

## STAFF PAPER

July 2019

## IASB® Meeting

Project	Comprehensive review of the <i>IFRS for SMEs</i> ® Standard		
Paper topic	IFRS 3 <i>Business Combinations</i>		
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**Purpose**

1. At this meeting we are asking Board members if the Request for Information, that will be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard (2019 Review), should seek views on whether and how the requirements of the *IFRS for SMEs* Standard could be aligned with IFRS 3 *Business Combinations* as revised in 2008 (IFRS 3 (2008)).
2. The objective of the Request for Information is to obtain evidence that will assist the Board in deciding whether and how to develop an Exposure Draft of amendments to the *IFRS for SMEs* Standard.

**Summary of staff recommendations**

3. The staff recommends that the Board seek views in the Request for Information, on whether and how Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Standard could be aligned with IFRS 3 (2008), namely:
  - (a) whether there is a need to introduce requirements for step acquisitions into the *IFRS for SMEs* Standard;

- (b) if there is a need to introduce requirements for step acquisitions into the *IFRS for SMEs* Standard, whether those requirements should be aligned with IFRS 3 (2008); and
  - (c) whether Section 19 of the *IFRS for SMEs* Standard should be aligned with IFRS 3 (2008) such that:
    - (i) acquisition-related costs are recognised as an expense at the time of the acquisition; and
    - (ii) contingent consideration is measured on initial recognition at fair value, and the undue cost or effort exemption is extended to apply to the fair value measurement of the contingent consideration.
4. The staff also recommends the Board clarifies in the Request for Information that it does not intend to amend the requirements in the *IFRS for SMEs* Standard to:
- (a) introduce the option to measure non-controlling interests (NCIs) at fair value;
  - (b) remove the reliability of the measurement threshold for recognising intangible assets;
  - (c) clarify that an assembled workforce must not be recognised; and
  - (d) provide additional guidance in relation to reacquired rights.

## Structure of this paper

5. This paper is structured as follows:
- (a) background (paragraphs 6–20):
    - (i) history of IFRS 3 (2008) (paragraphs 6–11);
    - (ii) findings from the PIR of IFRS 3 (2008) (paragraphs 12–15);
    - (iii) overview of Section 19 *Business Combinations and Goodwill* (paragraph 16);
    - (iv) IFRS 3 (2008) and the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (2012 Review) (paragraphs 17–20);
  - (b) applying the alignment principles (paragraphs 21–46);
    - (i) principle 1—relevance (paragraphs 23–26);
    - (ii) principle 2—simplicity (paragraphs 27–37);
    - (iii) principle 3—faithful representation (paragraphs 38–45);
  - (c) stakeholder views (paragraphs 46–52);
  - (d) other considerations (paragraphs 53–54);
  - (e) questions for the Board;
  - (f) Appendix A—Summary of SMEIG members’ views on whether to align the *IFRS for SMEs* Standard with IFRS 3 (2008); and
  - (g) Appendix B—Overview of Section 19 and differences between IFRS 3 (2008) and Section 19.

## Background

### ***History of IFRS 3 (2008)***

6. IFRS 3 was first issued in March 2004 (IFRS 3 (2004)) and replaced IAS 22 *Business Combinations*.
7. In January 2008, the Board issued a revised IFRS 3 (IFRS 3 (2008)) which was effective prospectively for annual periods beginning on or after 1 July 2009.
8. The Board completed a Post-implementation Review (PIR) of IFRS 3 (2008) in June 2015.
9. The objective of the Business Combinations project, which was undertaken jointly with the US Financial Accounting Standards Board, was to develop a single, high-quality accounting Standard for business combinations that would ensure the accounting for mergers and acquisitions activity is the same whether an entity is applying IFRS Standards or US generally accepted accounting principles<sup>1</sup>.
10. IFRS 3 (2008) seeks to enhance the relevance, reliability and comparability of information provided about business combinations and their effects.<sup>2</sup> It sets out principles for recognising and measuring acquired assets and liabilities, determining goodwill and making the necessary disclosures.
11. The package of amendments introduced by IFRS 3 (2008) included changes to:
  - (a) the accounting for step and partial acquisitions;
  - (b) the measurement of non-controlling interests (NCI);
  - (c) the recognition of contingent consideration and its subsequent measurement;
  - (d) the recognition requirements and guidance for intangible assets; and
  - (e) the treatment of acquisition costs.

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<sup>1</sup> *Project summary, feedback and effect analysis on IFRS 3 Business Combinations*, page 4.

<sup>2</sup> IFRS 3 *Business Combinations* (2008) paragraph 1.

**Findings from the PIR of IFRS 3 (2008)**

12. Feedback from the PIR of IFRS 3 (2008) was received from investors, other users of financial statements, preparers, auditors and regulators. Investors have mixed views on subsequent accounting for goodwill, separate recognition of intangible assets, measurement of non-controlling interests (NCIs) and subsequent accounting for contingent consideration.
13. Many preparers, auditors, regulators and others think that there are some areas in which implementation challenges have arisen and for which further clarification would be useful. These areas are the definition of a business, fair value measurement, impairment test for goodwill and contingent payments to selling shareholders who become employees<sup>3</sup>.
14. Academic research provided evidence that generally supported the current requirements of IFRS 3 (2008) particularly regarding the usefulness of reported goodwill, other intangible assets and goodwill and impairment.
15. Based on the findings from the PIR of IFRS 3, the Board added the following projects to its work plan:
  - (a) Definition of a Business—this project has been completed and resulted in an amendment to IFRS 3 (2008) issued in October 2018; and
  - (b) Goodwill and Impairment—this project is ongoing.

**Overview of Section 19 Business Combinations and Goodwill**

16. Section 19 of the *IFRS for SMEs* Standard is based on IFRS 3 (2004), although there are some significant differences. A list of these differences and an overview of the requirements of Section 10 is set out in Appendix B of this agenda paper.

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<sup>3</sup> Post-implementation Review—IFRS 3 Business Combinations, page 5

***IFRS 3 (2008) and the 2012 Comprehensive Review of the IFRS for SMEs Standard (2012 Review)***

17. The Board had already issued IFRS 3 (2008) when the 2012 Comprehensive Review of the *IFRS for SMEs* Standard (2012 Review) was undertaken. The 2012 Request for Information asked the following question about aligning Section 19 with IFRS 3(2008):

Question 1

Should Section 19 be amended to incorporate the following changes, to reflect the needs of users of SME financial statements and cost-benefit considerations?

- (a) acquisition-related costs;
- (b) the accounting for contingent consideration; and
- (c) step and partial acquisition.

18. The Board decided not to amend the *IFRS for SMEs* Standard to incorporate the changes introduced by IFRS 3 (2008) and made the following observations:<sup>4</sup>

The changes in IFRS 3 (2008) would result in significant complexity for SMEs, particularly because of the additional fair value measurements required. Based on feedback from the RFI, SMEIG members and other interested parties, the current requirements in the IFRS for SMEs (based on IFRS 3 (2004)) is working well in practice and is well understood and accepted by preparers and users of SME financial statements.

19. The Board decided not to align the accounting for IFRS 3 (2008) when it undertook the 2012 Review due to the complexity that the additional fair value measurement requirement would introduce.<sup>5</sup> This decision by the Board related to the improvements in IFRS 3 (2008) as a whole. In this paper we have analysed individually the key improvements introduced by IFRS 3 (2008).

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<sup>4</sup> Basis for Conclusions on the *IFRS for SMEs* Standard paragraph BC198(c).

<sup>5</sup> Basis for Conclusions on the *IFRS for SMEs* Standard paragraph BC198(c).

20. The staff proposes that as part of the 2019 Review, the Board consider aligning the *IFRS for SMEs* Standard with IFRS 3 (2008) for the following reasons:
- (c) the PIR for IFRS 3 (2008) has been completed by the Board.
  - (d) there now exists greater implementation experience of IFRS 3 (2008) as it has been applied in industry for a number of years.
  - (e) as the 2012 Review was the first review following of the *IFRS for SMEs* Standard being issued, the Board prioritised providing entities with a stable platform<sup>6</sup> over aligning the *IFRS for SMEs* Standard with full IFRS Standards. The Standard has been effective since 2009 with minor amendments made in 2015 following the 2012 Review. Entities are familiar with applying the requirements of the *IFRS for SMEs* Standard, including the accounting for business combinations.

### Applying the alignment principles

21. At its May 2019 meeting (Agenda Paper 30A), the Board decided that to determine whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, it would apply three principles:
- (a) relevance;
  - (b) simplicity; and
  - (c) faithful representation.
22. The following paragraphs apply the alignment principles to assist the Board in determining whether and how to align the *IFRS for SMEs* Standard with IFRS 3 (2008).

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<sup>6</sup> Basis for Conclusions on the *IFRS for SMEs* Standard paragraph BC189.

**Principle 1—Relevance**

23. As noted, the *IFRS for SMEs* Standard already addresses the accounting for business combinations and goodwill. For the 2019 Review, the question is not whether consolidation is relevant but whether the improvements introduced by IFRS 3 (2008) could benefit users of financial statements prepared in accordance with the *IFRS for SMEs* Standard and preparers applying the Standard.
24. In considering these improvements, the staff notes that IFRS 3 (2008):
- (a) addresses deficiencies that existed in IFRS 3 (2004) without changing the basic accounting; and
  - (b) remedies problems that emerged in the application of IFRS 3 (2004).
25. The following table reviews each of the significant improvements IFRS 3 (2008) introduced and sets out the staff's analysis of their relevance to entities applying the *IFRS for SMEs* Standard.



Topic	Amendment in IFRS 3 (2008)	Section 19 requirements	Improvements introduced by amendments in IFRS 3 (2008)	Relevance to entities applying the <i>IFRS for SMEs</i> Standard
Step and partial acquisitions	<p>For an acquisition achieved in stages (step acquisition) IFRS 3 (2004) required the acquirer to measure the fair value of assets and liabilities at each step of the acquisition for the purpose of measuring goodwill.</p> <p>For an acquisition achieved in stages IFRS 3 (2008) requires an acquirer to remeasure the previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss.<sup>7</sup></p>	Section 19 does not provide explicit guidance on the accounting for step acquisitions.	<p>The requirement to remeasure previously held equity interest at its acquisition-date fair value responded to concerns that cost accumulation practices led to many inconsistencies and deficiencies in financial reporting.</p> <p>Some may argue that the amendment simplified the accounting for goodwill in a step acquisition because an entity can no longer apply the cost accumulation approach which measures goodwill at each step in the acquisition.</p>	<p>Aligning the IFRS 3 (2008) requirements on step acquisitions with the <i>IFRS for SMEs</i> Standard would require that an entity:</p> <ul style="list-style-type: none"> <li>(a) measure the fair value of assets and liabilities acquired at the acquisition date and thereby determine the amount of goodwill at the acquisition date. Arguably, this change simplifies the accounting in this area.</li> <li>(b) remeasure its previously held equity interest in the acquisition.</li> </ul> <p>Aligning the <i>IFRS for SMEs</i> Standard to make this improvement will provide comparable and better-quality information to users. Currently (in the absence of requirements in the <i>IFRS for SMEs</i> Standard) entities may use cost accumulation practices.</p> <p>The staff recommends the Board seek views on:</p> <ul style="list-style-type: none"> <li>(a) the need to introduce requirements for step acquisitions into the <i>IFRS for SMEs</i> Standard; and</li> <li>(b) if there is need for such requirements, whether the requirements should be aligned with IFRS 3 (2008).</li> </ul>

<sup>7</sup> IFRS 3 (2008) paragraph 32.

Topic	Amendment in IFRS 3 (2008)	Section 19 requirements	Improvements introduced by amendments in IFRS 3 (2008)	Relevance to entities applying the <i>IFRS for SMEs</i> Standard
<p>Measuring non-controlling interests (NCIs)</p>	<p>For a business combination in which the acquirer achieves control without acquiring all the equity of the acquiree, IFRS 3 (2008) permits two methods to measure NCIs:</p> <p>(a) method 1—at fair value; or</p> <p>(b) method 2—at the NCI’s proportionate share of the acquiree’s net identifiable assets.</p> <p>Previously, only method 2 was permitted.</p>	<p>Section 19 only permits the use of method 2 (paragraph 19.14).</p>	<p>Measuring NCIs at fair value on the acquisition date is consistent with the way in which other components of equity are measured and is therefore useful in decision making as the value of NCIs can be identified.</p>	<p>Aligning the <i>IFRS for SMEs</i> Standard by introducing method 1 would introduce complexity in the Standard. The complexity arises because an entity is required to estimate the fair value of NCIs.</p> <p>Some respondents to the PIR stated that measuring NCIs at fair value presents significant practical difficulties, particularly when the shares of the acquiree are not traded in an active market.<sup>8</sup></p> <p>The staff does not recommend that the Board seeks views in the Request for Information on introducing an option to measure NCIs at fair value.</p>

<sup>8</sup> Post-implementation Review of IFRS 3 *Business Combinations* (2008) page 23.

Topic	Amendment in IFRS 3 (2008)	Section 19 requirements	Improvements introduced by amendments in IFRS 3 (2008)	Relevance to entities applying the <i>IFRS for SMEs</i> Standard
Acquisition-related costs	<p>IFRS 3 (2004) required acquisition-related costs to be added to the cost of the business combination.</p> <p>IFRS 3 (2008) requires acquisition-related costs to be recognised as an expense at the time of the acquisition.</p>	Any costs directly attributable to the business combination are added to the cost of the business combination (paragraph 19.11).	Acquisition-related costs are not part of the fair value exchange between the buyer and seller of the business combination and as such should be recognised separately.	<p>Acquisition-related costs do not represent the assets of the acquirer at the acquisition date but, rather, represent a separate transaction in which the buyer pays for the fair value of services received.</p> <p>The staff believes the Board should seek views on aligning Section 19 with the accounting for acquisition-related costs in IFRS 3 (2008).</p>

Topic	Amendment in IFRS 3 (2008)	Section 19 requirements	Improvements introduced by amendments in IFRS 3 (2008)	Relevance to entities applying the <i>IFRS for SMEs</i> Standard
Contingent consideration	<p>IFRS 3 (2004) required contingent consideration to be included in the cost of the business combination at the acquisition date, if the adjustment is probable and could be measured reliably with any subsequent changes to the estimate of contingent consideration being accounted for as adjustments to the cost of the business combination, thus affecting the amount of goodwill recognised.</p> <p>IFRS 3 (2008) requires that contingent consideration in a business combination be recognised at fair value (without regard to probability). Subsequent changes in the measurement of contingent consideration are accounted for as a financial instrument with changes in fair value recognised in profit or loss.</p>	<p>Contingent consideration is included in the cost of the business combination at the acquisition date, if its payment is probable and can be reliably measured.</p> <p>A change in the estimate of contingent consideration is treated as additional consideration and as an adjustment to the cost of the business combination. Consequently, it changes the amount of goodwill (paragraphs 19.12 to 19.13).</p>	<p>Contingent consideration is a financial liability; changes in the fair value are recognised in profit and loss.</p>	<p>The staff takes the view that recognising contingent consideration at fair value will provide users of financial statements prepared in accordance with the <i>IFRS for SMEs</i> Standard with improved information about the cost of the business combination.</p> <p>Furthermore, measuring contingent consideration at fair value faithfully represents the liability an entity has entered into through the business combination.</p> <p>The staff recommends the Board seek views on aligning Section 19 with the accounting for contingent consideration in IFRS 3 (2008).</p>

Topic	Amendment in IFRS 3 (2008)	Section 19 requirements	Improvements introduced by amendments in IFRS 3 (2008)	Relevance to entities applying the <i>IFRS for SMEs Standard</i>
Intangible Assets	<p>IFRS 3 (2008):</p> <ul style="list-style-type: none"> <li>(a) removed the reliability of the measurement threshold for recognising intangible assets;</li> <li>(b) clarified that an assembled workforce must not be recognised; and</li> <li>(c) provided additional guidance in relation to reacquired rights.</li> </ul> <p>Previously, no guidance had been provided regarding reacquired rights and intangible assets were required to be reliably measurable prior to recognition.</p>	<p>The acquirer shall recognise an intangible asset acquired in a business combination if its fair value can be measured reliably without undue cost or effort (paragraphs 19.12–19.13).</p>	<p>The amendment improves comparability and usefulness of information regarding intangible assets acquired in a business combination.</p>	<p>Staff do not recommend that the Board seeks views in the Request for Information on aligning the <i>IFRS for SMEs Standard</i> with IFRS 3 (2008) because removing the reliability of the measurement threshold for recognising intangible assets would introduce complexity.</p> <p>The complexity would not be justified due to the different approaches to the measurement of goodwill. IFRS 3 (2008) applies an impairment only approach to the subsequent measurements of goodwill.<sup>9</sup> It is therefore important that intangible assets with finite useful lives are recognised separately from goodwill.</p> <p>In contrast the <i>IFRS for SMEs Standard</i> applies an amortisation and impairment approach to subsequent measurement of goodwill and intangible assets. It is therefore less critical to separately recognise intangible assets with finite useful lives.</p> <p>Consequently, the staff recommends the Board makes clear in the Request for Information it does not intend to amend the <i>IFRS for SMEs Standard</i> for this item.</p>

<sup>9</sup> *IFRS for SMEs Standard* paragraph 19.23.

26. Should the Board agree with the staff recommendations in the table above, the significant differences in the accounting for a business combination between the *IFRS for SMEs* Standard and IFRS 3 (2008) will be as follows:
- (a) the definition of ‘business combination’ and ‘business’ differ between the *IFRS for SMEs* Standard and IFRS 3 (2008) and so may result in differences in application. The Board issued an amendment to IFRS 3 (2008) clarifying the definition of a business, but that amendment is outside the scope of the 2019 Review;
  - (b) after initial recognition applying the *IFRS for SMEs* Standard, goodwill is measured at cost less accumulated amortisation and any accumulated impairment losses. Applying IFRS 3 (2008), goodwill is not amortised but tested annually for impairment; and
  - (c) applying Section 18, an intangible asset acquired in a business combination shall be recognised unless its fair value cannot be measured reliably without undue cost or effort at the acquisition date.<sup>10</sup> IFRS 3 (2008) and IAS 38 *Intangible Assets* assume that if an intangible asset is separable or arises from contractual or other legal rights, the reliable measurement criterion is always satisfied.<sup>11</sup> IFRS 3 (2008) and IAS 38 do not provide undue cost or effort exemptions;

### **Principle 2—Simplicity**

27. The staff recommends that the Board does not seek views on aligning the *IFRS for SMEs* Standard for the following improvements:
- (a) introducing the option to measure NCIs at fair value;
  - (b) removing the reliability of the measurement threshold for recognising intangible assets;
  - (c) clarifying that an assembled workforce must not be recognised; and
  - (d) providing additional guidance in relation to reacquired rights.

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<sup>10</sup> *IFRS for SMEs* Standard paragraph 18.8.

<sup>11</sup> IAS 38 *Intangible Assets* paragraph 33.

28. The staff believes the approach in paragraph 27 introduces simplifications for the purpose of aligning the *IFRS for SMEs* Standard with IFRS 3 (2008).

### **Step and partial acquisitions**

29. As noted, the staff is proposing the Board seek views on introducing requirements on the accounting for step acquisitions and whether to align such requirements with IFRS 3 (2008).
30. IFRS 3 (2008) requires the fair value of a previously held equity interest to be determined at the acquisition date. Consequently, entities will need to estimate the fair value of previously held equity interests. The staff acknowledges this extends the use of fair value, which can be challenging for entities applying the *IFRS for SMEs* Standard.
31. The staff also acknowledges the need to strike a balance between introducing the use of fair value and providing relevant information for users. In recommending the Board seeks views on this improvement, the staff takes the view that entities applying the *IFRS for SMEs* Standard are already familiar with measuring goodwill on the acquisition date and as such, complexity arises from measuring previously held equity interests.
32. Should the Board decide to consult on this topic, the staff proposes drafting the requirements, so entities apply the fair value measurement guidance in the *IFRS for SMEs* Standard that the Board has tentatively decided to seek views on updating.

### **Contingent consideration**

33. The staff is also proposing that the Board seeks views on aligning the *IFRS for SMEs* Standard with IFRS 3 (2008) for contingent consideration to be recognised at fair value<sup>12</sup> (without regard to probability) and subsequently accounted for as a financial instrument (instead of as an adjustment to the cost of the business combination) with changes in fair value recognised in profit or loss.<sup>13</sup>

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<sup>12</sup> *Annual Improvements to IFRS Standards 2010–2012 Cycle* clarifies that contingent consideration that is classified as an asset or a liability shall be measured at fair value at each reporting date. This clarification will be considered by the staff at the drafting stage.

<sup>13</sup> IFRS 3 (2008) paragraph 39.

34. Staff acknowledges that requiring contingent consideration to be measure at fair value will extend the use of fair value in the *IFRS for SMEs* Standard. However, staff is of the view that in assessing the economic effectiveness of the acquisition, an entity will have estimated the fair value of the contingent consideration. Furthermore, entities will apply the fair value measurement guidance in the *IFRS for SMEs* Standard that the Board has tentatively decided to seek views on updating.
35. That said, the staff proposes that if an entity determines the fair value cannot be estimated, the entity should apply the undue cost or effort exemption in paragraph 2.14A of the *IFRS for SMEs* Standard. The staff recommends that the Board seek views, in the Request for Information, on permitting the use of the undue cost or effort exemption to estimate the fair value of the contingent consideration.
36. In applying the exemption, entities would still be required to disclose the fact that and reasons why applying the requirements of the fair value determination involve undue cost or effort.
37. The accounting for subsequent changes in contingent consideration is not complex as the changes are recognised in profit or loss.<sup>14</sup> Consequently, there is also no need to remeasure the goodwill due to changes, which further simplifies the requirements for entities.

### ***Principle 3—Faithful representation***

38. The requirements of IFRS 3 (2008) do not introduce a new method of accounting but, rather, expand the use of the acquisition method with which entities applying the *IFRS for SMEs* Standard are already familiar.
39. The analysis on the relevance principle identifies those significant improvements introduced by IFRS 3 (2008) in relation to which the staff recommends the Board seek views in the Request for Information on aligning the *IFRS for SMEs* Standard.

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<sup>14</sup> IFRS 3 (2008) paragraph 58(b)(ii).



40. The staff notes that, applying the simplicity principle, proposes alignment to take into account only certain improvements introduced by IFRS 3 (2008) is in itself a simplification.
41. The staff also proposes the Board seeks views on permitting the use of the undue cost or effort exemption when estimating the fair value of contingent consideration.
42. The staff accepts that the improvements on which it recommends the Board seeks views in the Request for Information will expand the use of fair value and will require that entities make more judgements. However, as has been explained, there is already guidance in the *IFRS for SMEs* Standard on measuring fair value.<sup>15</sup> The staff thinks introducing these requirements provides users of financial statements with an improved understanding of the cost of the business combination.
43. In the staff's view, implementing the recommendation would mean the amount of goodwill recognised more faithfully represents the underlying economics of the business combination. Users of financial statements prepared in accordance with the *IFRS for SMEs* Standard would gain an improved understanding of the cost of the business combination.

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<sup>15</sup> See Agenda Paper 30B on IFRS 13 *Fair Value Measurement* from the May 2019 Board meeting.

44. The staff does not propose alignment for:
- (a) removing the reliability of the measurement threshold for recognising intangible assets; and
  - (b) introducing the option to measure NCIs at fair value.
45. The staff believes that even without these requirements, faithful representation will be maintained because:
- (a) intangible assets that have not been separately recognised in the business combination will still be accounted for through the annual amortisation of goodwill; and
  - (b) removing the option to measure NCI at fair value is consistent with the Board's approach to simplification of the *IFRS for SMEs* Standard.

### Stakeholder views

46. In February 2019 the staff asked members of the Small and Medium-sized Entities Implementation Group (SMEIG) for their views on whether to align the *IFRS for SMEs* Standard with IFRS 3 (2008). A summary of responses is set out in Appendix A.
47. The main objection raised by SMEIG members against aligning the *IFRS for SMEs* Standard with IFRS 3 (2008) relates to the complexity of IFRS 3 (2008).
48. Other stakeholder views on whether to align the *IFRS for SMEs* Standard with IFRS 3 (2008) are mixed. The Asian-Oceanian Standard-Setters Group (AOSSG) survey on the *IFRS for SMEs* Standard found that nine jurisdictions, Cambodia,<sup>16</sup> India, Korea, Malaysia,<sup>17</sup> Nepal, Pakistan,<sup>18</sup> the Philippines, Sri Lanka, and Syria<sup>19</sup> opposed aligning the *IFRS for SMEs* Standard with IFRS 3 (2008). In their view, although the Board completed the PIR for IFRS 3 (2008), there still exist further actions to be undertaken regarding the definition of a business, accounting for goodwill and the identification and

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<sup>16</sup> Cambodia allows SMEs to use the *IFRS for SMEs* Standard, which is adopted without modification.

<sup>17</sup> The Philippines, Sri Lanka and Malaysia use accounting standards that are substantively identical to the *IFRS for SMEs* Standard.

<sup>18</sup> India, Korea, Nepal and Pakistan do not use the *IFRS for SMEs* Standard.

<sup>19</sup> No information is available about the use of the *IFRS for SMEs* Standard in Syria.

fair value measurement of intangible assets such as customer relationships and brand names.<sup>20</sup>

49. One jurisdiction, Thailand,<sup>21</sup> was in favour of aligning the *IFRS for SMEs* Standard with IFRS 3 (2008) because some SMEs that have acquired subsidiaries and joint ventures are not listed but their ultimate parent applies full IFRS Standards. These SMEs then have the burden to convert from the *IFRS for SMEs* Standard to IFRS 3 (2008) for the purposes of financial statement consolidation with the ultimate parent.<sup>22</sup>
50. The staff agrees with the position held by the AOSSG and, therefore, does not recommend that the Board seek views on changing the requirements in the *IFRS for SMEs* Standard for accounting for goodwill and the identification of intangible assets. Furthermore, the definition of a business is outside the scope of the 2019 Review.
51. The UK Financial Reporting Council (FRC) proposed not to incorporate IFRS 3 (2008) into *FRS 102—The Financial Reporting Standard applicable in the UK and Republic of Ireland*.<sup>23</sup> The majority of respondents agreed with the FRC’s proposal, while three respondents agreed with reservations. Only one respondent disagreed with the FRC’s proposal and was of the view the FRC should continue to consider incorporating IFRS 3 (2008). The respondents who agreed, with reservations, said:
- (a) the FRC should consider changing the measurement of contingent consideration from best estimate to fair value now that company law has changed to permit this treatment;
  - (b) the FRC should consider changing the accounting for acquisition costs so that they are recognised as an expense;
  - (c) the FRC should consider changing FRS 102 in step with the *IFRS for SMEs* Standard and after completion of the PIR of IFRS 3 (2008); and

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<sup>20</sup> AOSSG, [Report of AOSSG Survey on the IFRS for SMEs Standard](#), 2018.

<sup>21</sup> China does not use the *IFRS for SMEs* Standard.

<sup>22</sup> AOSSG, [Report of AOSSG Survey on the IFRS for SMEs Standard](#), 2018.

<sup>23</sup> FRS 102 is a standard based on the *IFRS for SMEs* Standard.

- (d) an IFRS Standard-based solution would be likely to result in better-quality information for larger entities or groups, but that this may not be true for smaller entities.

52. The staff notes that the points presented by respondents to the FRC's consultation are consistent with the staff's analysis and proposes that the alignment of the *IFRS for SMEs* Standard with IFRS 3 (2008) only be considered for the topics discussed in paragraphs 23–37 of this paper.

### Other considerations

53. As noted in paragraph 15(a) above, the Board issued an amendment to IFRS 3 (2008) on the definition of a business. The amendment will be applied to acquisitions that occur on or after 1 January 2020. The staff therefore does not propose that the definition of a business be considered for alignment during the 2019 Review of the *IFRS for SMEs* Standard.
54. The amendments relating to the following two topics will be addressed by staff during the drafting stage of the project:
- (a) *Annual Improvements to IFRS Standards 2010–2012 Cycle* which clarifies that contingent consideration that is classified as an asset or a liability shall be measured at fair value at each reporting date;
  - (b) *Annual Improvements to IFRS Standards 2011–2013 Cycle* which clarifies that IFRS 3 excludes from its scope the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself; and
  - (c) *Annual Improvements to the IFRS Standards 2015–2017 Cycle* which clarifies that when an entity obtains control of a business that is a joint operation, it remeasures the previously held interest in that business.

**Questions for the Board**

Board members are asked if they agree with the staff recommendations to seek views in the Request for Information on the alignment of the *IFRS for SMEs* Standard with IFRS 3 (2008), including:

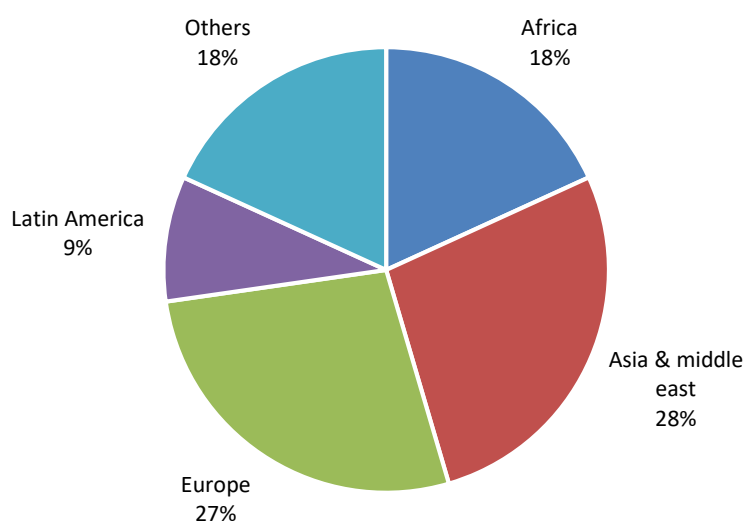
- (a) whether there is a need to introduce requirements for step acquisitions into the *IFRS for SMEs* Standard;
- (b) if there is a need to introduce requirements for step acquisitions into the *IFRS for SMEs* Standard, whether those requirements should be aligned with IFRS 3 (2008); and
- (c) whether Section 19 of the *IFRS for SMEs* Standard should be aligned with IFRS 3 (2008) such that:
  - (i) acquisition-related costs are recognised as an expense at the time of the acquisition; and
  - (ii) contingent consideration is measured on initial recognition at fair value, and the undue cost or effort exemption is extended to apply to the fair value measurement of the contingent consideration.

The staff also recommends the Board clarify in the Request for Information that it does not intend to amend the requirements in the *IFRS for SMEs* Standard to:

- (a) introduce the option to measure non-controlling interests (NCIs) at fair value;
- (b) remove the reliability of the measurement threshold for recognising intangible assets;
- (c) clarify that an assembled workforce must not be recognised; and
- (d) provide additional guidance in relation to reacquired rights.

## Appendix A—Summary of SMEIG members' views on whether to align the *IFRS for SMEs* Standard with IFRS 3 (2008)

- A1 On 29 January 2019 a questionnaire was sent to SME Implementation Group (SMEIG) members to seek their views on whether to align the *IFRS for SMEs* Standard with IFRS 3 (2008).
- A2 Eleven SMEIG members (42%) responded to the survey. The geographical distribution of the responses received is shown in this chart:



- A3 The main reasons given by SMEIG members for not aligning the *IFRS for SMEs* Standard with IFRS 3 (2008) are that:
- IFRS 3 (2008) is generally not relevant to SMEs (3 respondents);
  - Section 19 is accepted and works well in practice (3 respondents);
  - some specific requirements of IFRS 3 (2004) have been incorporated into Section 19 and are easier to apply than the requirements of IFRS 3 (2008) (2 respondents); and
  - aligning the standards would require more use of the fair value measurement which is already considered complex (1 respondent).

- A4 The main reasons given by SMEIG members for aligning the *IFRS for SMEs* Standard with IFRS 3 (2008) are that:
- (a) IFRS 3 introduced new and important definitions, such as the definition of a business and the definition of a business combination, that should be considered during the 2019 Review (1 respondent); and
  - (b) aligning the Standards would enable preparers to provide financial statements that users are better able to understand (1 respondent).

## **Appendix B—Overview of Section 19 and differences between IFRS 3 (2008) and Section 19**

### **Overview of Section 19**

#### ***Introduction to the requirements***

- B1. The objective of Section 19 is to prescribe the accounting treatment for business combinations and goodwill, so users are presented with financial statements that reflect the economic substance of a business combination and its effects.
- B2. Business combinations are accounted for applying the purchase method, which involves:
- (a) identifying the acquirer;
  - (b) measuring the cost of the business combination; and
  - (c) measuring the assets acquired and the liabilities and contingent liabilities assumed in the business combination.
- B3. The acquirer measures the goodwill acquired in a business combination at cost less any accumulated amortisation and accumulated impairment losses. Goodwill is considered to have a finite useful life and is amortised over that finite period.
- B4. Section 19 also specifies disclosure requirements for business combinations that were effected in the reporting period and for goodwill that is recognised in the statement of financial position.

#### ***Differences between IFRS 3 (2008) and Section 19***

- B5. The main differences between the requirements of IFRS 3 (2008) and Section 19 are as described in the paragraphs that follow.
- B6. The definitions of ‘business combination’ and ‘business’ in the *IFRS for SMEs* Standard are different from those in IFRS 3 (2008), possibly resulting in differences in application.



- B7. Applying paragraph 19.11(b) of the *IFRS for SMEs* Standard, the cost of a business combination includes any costs directly attributable to the business combination (for example, finder's fees and advisory, legal, accounting, valuation and other professional or consulting fees that are directly attributable to the business combination). By contrast, IFRS 3 (2008) explicitly excludes such costs from the cost of a business combination (paragraph 53 of IFRS 3). Consequently, such costs generally form part of goodwill under the *IFRS for SMEs* Standard, whereas under IFRS 3 they are recognised as expenses in the period in which the costs are incurred and the services are received.
- B8. Applying IFRS 3, if a business combination is achieved in stages, the acquirer remeasures any previously held equity interest in the acquiree at its acquisition-date fair value and takes this amount into account in the determination of goodwill (paragraphs 41–42 of IFRS 3 (2008)). Section 19 of the *IFRS for SMEs* Standard does not provide explicit guidance on the accounting for a step acquisition.
- B9. Contingent consideration is included in the cost of a business combination applying the *IFRS for SMEs* Standard, if its payment is probable and the amount can be measured reliably (paragraph 19.12). IFRS 3 (2008), on the other hand, requires the fair value of contingent consideration to be included in the cost of a business combination regardless of whether payment is probable; its fair value being determined by considering the possible outcomes and estimating the probability of each (paragraph 39 of IFRS 3(2008)).
- B10. Applying the *IFRS for SMEs* Standard, if subsequently, the contingent consideration becomes both probable and can be measured reliably, the fair value amount is treated as an adjustment to the cost of the business combination (paragraph 19.13) and so will affect the amount recognised for goodwill. Under IFRS 3, changes in the fair value of contingent consideration only affect the cost of the business combination if they are measurement period adjustments (adjustments made during the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination), otherwise they are accounted for separately (paragraph 58 of IFRS 3 (2008)).

- B11. After initial recognition applying the *IFRS for SMEs* Standard, goodwill is measured at cost less accumulated amortisation and any accumulated impairment losses. Goodwill is amortised over its useful life and cash-generating units to which goodwill has been allocated are subject to an impairment test if there is an indication of impairment. If an entity cannot establish reliably the useful life of goodwill, the life shall be determined based on management's best estimate but shall not exceed 10 years (paragraph 19.23). Applying full IFRS Standards, goodwill is not amortised. However, cash-generating units to which goodwill has been allocated are subject to an impairment test at least annually and, additionally, when there is an indication of impairment (paragraphs 10(b) and 90 of IAS 36 *Impairment of Assets*).
- B12. Applying Section 18, an intangible asset acquired in a business combination shall be recognised unless its fair value cannot be measured reliably without undue cost or effort at the acquisition date (paragraph 18.8). IFRS 3 (2008) and IAS 38 *Intangible Assets* assume that if an intangible asset is separable or arises from contractual or other legal rights the reliable measurement criterion is always satisfied (paragraph 33 of IAS 38) and do not provide undue cost or effort exemptions.
- B13. Applying the *IFRS for SMEs* Standard, a non-controlling interest is measured at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets (sometimes called the proportionate share method—paragraph 19.14). Using this method, goodwill that is attributable to the non-controlling interest is not recognised. Applying IFRS 3 (paragraph 19), the non-controlling interest is measured using either the full goodwill method or the proportionate share method. The difference between the two is that with the full goodwill method, the non-controlling interest's stake in the entity is valued at fair value and this is used, along with consideration paid by the parent for its stake in the subsidiary, to calculate the goodwill arising on 100% of the subsidiary. The full goodwill is recognised in the consolidated financial statements (that is, it includes goodwill attributable to the non-controlling interest). If the full goodwill method is used, at the acquisition date of a partly owned subsidiary, both goodwill and non-controlling interest are different from those calculated applying the *IFRS for SMEs* Standard. IFRS 3 (2008) and the *IFRS for SMEs* Standard are different in other ways:

- (a) under the *IFRS for SMEs* Standard, the method used to account for business combinations is called the purchase method. Under IFRS 3 (2008) it is called the acquisition method.
- (b) IFRS 3 (2008) contains additional exceptions from the recognition and fair value measurement requirements for the acquiree's identifiable assets and liabilities, for example, it includes exemptions and specific requirements for indemnification assets, leases, reacquired rights and share-based payments.
- (c) IFRS 3 (2008) contains additional guidance in some specific areas that are not covered by the *IFRS for SMEs* Standard, for example reverse acquisitions, business combinations achieved without the transfer of consideration and the identification of intangible assets.
- (d) the *IFRS for SMEs* Standard is drafted using simpler language than that used in full IFRS Standards.