Bundesverband deutscher Banken

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

3 April 2003
H3.9 - Su/To

ED 3: Business Combinations
ED-IAS 36: Impairment of Assets
ED-IAS 38: Intangible Assets

Dear Sir David,

Thank you for the opportunity to comment on the exposure draft ED 3: Business Combinations and the associated amendments to IAS 36 and IAS 38. We warmly welcome the chance to express our views.

Our replies to the questions posed by the Board are as follows:

Bundesverband deutscher Banken e. V. • Postfach 04 03 07 • 10062 Berlin • Burgstraße 28 • 10178 Berlin • Tel: (030) 16 63-0 • Fax: (030) 16 63-13 99

ED-3: Business Combinations

Question 1 — Scope

The Exposure Draft proposes :

(a) to exclude from the scope of the IFRS business combinations in which separate entities or operations of entities are brought together to form a joint venture, and business combinations involving entities under common control (see proposed paragraphs 2 and 3 and paragraphs BC9-BC11 of the Basis for Conclusions).

Are these scope exclusions appropriate? If not, why not?

(b) to include in the IFRS a definition of business combinations involving entities under common control, and additional guidance on identifying such transactions (see proposed paragraphs 9-12 and Appendix A, and paragraphs BC12-BC15 of the Basis for Conclusions,).

Are the definition and additional guidance helpful in identifying transactions within the scope exclusion? If not, what additional guidance would you suggest, and why?

Reply:

We believe rules need to be established for all types of business combinations. The exclusion from the scope of ED 3 of joint ventures and entities under common control is therefore unsatisfactory. The Board states that it intends to address these issues in the second phase of the Business Combinations project. When this second phase has been concluded, therefore, the whole business combinations topic should be covered in full. We assume that until then, the rules for joint ventures in IAS 31 are to apply.

We agree with both the definition of "common control" and the additional guidance.

Question 2— Method of accounting for business combinations

The Exposure Draft proposes to eliminate the use of the pooling of interests method and require all business combinations within its scope to be accounted for by applying the purchase method (see proposed paragraphs 13-15 and paragraphs BC18-BC35 of the Basis for Conclusions).

Is this appropriate? If not, why not? If you believe the pooling of interests method should be applied to a particular class of transactions, what criteria should be used to distinguish those transactions from other business combinations, and why?

Reply:
In principle, we welcome the elimination of the pooling of interests method. This is a major step towards convergence with US GAAP. Furthermore, it will enhance the information content and comparability of financial statements.

We agree with the Board that it is normally possible to clearly identify the acquiring entity (paragraph 18). However, as the Board states in its Basis for Conclusions, there are some borderline cases where a clear identification of the acquirer is not possible (true merger). But suitable treatment of this type of business combination will not be discussed until the second phase of the project. In the meantime, the purchase method is to be applied. Since the purchase method is not, in our view, appropriate for accounting for true mergers, we welcome the Board's intention to find a separate solution for this type of combination in the project's second phase.

Question 3— Reverse acquisitions

Under IAS 22 Business Combinations, a business combination is accounted for as a reverse acquisition when an entity (the legal parent) obtains ownership of the equity of another entity (the legal subsidiary) but, as part of the exchange transaction, issues enough voting equity as consideration for control of the combined entity to pass to the owners of the legal subsidiary. In such circumstances, the legal subsidiary is deemed to be the acquirer. The Exposure Draft:

(a) proposes to modify the circumstances in which a business combination could be regarded as a reverse acquisition by clarifying that for all business combinations effected through an exchange of equity interests, the acquirer is the combining entity that has the power to govern the financial and operating policies of the other entity (or entities) so as to obtain benefits from its (or their) activities. As a result, a reverse acquisition occurs when the legal subsidiary has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities (see proposed paragraph 21 and paragraphs BC37-BC41 of the Basis for Conclusions).

Is this an appropriate description of the circumstances in which a business combination should be accounted for as a reverse acquisition? If not, under what circumstances, if any, should a business combination be accounted for as a reverse acquisition?

(b) proposes additional guidance on the accounting for reverse acquisitions (see proposed paragraphs Bi -B14 of Appendix B).

Is this additional guidance appropriate? If not, why not? Should any additional guidance be included? If so, what specific guidance should be added?

Reply:
We consider the description of reverse acquisition and the additional guidance to be appropriate.

Question 4— Identifying the acquirer when a new entity is formed to effect a business combination

The Exposure Draft proposes that when a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination should be adjudged the acquirer on the evidence available (see proposed paragraph 22 and paragraphs BC42-BC46 of the Basis for Conclusions).

Is this appropriate? If not, why not?

Reply:
We agree with the Board's view that the acquirer can always be identified as one of the entities existing before the combination.

Question 5 - Provisions for terminating or reducing the activities of the acquiree

Under IAS 22, an acquirer must recognise as part of allocating the cost of a business combination a provision for terminating or reducing the activities of the acquiree (a 'restructuring provision') that was not a liability of the acquiree at the acquisition date, provided the acquirer has satisfied specified criteria. The Exposure Draft proposes that an acquirer should recognise a restructuring provision as part of allocating the cost of a business combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets (see proposed paragraph 40 and paragraphs BC55-BC66 of the Basis for Conclusions).

Is this appropriate? If not, what criteria should an acquirer be required to satisfy to recognise a restructuring provision that was not a liability of the acquiree as part of allocating the cost of a combination, and why?

Reply:
We welcome the new rule. It will result in all provisions being treated equally as required by IAS 37.

Question 6— Contingent liabilities

The Exposure Draft proposes that an acquirer should recognise separately the acquiree 's contingent liabilities at the acquisition date as part of allocating the cost of a business combination, provided their fair values can be measured reliably (see proposed paragraphs 36 and 45 and paragraphs BC80-BC85 of the Basis for Conclusions).

Is this appropriate? If not, why not?

Reply:
The proposed approach of recognising the acquiree's contingent liabilities separately is not in line with the Framework or with IAS 37 provisions, which require contingent liabilities to be reported in the notes, not in the balance sheet. It makes little economic sense to formulate a general principle in IAS 37 prohibiting recognition of a contingent liability while insisting that the same contingent liability be recognised in the event of a business combination. As a result, contingent liabilities would be recognised in the consolidated accounts of the combined entity but could not be recognised in the annual accounts. A business combination does not change the character of a contingent liability, however.

Furthermore, the recognition of contingent liabilities would not be consistent with the treatment of contingent assets, which are not allowed to be recognised. This approach would result in an asymmetrical reporting of contingent assets and contingent liabilities in the consolidated accounts, which is not compatible with their objective of providing relevant and reliable information. The criteria for reporting contingent assets and liabilities should not be subject to a partial revision in the context of business combinations. It should be left to the Framework and a revised IAS 37 to establish uniform and consistent rules.

Question 7— Measuring the identifiable assets acquired and liabilities and contingent liabilities assumed

IAS 22 includes a benchmark and an allowed alternative treatment for the initial measurement of the iden4fiable net assets acquired in a business combination, and therefore for the initial measurement of any minority interests. The Exposure Draft proposes requiring the acquiree 's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any minority interest in the acquiree will be stated at the minority's proportion of the net fair values of those items. This proposal is consistent with the allowed alternative treatment in IAS 22 (see proposed paragraphs 35 and 39 and paragraphs BC88-BC95 of the Basis for Conclusions).

Is this appropriate? If not, how should the acquiree's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of a business combination be measured when there is a minority interest in the acquiree, and why?

Reply:
In principle, we agree with eliminating the option which allows proportionate or full revaluation measurement. This will enhance the comparability of financial statements.

Question 8- Goodwill

The Exposure Draft proposes that goodwill acquired in a business combination should be recognised as an asset and should not be amortised. Instead, it should be accounted for after initial recognition at cost less any accumulated impairment losses (see proposed paragraphs 50-54 and paragraphs BC96 - BC108 of the Basis for Conclusions).

Do you agree that goodwill acquired in a business combination should be recognised as an asset? If not, how should it be accounted for initially, and why? Should goodwill be accounted for after initial recognition at cost less any accumulated impairment losses? If not, how should it be accounted for after initial recognition, and why?

Reply:
We share the Board's view that goodwill should be recognised as an asset. We do not see goodwill as an identifiable asset within the meaning of the Framework, however, but as a residual item on the balance sheet which is made up of the difference between the cost of the acquired entity and the acquirer's interest in the fair value of the acquiree's assets and liabilities.

We strongly advocate retaining systematic goodwill amortisation as an alternative treatment alongside the impairment only approach.

The approach of dispensing with systematic goodwill amortisation in favour of a periodic impairment test is, in theory, well-founded. Systemic amortisation does not, after all, normally correspond to the actual loss in value. Furthermore, the heterogeneous nature of goodwill, which is made up of individual components with both limited and unlimited useful lives, means determining the total useful life is inevitably arbitrary.

In practice, however, implementing the impairment only approach will be extremely problematic. Application of this approach presupposes a reliable, unequivocal and logical valuation of goodwill. But since goodwill is a residual and, in addition, becomes indistinguishable from internally generated goodwill in the course of subsequent years, a direct measurement of its value is not possible. Valuation is normally based exclusively on performance expectations and profit estimates of the management. The considerable discretionary leeway which thus arises opens up opportunities to "shape" financial statements and could be misused to manipulate the amount and timing of goodwill amortisation. The reliability of the figures would be sacrificed in favour of a theoretically superior impairment only approach. What is more, the impairment test proposed in ED IAS 36 is so complex it would be virtually impossible to implement in practice.

Question 9— Excess over the cost of a business combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities

In some business combinations, the acquirer's interest in the net fair value of the acquiree 's identifiable assets, liabilities and contingent liabilities recognised as part of allocating the cost of the combination exceeds that cost. The Exposure Draft proposes that when such an excess exists, the acquirer should:

(a) *reassess the identification and measurement of the acquiree 's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and*

(b) *recognise immediately in profit or loss any excess remaining after that reassessment.*

(See proposed paragraphs 55 and 56 and paragraphs BC109 - BC120 of the Basis for Conclusions.)

Is this treatment appropriate? If not, how should any such excess be accounted for, and why?

Reply:
We do not agree with the proposed treatment of negative goodwill. We suggest retaining the existing rules, under which negative goodwill is treated along the same lines as positive goodwill.

Even after eliminating possible valuation errors it is possible to be left with a certain amount of negative goodwill. This is not always due to a “bargain purchase”, but may reflect future expected losses. Immediate recognition in profit or loss is therefore inappropriate.

Question 10— Completing the initial accounting for a business combination and subsequent adjustments to that accounting

The Exposure Draft proposes that:

(a) *if the initial accounting for a business combination can be determined only provisionally by the end of the reporting period in which the combination occurs because either the fair values to be assigned to the acquiree 's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer should account for the combination using those provisional values. Any adjustment to those values as a result of completing the initial accounting is to be recognised within twelve months of the acquisition date (see proposed paragraphs 60 and 61 and paragraphs BC123 - BC126 of the Basis for Conclusions).*

Is twelve months from the acquisition date sufficient time for completing the accounting for a business combination? If not, what period would be sufficient, and why?

(b) *with some exceptions carried forward as an interim measure from IAS 22, adjustments to the initial accounting for a business combination after that accounting is complete should be recognised only to correct an error (see proposed paragraphs 62 and 63 and paragraphs BC127 - BC132 of the Basis for Conclusions).*

> *Is this appropriate? It not, under what other circumstances should the initial accounting be amended after it is complete, and why?*

Reply:
We endorse this rule. Twelve months is an adequate period to make any value adjustments. After this period, amendments to the initial value should only be permitted to correct an error.

ED-IAS 36: Impairment of Assets

Question 1 — Frequency of impairment tests

Are the proposals relating to the frequency of impairment testing intangible assets with indefinite useful lives and acquired goodwill appropriate (see proposed paragraphs 8 and 8A and paragraphs C6, C7 and C41 of the Basis for Conclusions)? If not, how often should such assets be tested for impairment, and why?

Reply:
As mentioned above, we have fundamental reservations about dropping systematic goodwill amortisation in favour of the impairment only approach (see ED 3 — Question 8). Should the impairment only approach be introduced, however, we consider annual impairment testing of intangible assets with indefinite useful lives and acquired goodwill to be appropriate. This test should always be carried out at the end of the annual reporting period, regardless of whether or not there are any indications of a decrease in value. We reject the idea of having to carry out more frequent testing for impairment. Conducting impairment tests at varying points in time would have an adverse effect on the comparability of the accounts. As a matter of principle, the only relevant value is that which is assigned on the balance sheet date.

Question 2—Intangible assets with indefinite useful lives

The Exposure Draft proposes that the recoverable amount of an intangible asset with an indefinite useful life should be measured, and impairment losses (and reversals of impairment losses) for such assets accounted for, in accordance with the requirements in IAS 36 for assets other than goodwill (see paragraphs C10 – C11) of the Basis for Conclusions).
Is this appropriate? If not, how should the recoverable amount be measured, and impairment losses (and reversals of impairment losses) be accounted for?

Reply:
We agree with the proposed rule.

Question 3— Measuring value in use

The Exposure Draft proposes additional guidance on measuring the value in use of an asset. Is this additional guidance appropriate? In particular:

(a) should an asset's value in use reflect the elements listed in proposed paragraph 25A? If not, which elements should be excluded or should any additional elements be included? Also, should an entity be permitted to reflect those elements either as adjustments to the future cash flows or adjustments to the discount rate (see proposed paragraph 26A and paragraphs C66 and C67 of the Basis for Conclusions)? If not, which approach should be required?

(b) should the assumptions on which cash flow projections are based take into account both past actual cash flows and management's past ability to forecast cash flows accurately (see proposed paragraph 27 (a)(ii) and paragraphs C66 and C67 of the Basis for Conclusions)? If not, why not?

(c) is the additional guidance in proposed Appendix B to [draft] IAS 36 on using present value techniques in measuring an asset's value in use appropriate? If not, why not? Is it sufficient? If not, what should be added?

Reply:
In principle, we consider the proposed procedure for measuring value in use to be appropriate. ED IAS 36.27(a) (ii) envisages that, when measuring value in use, both the actual cash flows of former periods and management's past ability to forecast cash flows accurately should taken into account. It will probably be difficult to implement this requirement in practice.

Question 4— Allocating goodwill to cash-generating units

The Exposure Draft proposes that for the purpose of impairment testing, acquired goodwill should be allocated to one or more cash-generating units.

(a) Should the allocation of goodwill to one or more cash-generating units result in the goodwill being tested for impairment at a level that is consistent with the lowest level at which management monitors the return on the investment in that goodwill, provided such monitoring is conducted at or below the segment level based on an entity's primary reporting format (see proposed paragraphs 73-77 and paragraphs C1 8 - C20 of the Basis for Conclusions)? If not, at what level should the goodwill be tested for impairment, and why?

(b) If an entity disposes of an operation within ü cash-generating unit to which goodwill has been allocated, should the goodwill associated with that operation be included in the carrying amount of the operation when determining the gain or loss on disposal (see proposed paragraph 81 and paragraphs C21 C23 of the Basis for Conclusions)? If not, why not? If so, should the amount of the goodwill be measured on the basis of

the relative values of the operation disposed of and the portion of the unit retained or on some other basis?

(c) If an entity reorganises its reporting structure in a manner that changes the composition of one ore more cash-generating units to which goodwill has been allocated, should the goodwill be reallocated to the units affected using a relative value approach (see proposed paragraph 82 and paragraphs C24 and C25 of the Basis for Conclusions)? If not, what approach should be used?

Reply:
If the impairment only approach is introduced, we regard the proposed allocation of goodwill to cash-generating units as appropriate.

Question 5— Determining whether goodwill is impaired

The Exposure Draft proposes:

(a) that the recoverable amount of a cash-generating unit to which goodwill has been allocated should be measured as the higher of the unit's value in use and net selling price (see proposed paragraphs 5 (definition of recoverable amount) and 85 and paragraph C17 of the Basis for Conclusions).
Is this appropriate? If not, how should the recoverable amount of the unit be measured?

(b) the use of a screening mechanism for iden4fying potential goodwill impairments, whereby goodwill allocated to a cash-generating unit would be identified as potentially impaired only when the carrying amount of the unit exceeds its recoverable amount (see proposed paragraph 85 and paragraphs C42 - C51 of the Basis for Conclusions).
Is this an appropriate method for identifying potential goodwill impairments? If not, what other method should be used?

(c) that if an entity identifies goodwill allocated to a cash-generating unit as potentially impaired, the amount of any impairment loss for that goodwill should be measured as the excess of the goodwill's carrying amount over its implied value measured in accordance with proposed paragraph 86 (see proposed paragraphs 85 and 86 and paragraphs C28 - C40 of the Basis for Conclusions).
Is this an appropriate method for measuring impairment losses for goodwill? If not, what method should be used, and why?

Reply:
We agree with the definition of recoverable amount in ED IAS *36.5*.

The proposed two-tier approach for calculating potential goodwill impairments contains serious conceptual flaws, in our view. Internally generated goodwill is merged with acquired goodwill, with the result that it is no longer possible to identify whether the acquired goodwill has actually been impaired. There is a danger of internally generated goodwill preventing a necessary write-off of acquired goodwill. This is at odds with

IAS 38, which explicitly prohibits the recognition of internally generated goodwill. The Board acknowledges this problem (cf. C65 Basis for Conclusions) but sees no possibility of devising a practicable, workable impairment test which will eliminate the influence of internally generated goodwill.

Question 6- Reversals of impairment losses for goodwill

The Exposure Draft proposes that reversals of impairment losses recognised for goodwill should be prohibited (see proposed paragraph 123 and paragraphs C62 C65 of the Basis for Conclusions).
Is this appropriate? If not, what are the circumstances in which reversals of impairment losses for goodwill should be recognised?

Reply:
In principle, we take the view that the same rules should apply to reversals of impairment losses for goodwill as those applying to other assets. Nevertheless, the proposed prohibition of recognition is appropriate inasmuch as it is not possible to differentiate between internally generated and acquired goodwill when calculating write-off requirements (see Question 5).

Question 7— Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

The Exposure Draft proposes requiring a variety of information to be disclosed for each segment, based on an entity's primary reporting format, that includes within its carrying amount goodwill or intangible assets with indefinite useful lives (see proposed paragraph 134 and paragraphs C69 C82 of the Basis for Conclusions).

(a) Should an entity be required to disclose each of the items in proposed paragraph 134? If not, which items should be removed from the disclosure requirements, and why?

(b) Should the information to be disclosed under proposed paragraph 134 be disclosed separately for a cash-generating unit within a segment when one or more of the criteria in proposed paragraph 137 are satisfied? If not, why not?

Reply:
Disclosure should provide the users of an entity's financial statements with a clear picture of its overall financial situation, but should not overburden them with information. With this in mind, we believe the proposed requirements go too far. To understand an entity's situation, it is enough to have information relating to the company as a whole. In addition, the requirements listed in ED IAS 36.134 (e) +(f) should be dropped.

We would like to point out that even extensive disclosure requirements will be unable to rectify the central flaws of the impairment only approach, such as the lack of objectivity and verifiability of the valuations.

ED-IAS 38: Intangible Assets

Question 1— Identifiability

The Exposure Draft proposes that an asset should be treated as meeting the identifiability criterion in the definition of an intangible asset when it is separable or arises from contractual or other legal rights (see proposed paragraphs 10 and 11 and paragraphs B6- Bl0 of the Basis for Conclusions).

Are the separabilitiy and contractual/other legal rights criteria appropriate for determining whether an asset meets the identifiability criterion in the definition of an intangible asset? If not, what criteria are appropriate, and why?

Reply:
We endorse the proposed criteria for identifying an intangible asset. These do not contain any new rules, in our view, but merely spell out the existing provisions of IAS 38.

Question 2— Criteria for recognising intangible assets acquired in a business combination separately from goodwill

The Exposure Draft proposes clarifying that for an intangible asset acquired in a business combination, the probability recognition criterion will always be satisfied and, with the exception of an assembled workforce, sufficient information should always exist to measure its fair value reliably (see proposed paragraphs 29-32 and paragraphs B11 -B15 of the Basis for Conclusions). Therefore, as proposed in ED 3, an Exposure Draft of a proposed International Financial Reporting Standard Business Combinations an acquirer should recognise, at the acquisition date and separately from goodwill, all of the acquiree 's intangible assets, excluding an assembled workforce, that meet the definition of an intangible asset (see proposed paragraphs 36, 43 and 44 of ED 3).

Do you agree that, with the exception of an assembled workforce, sufficient information can reasonably be expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination? If not, why not? The Board would appreciate respondents outlining the specific circumstances in which the fair value of an intangible asset acquired in a business combination could not be measured reliably.

Reply:
No, we do not agree with the view that intangible assets acquired in a business combination will — with the exception of an assembled workforce always fulfil the recognition criteria of ED IAS 38.18.

This would result in unequal treatment of acquired intangible assets and internally generated intangible or other assets. Paragraph 89 of the Framework sets out the basic conditions which must be fulfilled for an asset to be recognised. The Board is now proposing a different method for intangible assets acquired in a business combination. We believe asset recognition is an issue of a fundamental nature which should be regulated in the Framework for application to all individual standards. Diverging rules for individual sets of circumstances arc not useful, in our view.

We have fundamental reservations about the assumption that it will always be possible to measure reliably the fair value of an intangible asset acquired in a business combination. As outlined above in our comments on ED 3: Business Combinations, market prices for these assets do not normally exist.

Question 3—Indefinite useful life

The Exposure Draft proposes to remove from IAS 38 the rebuttable presumption that an intangible asset's useful life exceed twenty years, and to require its useful life to be regarded as indefinite when, based on an analysis of all of the relevant factors, there is no foreseeable limit on the period of time over which the asset is expected to generate net cash inflows for the entity (see proposed paragraphs 85- 88 and paragraphs B29 B32 of the Basis for Conclusions).

Is this appropriate? If not, under what circumstances, any, should an intangible asset be regarded as having an indefinite useful life?

Reply:
We agree with removing the limit on the useful life of intangible assets since the maximum period of twenty years is arbitrary.

Question 4— Useful life of intangible asset arising from contractual or other legal rights

The Exposure Draft proposes that if an intangible asset arises from contractual or other legal rights that are conveyed for a limited term that can be renewed, the useful life shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost (see proposed paragraphs 91 and 92 and paragraphs B33 - B35 of the Basis for Conclusions).

Is this an appropriate basis for determining the useful life of an intangible asset arising from contractual or other legal rights that are conveyed for a limited term that can be renewed? If not, under what circumstances should the useful life include the renewal period(s)?

Reply:
We agree with the proposed procedure.

Question 5— Non-amortisation of intangible assets with indefinite useful lives

The Exposure Draft proposes that an intangible asset with an indefinite useful life should not be amortised (see proposed paragraphs 103 and 104 and paragraphs B36 - B38 of the Basis for Conclusions).

Is this appropriate? If not, how should such assets be accounted for after their initial recognition?

Reply:
In principle, we agree with the proposal to dispense with systematic amortisation of intangible assets with an indefinite useful life. However, we consider an impairment test based on future cash flows, for example, to be extremely subjective and virtually impossible to verify.

Yours sincerely,

Katrin Burkhardt　　　　Silvia Schütte