

STAFF PAPER

December 2014

IASB Meeting

Project	Post-implementation review IFRS 3 <i>Business Combinations</i>		
Paper topic	Findings		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of the paper

1. The objective of this paper is to identify the areas of IFRS 3 *Business Combinations* that, in our view, are the most significant areas on which feedback was received and that the IASB should consider for follow-up to the Post-implementation Review (PIR) of IFRS 3.
2. In this paper, we classify the areas of focus of IFRS 3 considering both information received from stakeholders who provided feedback to the PIR and the academic review's results¹. The more significant areas of focus would feature in the 'areas for follow-up' in the feedback statement of the PIR of IFRS 3.

Background information**Objectives of a PIR**

3. According to our *Due Process Handbook*²:
 - (a) A PIR is an opportunity to assess the effect of the new requirements on investors, preparers and auditors.

¹ See AP12A (December 2014 IASB meeting) for a detailed comparison of feedback received from our constituents and academic evidence.

² See paragraph 6.55.

- (b) The review must consider the issues that were important or contentious during the development of the publication as well as issues that have come to the attention of the IASB after the document was published.
- (c) The IASB consults the IFRS community to identify areas where possible unexpected costs or implementation problems were encountered.

Areas of focus identified during the PIR of IFRS 3

4. On the basis of the comment letters received and the information gathered during the outreach activities conducted during the second phase³ of the PIR, we have identified the following areas of focus:
- (a) applying the definition of a business;
 - (b) identification and fair value measurement of intangible assets such as customer relationships and brand names;
 - (c) fair value measurement of contingent consideration and contingent liabilities;
 - (d) the recognition of negative goodwill in profit or loss;
 - (e) subsequent accounting for goodwill (ie impairment-only approach versus amortisation and impairment approach);
 - (f) testing goodwill for impairment;
 - (g) measurement of non-controlling interests;
 - (h) accounting for step acquisitions and loss of control;
 - (i) information about the subsequent performance of the acquiree;
 - (j) pro-forma prior year comparative information;
 - (k) subsequent accounting for contingent consideration; and

³ The summary of the comments received can be found here:
<http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/September/AP12F-IFRS%20IC%20Issues-PIR%20IFRS%203.pdf>

- (l) accounting for contingent payments to selling shareholders who become employees (are they consideration or remuneration?).

Staff analysis

Criteria for prioritising the areas of focus

5. We think that the PIR of IFRS 3 has enabled us to assess the effect of the application of IFRS 3 on financial reporting from the perspective of preparers of financial statements, investors, market regulators, the audit profession, accounting standard-setters, and academics. In particular, during the PIR of IFRS 3, we have received feedback on whether:
 - (a) IFRS 3 provides information that is useful to users of financial statements;
 - (b) there are areas of IFRS 3 that represent implementation challenges and, as a result, create barriers to the consistent implementation of the requirements; and
 - (c) unexpected costs have arisen when preparing, auditing or enforcing the requirements of IFRS 3 or when using the information provided by the Standard.
6. We note that:
 - (a) IFRS 3 and Statement 141(revised 2007) *Business Combinations* of the US standard setter, the Financial Accounting Standards Board (FASB) are converged standards.
 - (b) Accounting Standards Advisory Forum (ASAF) members generally supported maintaining convergence with US Generally Accepted Accounting Principles (US GAAP). Consequently, they suggested that any amendments to IFRS 3 should be discussed with the FASB⁴.

⁴ See ASAF Summary (October 2014): <http://www.ifrs.org/About-us/IASB/Advisory-bodies/ASAF/Documents/ASAF-summary-Oct-2014.pdf>

- (c) The IFRS Advisory Council (the Advisory Council) encouraged the IASB to continue to work to keep convergence, leveraging ASAF to achieve this⁵.
- (d) The Financial Accounting Foundation (FAF), the oversight body of the FASB, completed the PIR of FASB Statement 141 in May 2013⁶.
- (e) The FASB added to its technical agenda⁷ the following projects:
 - (i) *Clarifying the Definition of a Business*: the FASB Staff is focusing its analysis on clarifying the definition of a business, while continuing to research potential solutions for differences in the recognition and derecognition accounting for assets and businesses.
 - (ii) *Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities*: the FASB Staff is performing research on the amortisation of goodwill, with a focus on identifying the most appropriate useful life if goodwill were amortised, and on simplifying the impairment test.
 - (iii) *Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-for-Profit Entities*: this project will evaluate whether certain intangible assets should be subsumed into goodwill, with a focus on customer relationships and non-compete agreements.

7. We have assessed the significance of the areas of focus on which we received feedback⁸ and we have done so using the following criteria:

- (a) Have investors⁹ expressed concerns about the usefulness of the information provided by the current requirements?

⁵ See Advisory Council Report (June 2014): <http://www.ifrs.org/The-organisation/IFRS-Advisory-Council/Documents/IFRS-Advisory-Council-Meeting-Report-June-2014.pdf>

⁶ The FAF's PIR Report can be found here: http://www.accountingfoundation.org/cs/ContentServer?c=Document_C&pagename=Foundation%2FDocument_C%2FFAFDocumentPage&cid=1176162641881

⁷ For further details, please see http://www.fasb.org/jsp/FASB/Page/TechnicalAgendaPage&cid=1175805470156#tab_1175805471236

⁸ These areas of focus are listed in paragraph 4 of this paper.

⁹ Including the Capital Markets Advisory Committee (CMAC).

- (b) Have preparers¹⁰, auditors or regulators expressed concerns about the application of the current requirements?
- (c) Is the area of focus included in the issues recommended by the ASAF for further work?
- (d) Is the area of focus included in the FAF’s Report on PIR of Statement 141(R) or on the FASB agenda?

Analysis of the information received

8. In the following table we have assessed each of the areas of focus listed in paragraph 4 of this paper against the criteria listed in paragraph 7 of the paper. Our assessment is based on the information received from comment letters and outreach activities.

Areas of focus	Are investors concerned?	Are preparers, auditors or regulators concerned?	Is the area of focus recommended by ASAF?	Is the area of focus in the FAF’s report/FASB Agenda?	Assessment of significance
Challenges in applying the definition of a business.	Not applicable	YES	YES—higher priority	YES—FASB agenda and FAF’s report	Medium/High
Identification and fair value measurement of intangible assets such as customer relationships and brand names.	Mixed views	YES	Medium priority	YES— FASB agenda and FAF’s report	Medium/High ¹¹
Fair value measurement of contingent consideration and contingent liabilities.	NO	YES	Lower priority	YES—FAF’s report	Medium

¹⁰ Including the Global Preparers Forum (GPF).

¹¹ In our view this project is related to the subsequent accounting for goodwill, which is, in our view, a higher-priority project.

Areas of focus	Are investors concerned?	Are preparers, auditors or regulators concerned?	Is the area of focus recommended by ASAF?	Is the area of focus in the FAF's report/FASB Agenda?	Assessment of significance
Usefulness of the recognition of negative goodwill in P&L	Not significantly concerned	Not applicable	Lower priority	NO	No follow-up in the short or medium term
Subsequent accounting for goodwill (impairment versus amortisation + impairment)	Mixed views	YES	YES—higher priority	YES—FASB agenda	Higher
Ineffectiveness and complexity of impairment test	YES	YES	YES—higher priority	YES—FASB agenda	Higher
Measurement of non-controlling interests	Investors do not support the current measurement options. Mixed views on the preferred method.	YES	Lower priority	FAF is reviewing FASB Statement 160, <i>Noncontrolling Interests in Consolidated Financial Statements</i>	Lower
Usefulness of the accounting for step acquisitions and loss of control	YES	Not applicable	Medium priority	YES—FAF's report	Medium
Information about the subsequent performance of the acquiree	Investors are asking for this disclosure	YES. This disclosure is difficult to provide.	Lower priority	NO	Lower
Pro-forma prior year comparative information.	Investors are asking for this disclosure	YES. This disclosure is difficult to provide.	Lower priority	NO	Lower

Areas of focus	Are investors concerned?	Are preparers, auditors or regulators concerned?	Is the area of focus recommended by ASAF?	Is the area of focus in the FAF's report/FASB Agenda?	Assessment of significance
Usefulness of the subsequent accounting for contingent consideration	Mixed views	YES	Medium priority	NO ¹²	Medium
Accounting for contingent payments to selling shareholders who become employees	Not applicable	YES	Lower priority	NO	No follow-up in the short or medium term

Academic review results

9. In the following paragraphs we report a summary of the conclusions reached comparing constituent feedback and academic evidence¹³.

Separate recognition of intangible assets from goodwill

10. PIR feedback indicates there are mixed views from users about the separate recognition of identifiable intangible assets. Academic research indicates that identifiable intangible assets are value relevant and, in some studies, identifiable intangible assets are more relevant under IFRS than prior national GAAP. Thus the research provides some support for the IFRS 3 approach. Nevertheless, the extent of benefits varies between countries.

Non-amortisation of goodwill

11. PIR feedback indicates there are mixed views from users about the non-amortisation of goodwill. Academic research indicates that goodwill measured under IFRS 3 is

¹² The fair value measurement of contingent consideration is an issue included in the FAF's Report, but the subsequent accounting is not specifically mentioned.

¹³ For further details, please see AP12A (December 2014 IASB meeting)

value relevant. In addition, some studies concluded impairment recognition provides useful information. Further, studies comparing the amortisation and impairment regime and the impairment-only regime often concluded the latter is more useful.

12. Academic evidence points to some managers using their discretion in recognising impairment in ways that are potentially favourable to themselves. Nevertheless, some studies conclude that impairment reflects economic fundamentals because it is associated with share price.

Staff recommendation

13. On the basis of our analysis of the information received, we think that the most significant areas of focus that the IASB should look at are the following:
 - (a) ineffectiveness and complexity of testing goodwill for impairment; and
 - (b) subsequent accounting for goodwill (ie impairment-only approach versus amortisation and impairment approach).
14. We think that the subsequent accounting for goodwill is an area of focus of higher significance, even though academic research indicates that the current requirements are value relevant, because:
 - (a) many constituents asked the IASB to revisit this matter; and
 - (b) the subsequent accounting for goodwill is already on the FASB Agenda and FASB Staff is now performing research on the amortisation of goodwill.
15. Other significant areas of focus that we think that the IASB should follow up on are the following:
 - (a) challenges in applying the definition of a business; and
 - (b) identification and fair value measurement of intangible assets such as customer relationships and brand names.
16. As noted above (see paragraph 6e) the FASB has already added these matters to its agenda and the FASB Staff is performing research on these topics. Consequently, in our view, the IASB should look at identification and measurement of intangible

assets, even though academic research indicates that the current requirements are value relevant.

17. In the table below we have classified all the areas of focus listed in paragraph 4 of this paper into five groups on the basis of our assessment of their significance and we have proposed whether and what follow-up to recommend. We are not asking the IASB to make decisions at this meeting on what next steps to take, but ask for any comments that IASB members have on these.

Area of focus	Assessed significance	Possible next steps
Ineffectiveness and complexity of testing goodwill for impairment.	Higher	Review IAS 36 (IAS 36 is not converged with US GAAP). Consider improvements to the impairment model; in particular consider the scope for simplification.
Subsequent accounting for goodwill (ie impairment-only approach versus amortisation and impairment approach).	Higher	Work with the FASB. FASB is exploring the amortisation and impairment approach with a focus on how to identify the useful life of goodwill.
Challenges in applying the definition of a business.	Medium/high	Work with the FASB. FASB is focusing its analysis on clarifying the definition of a business and the related application guidance.
Identification and fair value measurement of intangible assets such as customer relationships and brand names.	Medium/high	Work with the FASB. FASB is assessing whether certain intangible assets (eg customer relationships) should be subsumed into goodwill.
Usefulness of the subsequent accounting for contingent consideration.	Medium	Further analysis. Some participants suggest investigating whether in some circumstances changes in the fair value of contingent consideration should be recognised against the assets acquired.
Fair value measurement of contingent consideration and contingent liabilities.	Medium	Further analysis. Some participants suggest investigating whether contingent consideration and contingent liabilities should be recognised only if they can be measured reliably.

Area of focus	Assessed significance	Possible next steps
Usefulness of the accounting for step acquisitions and loss of control.	Medium	Further analysis. Some participants suggest investigating whether remeasurement gains should be recognised in OCI.
Measurement of non-controlling interests.	Lower	Further analysis. Some participants suggest investigating whether the measurement of NCI should be a one-time accounting policy choice for all business combinations (ie it should not be a transaction-by-transaction choice).
Information about the subsequent performance of the acquiree.	Lower	Further analysis, eg investigate how practicable would be to prepare this information.
Pro-forma prior year comparative information.	Lower	Further analysis, eg investigate how practicable would be to prepare this information.
Usefulness of the recognition of negative goodwill in P&L.	No follow-up in the short or medium term	
Accounting for contingent payments to selling shareholders who become employees.	No follow-up in the short or medium term	

Questions to the IASB members

1. Do you agree with our recommended classification of the areas of focus?
2. Do you have any comments on the possible next steps identified?