

Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
United Kingdom

Düsseldorf, July 30, 2004
511/520

Dear Sir David

Re.: Exposure Draft of Proposed Amendments to IFRS 3 Business Combinations: Combinations by Contract Alone or Involving Mutual Entities

We are pleased to have the opportunity to comment on the Exposure Draft of Proposed Amendments mentioned above and would like to submit our comments as follows:

Applicability of the proposed amendments as an interim solution

With the proposed amendments of IFRS 3 the Board primarily intends to provide an interim solution for those business combinations, in which it is difficult to identify an acquirer. Therefore, we would have expected sufficient guidance in this respect. However, the Board did not deal with this issue and instead developed guidance on the determination of deemed cost of the acquisition, which – in our view – is not consistent with the concept of the purchase method. Furthermore, if no real acquirer can be identified, i.e. in case of a true merger, applying the purchase method might lead to misleading results. Particularly in case of the combination of mutual entities we doubt that these combinations always result in one mutual entity obtaining control. Hence, there should be a broad discussion whether in such cases the pooling of interests method or the fresh start method should be applied.

In this respect we see a conceptual problem with the Exposure Draft. On the one hand IFRS 3 stipulates in paragraph 4, that not all business combinations would re-

sult in one party obtaining control. On the other hand paragraph 17 states, that an acquirer shall be identified for all business combinations and that the acquirer is the combining entity that obtains control of the other combining entities. In our view, this seems to be contradictory. However, according to this obtaining control is a prerequisite for a business combination.

Paragraph 4 (b) (ii) of the Background indicates, that one mutual entity obtains control in case of a combination of mutual entities. The Board should clarify whether this means that business combinations involving mutual entities would only be in the scope of IFRS 3 if one mutual entity obtains control. This issue should be clarified for business combinations by contract alone as well.

The applicability of the proposed amendments to IFRS 3 will also be difficult because the terms “mutual entities” and “combination by contract alone” are not defined sufficiently. An understanding of these terms is vital for a reasonable application of the Exposure Draft. In particular the German commercial legislation leaves room for a lengthy discussion to which types of business combinations the proposed amendments should be applied.

Thus, instead of introducing an interim solution with serious practical and conceptual shortcomings a lasting standard dealing with transactions covered by the scope of the proposed amendments to IFRS 3 should be developed as soon as possible.

Deemed cost of the business combination

According to BC8 no exception to applying the purchase method is permitted for combinations by contract alone or involving two or more mutual entities. Hence, an acquisition of an entity is assumed in any case. If an acquisition is assumed, however, it is not reasonable in our view that the deemed cost of the business combination is only the net fair value of the acquiree's identifiable assets and (contingent) liabilities in case of combinations by contract alone or the net fair value of the acquiree's identifiable assets and (contingent) liabilities plus the consideration given in exchange for control of the acquiree in case the acquirer and the acquiree both are mutual entities. In our opinion, the deemed cost of the business combination should be the entire value of the acquiree similar to the practice in case of a reverse acquisition. Because one assumes that the acquirer has obtained control, we see no reason why the acquirer would not have control over the goodwill of the acquiree.

Transitional and effective date requirements

If, despite our comments above, the amendments of IFRS 3 will be adopted, we do not agree that no amendments be made to the transitional and effective date requirements in IFRS 3. The proposal by the IASB would lead to a retrospective application of the proposed amendments to IFRS 3 because the effective date lies before the adoption date. This can only be accepted as an exceptional case. The IASB should keep in mind that preparers need sufficient time to adapt new standards or amendments to current standards.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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