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# Business Combinations and Impairment Reviews

The focus on fair value reporting changed the accounting rules for mergers and acquisitions with the issuance of new accounting standards SFAS 141 (Business Combinations), SFAS 142 (Goodwill and Other Intangible Assets), IFRS 3 (Business Combinations), IAS 36 (Impairment of Assets) and IAS 38 (Intangible Assets). These standards ended pooling of interest accounting and goodwill amortization, and substituted a framework for analyzing goodwill for impairment.

Within Germany the IDW standards IDW RS HFA 16, which is an interpretation of IFRS 3, and IDW RS HFA 10 (valuation of interest in firms for reporting purposes) have to be considered.

## IFRS 3 / SFAS 141: Business Combinations

Merger accounting is prohibited under IFRS 3 and SFAS 141. One of the key aspects of IFRS 3 and respectively SFAS 141 is that all identifiable tangible and intangible assets as well as liabilities and contingent liabilities of the target company have to be identified and "fair valued". The residual goodwill is determined as the difference between the purchase price and the sum of the fair values of the identifiable assets, liabilities and contingent liabilities.

Some of the intangible assets which, if present, must be recognized pursuant to a transaction include:

- Marketing related intangibles such as trade names and trademarks
- Technology based intangibles such as patents and software
- Customer related intangibles such as customer contracts and related relationships
- Contractual based intangibles such as licenses and franchise agreements
- Artistic related intangibles such as literary and musical works as well as pictures and photographs



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The allocation of value between identifiable intangible assets and "pure" goodwill and the apportionment thereof to the appropriate cash-generating unit is critical given the possible effects on future earnings and of failed impairment tests.

It is unlikely that these identifiable intangibles have been valued in the past and therefore the valuation process is a major step in post merger integrations. There are a number of valuation methodologies available to the expert appraiser, although the most widely used are income-based approaches. The process needs to be robust, in order to withstand the scrutiny of regulators, auditors and investors and involves extracting source documentation, interviewing key personnel and ultimately understanding the importance of the identifiable intangibles to the organization.

### **IAS 38 / SFAS 142: Intangible Assets**

IAS 38 stipulates that an asset which lacks physical substance is only identified as an intangible asset if it meets criteria such as its explicit identification or its ability to independently generate future economic benefits. Depending on the finite or indefinite life of the intangible asset, accounting procedures vary greatly, particularly with regard to depreciation or impairment testing. Of increasing importance is the treatment of synergies and the resulting support for goodwill derived. Accounting for goodwill and intangible assets with indefinite useful lives is an exceedingly sensitive issue which is incorporated in SFAS 142.

A very specific intangible asset is so called in-process research & development project. The valuation and accounting treatment of these assets is very specific and requires a great deal of experience.

### **IAS 36 / SFAS 142: Impairment of assets**

Under IAS 36 and SFAS 142 impairment testing of goodwill and intangibles assigned an indefinite life must be undertaken every year. Whilst impairment testing is not a new concept the disclosure requirements force companies to be consistent in the valuation approach adopted from year to year. For example, where the "value in use" approach has been used to measure the recoverable amount, disclosure of the discount rate adopted and the key assumptions used for the cash flow projections will be required. The disclosure of such financial detail is a significant departure from previous requirements and therefore a formal approach for valuing the goodwill and intangibles on an annual basis should be implemented and documented.

### **IDW RS HFA 16: Business Combinations & Impairment of assets regarding IFRS**

We perform the valuations for German clients in accordance with the German accounting standard IDW RS HFA 16. This standard is binding for German auditors regarding the initial consolidation of acquisitions (IFRS 3 & IAS 38) and impairment testing (IAS 36).



## **IDW RS HFA 10: Valuation of interest in firms for reporting purposes**

For German accounting objectives interests in firms basically have to be reported at the lower of their acquisition costs or their fair value. An impairment only applies if the diminution is permanent (§ 253 HGB). Normally the fair value is derived from a business enterprise valuation. The Institute of German Auditors (IDW) has released the standard IDW RS HFA 10. This standard regulates how such appraisals have to be performed. Any resulting impairment is charged to the profit and loss account.

## **How American Appraisal can assist you**

American Appraisal is the leading worldwide independent valuation consulting firm. Our global network enables us to advise global players, leading medium-sized businesses and strongly growing technology companies in a professional way. Our experience in Central Europe includes the completion of intangible asset valuations for both small and large corporations. We have performed a significant number of high profile valuations for European listed entities under IFRS 3. We have also completed many valuations under US-GAAP (SFAS 141) for US listed entities. We conduct reconciliations for entities which report according to IFRS and US-GAAP.

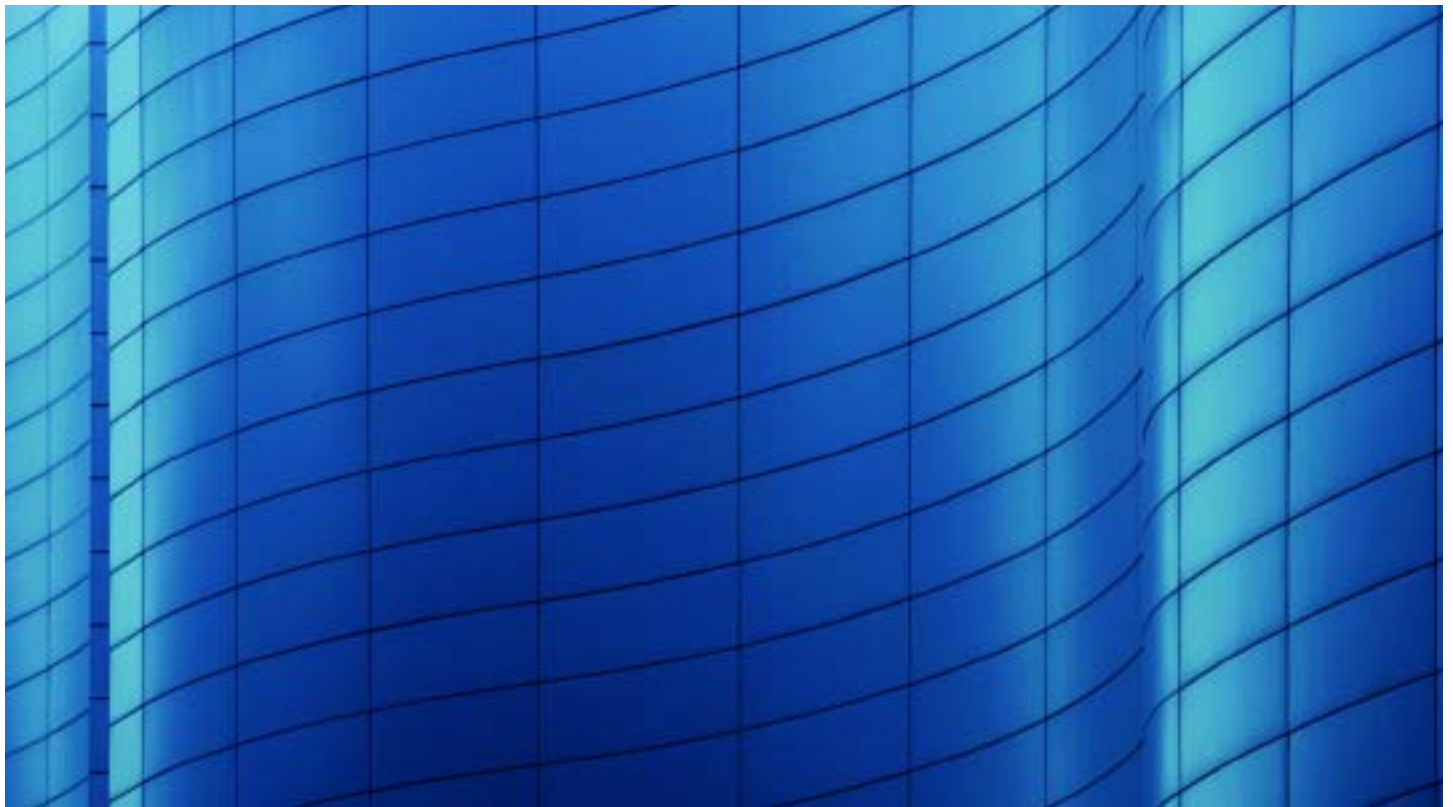
We have undertaken numerous impairment reviews of goodwill and intangible assets and regularly advise companies on the optimum strategies for complying with IFRS 3, IAS 36, IAS 38, SFAS 141, SFAS 142 and IDW RS HFA 16 within Germany. Furthermore we have conducted many valuations for impairment tests referring to IDW RS HFA 10.

We highlight the areas where robust valuation techniques will be required for corporate reporting under IFRS and US-GAAP and how American Appraisal can assist in carrying out these regulatory requirements.

First hand information is guaranteed via our involvement in the bodies consulting the regulatory authorities for the treatment and valuation of intangible assets and valuation in general. This leads to an efficient auditing process.

In addition to being the leading independent practice in Central Europe to offer a depth and breadth of experience comparable to the specialist departments of the 'Big 4' accounting firms, American Appraisal also provides valuations of tangible assets including plant and machinery and real estate. This capability enables us to offer a range of valuation services which is unrivalled in Central Europe.

As an independent specialist American Appraisal is dedicated to cutting edge expertise in valuation. Our clients benefit from our specialization and premium service.





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**American Appraisal**  
Bockenheimer Landstr. 22  
60323 Frankfurt am Main / Germany  
Tel: +49-69-719184-0 / Fax: +49-69-719184-44  
Website: [www.american-appraisal.de](http://www.american-appraisal.de)

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