Deutsches Rechnungslegungs Standards
German Accounting Standards Committee e. V.
Der Standardisierungsrat

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Sir David Tweedie
Chairman International Accounting Standards Board
30 Cannon Street
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Berlin, 16. Juli 2004

Dear Sir David

ED of Proposed Amendments to the Scope of IFRS 3 *Business Combinations*

German Accounting Standards Board appreciates the opportunity to comment on the ED of Proposed Amendments to the Scope of IFRS 3 *Business Combinations.*

<u>Question 1</u>

The Exposure Draft proposes:

(a) to remove from IFRS 3 the scope exclusions for business combinations involving two or more mutual entities and business combinations in which separate entities are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.

(b) to require the acquirer to measure the cost of a business combination as:

(i) the aggregate of the following amounts when the combination is one in which the acquirer and acquiree are both mutual entities:

- *the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities; and*
- *the fair value, at the date of exchange, of any assets given, liabilities incurred or assumed, or equity instruments issued by the acquirer in full or partial exchange for control of the acquiree.*

Therefore, goodwill would be recognised in the accounting for such transactions only to the extent of any consideration given by the acquirer in full or partial exchange for control of the acquiree.

(ii) the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities when the combination is one in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest. Therefore, no goodwill would arise in the accounting for such transactions.

Is this an appropriate interim solution to the accounting for such transactions until the Board develops guidance on applying the purchase method to such transactions as part of a subsequent phase of its Business Combinations project? If not, what other approach would you recommend as an interim solution to the accounting for such transactions, and why?

Response of GASB

GASB agrees to the proposed accounting for business combinations involving two or more mutual entities and for business combinations in which separate entities are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest in the way described below. The drafted guidance is only acceptable keeping in mind that it is intended as an interim solution.

GASB is of the opinion that practical application of the proposed amendments will lead to problems that should not be ignored. First of all, the terms “mutual entity” and “business combination by contract alone” are not sufficiently defined. In the context of the German legal system it leaves room for discussion to which business combinations the interim solution has to be applied.

Secondly, the nature of a business combination by contract alone is that effectively no acquisition has taken place and no consideration has been exchanged. By definition, a business combination by contract alone is not an acquisition solely arranged by one dominant party. Without getting further guidance from the proposed standard it will therefore be difficult to unambiguously identify an acquirer who has to account for the transaction in accordance with the proposed amendments to IFRS 3.

GASB wants to emphasize that a sound Standard including a lasting guidance on the accounting for transactions described above should be developed as soon as possible. While doing so the scope exclusion in IFRS 3 should be eliminated. In cases described in the Exposure Draft preparers should first have to follow the rules laid out in IFRS 3. Only in cases where this would lead to substantially misleading results the proposed rules of the Exposure Draft should be used. This method of use should be applicable until a final rule has been developed.

While preparing the new standard IASB should take into consideration the existence of true mergers. If effectively no acquirer can be identified application of the purchase method might lead to misleading results. In order to address the problem appropriately IASB should further discuss alternative accounting treatments, such as the fresh start method.

Question 2

The Exposure Draft proposes that no amendments be made to the transitional and effective date requirements in IFRS 3. This would have the effects set out in paragraph 6(a)-(c) above on the accounting for business combinations in which the acquirer and acquiree are both mutual entities or in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.

Is this appropriate? If not, what transitional and effective date arrangements would you recommend for such business combinations, and why?

Response of GASB

GASB does not agree to the proposal of not making amendments to the transitional and effective date requirements in IFRS 3 as issued on March 31st 2004. In the given case this will effectively lead to a true retrospective application of a new accounting rule. Such a requirement is in conflict with German law and the law in other European countries. Therefore GASB considers it necessary to introduce transitional and effective date requirements different from those previously stated in IFRS 3.

Furthermore, GASB wants to emphasize again the need for a sound standard covering the accounting for transactions described above. Such a standard should be developed as soon as possible.

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

Yours sincerely,

Prof. Dr. Klaus Pohle
President