current treatment, the proposed full goodwill method will require any goodwill impairment losses to be allocated to the controlling and non-controlling interests. In the case of high level cash-generating units including at least two partly-owned subsidiaries this will require first the allocation of impairment losses to the components of the cash-generating unit (i.e. to the partly-owned subsidiaries) which will also increase the complexity of carrying out impairment testings.

However, the IASB concludes in BC 155 to IAS 36 that "the proposed level of the impairment test would mean that goodwill could not be identified or associated with an asset group at a level lower than the cash-generating unit to which the goodwill is allocated, except arbitrarily". We think that this conclusion implies that goodwill impairment losses could not be allocated to the lower level components of the cash-generating without arbitrariness. Therefore we are concerned that the proposed full goodwill method might be inconsistent with IAS 36.

Additionally, we would like to point out that the proposed treatment in ED IFRS 3amendD10.C.10 does not seem to be appropriate since in later reporting periods the initial proportion of the individual purchased goodwill amounts attributable to the partially-owned subsidiaries to the aggregated goodwill attributed to the cash generating unit might change.

Moreover we noted that in the case of a discontinued operation IAS 36.86 requires the inclusion of goodwill "…on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained…". Consequently the goodwill associated with the operation disposed of will not to be measured on the basis of the purchased goodwill less allocated impairment. This treatment increases our concerns of an inconsistency between the ED and IAS 36.

Section C
GASB´s comments on ED IAS 27amend

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).
Do you agree? If not, why not and what alternative would you propose?

GASB appreciates that the IASB specifies the consequences of its prior decision to present non-controlling interests in the consolidated balance sheet within equity. With this requirement IASB has taken a decision in favour of the entity concept. The proposal to account for changes in ownership interest without loss of control as transactions between equity holders is in line with this concept.

However, we would like to point out that in the case of increasing market values an increase in ownership interest after control is obtained reduces the carrying amount of equity in the consolidated balance sheet. We are not sure if this treatment meets the information interests of the investors.

In addition we notice that the prospective application of the full goodwill method enhances this effect since the carrying amount of non-controlling interest under the current IFRS 3 is less than under the proposed full goodwill method.

In view of the fact that the usefulness of information is doubtful and we are also not convinced by the full goodwill method we prefer the alternative approach of accounting such transactions as purchase and disposal respectively.

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).
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?

GASB refers to the connection to ED IFRS 3amend.56 and the corresponding question 10. In conformity with the opinion expressed there we disagree with the fair value remeasurement of the equity investment remaining in the former subsidiary at the date control is lost. Consequently we also disagree with recognising the difference between the fair value and the carrying amount of any investment remaining in the former subsidiary in profit or loss. Our reasoning is laid out in the answer to question 10 under ED IFRS 3amend as well.

QUESTION 3

As explained in question one, 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. On the other hand, 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. In order to reduce this risk, the Exposure Draft proposes that if one or more of the indicators in paragraph 30G 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 unless it can be clearly demonstrated that such accounting would be inappropriate (see paragraphs BC11-BC16).

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 30G are present? Are the proposed factors suitable indicators? If not, what alternative indicators would you propose?

GASB appreciates IASB's proposals for restricting creative accounting and we generally consider this an appropriate means. Besides we welcome that the IASB considers the development of a separate statement on linked transactions in the form of an IFRIC Interpretation (BC12) since we think this is more in line with IASB's principle-based approach.

However, additional guidance might be required since the IASB does not describe how to apply this requirement when multiple arrangements that result in a loss of control are settled before as well as after the balance sheet date. There seem to be two possibilities: the entity could either immediately recognise a profit or loss or recycle the profit or loss at the date control is lost.

Furthermore GASB recommends including an example for a better understanding of the issue.

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.
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?

We recognise that the proposed amendment is in line with the entity theory the IASB pursues. But from our point of view misleading information may result from the aggregation of several positive and negative non-controlling interests. Therefore we prefer the current treatment under IAS 27.35 or recommend requiring additional disclosure of the negative amount of non-controlling interests insofar as there are no binding obligation to make an additional capital contribution to cover these losses.

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.
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?

Generally GASB favours the retrospective application of the requirements as this enhances comparability over time. However, under the exemptions mentioned above the prospective treatment seems to be justifiable in respect of practicability. Therefore GASB agrees with the proposed transitional provisions.

Nevertheless, we wonder why IAS 27.43 B (a) refers only to increases, which implies that a prospective application of the provision is limited to increases, while decreases need to be accounted for retrospectively. GASB recommends clarifying that the prospective treatment applies to increases as well as decreases.

Furthermore we would like to refer to the correlation between the prospective application of the full goodwill method and ED IAS 27amend30A. As mentioned in our comments on question 1 the prospective application of the full goodwill method results in a higher reduced amount of equity in the case of an increase in ownership interest after control is obtained.

OTHER COMMENTS

Paragraph 30B describes how goodwill is to be reassigned when changes in the parent's ownership interest in a subsidiary occur that do not result in a loss of control. GASB is under the impression that these provisions do not define precisely enough just how the goodwill should be reassigned. The Standard states the reassignment of goodwill should be based on the relative carrying amounts of goodwill to each of those groups of equity holders on the date control was obtained. But there is a difference in taking as a starting point for reassignment either the original goodwill of the non-controlling interests ([15 % x 15] / 10 % = 22,5; Δ = 7,5) or the original goodwill of the controlling interests ([85 % x 285] / 90 % = 269,16; Δ = 15,83).

Furthermore GASB has doubts whether the procedure shown in example 4 is reasonable since different solutions depending on the starting point do not seem acceptable. Therefore we suggest dealing with the control premium as an absolute term. The carrying amount of goodwill would be multiplied by the controlling (300 x 85 % = 255) or non-controlling interest (300 x 15 % = 45) first. The control premium would be added (255 + 15 = 270) or subtracted (45 – 15 = 30) only in a second step.