STAFF PAPER

9–13 December 2013

IASB Meeting

Project	**Post-implementation Review**
Paper topic	IFRS 3 *Business Combinations*—Proposed questions for the RfI

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Purpose of this paper

1. This Agenda Paper incorporates the feedback received from the IASB in relation to the questions that the staff proposed at the IASB's November 2013 meeting[1] for inclusion in the Request for Information (RfI) on the post-implementation review (PiR) of IFRS 3 *Business Combinations*.

2. This Agenda Paper also asks the IASB whether it has any further feedback for the staff on the content, structure and revised set of questions for the RfI and whether it grants the staff permission to publish the RfI.

Revised set of questions for the RfI

3. Appendix I to this Agenda Paper includes a revised set of tentative questions to be included in the RfI.

4. We note that we will receive input from the Accounting Standards Advisory Forum (ASAF) meeting in December. The posting deadline of this Agenda Paper was earlier than the date of the ASAF meeting and, as a result, it does not incorporate the input from ASAF. We will, however, inform the IASB of the feedback received from the ASAF meeting that this Agenda Paper does not capture.

[1] Agenda Paper 13A and 13B discussed at the November 2013 IASB meeting can be found at: http://www.ifrs.org/Meetings/Pages/IASB-Nov-13.aspx

Next steps

5. We estimate that the publication of the RfI will take place in January-February 2014.

6. We foresee the following structure for the RfI:

   (i) Introduction

   (ii) Background of IFRS 3 *Business Combinations*

   (iii) Invitation to Comment (see Appendix I to this paper)

   (iv) Next steps

7. On the basis of the structure detailed above and on the questions set out in Appendix I, the staff requests the IASB permission to publish the RfI. The full document will be provided to the IASB members for review prior to publication.

Question for the IASB

Question 1	
(a)	Does the IASB have any feedback for the staff on the content, structure or tentative questions for inclusion in the RfI, which are included in Appendix I to this paper?
(b)	Does the IASB grant the staff permission to publish an RfI on IFRS 3?

Appendix 1—Tentative questions for inclusion in the RfI

Invitation to comment

The IASB invites comments on any aspect of the application of IFRS 3 *Business Combinations*.

Comments are most helpful to us, in our assessment of the effect of applying IFRS 3, if they are supported by examples from published financial statements or other relevant evidence.

You do not have to answer every question and you are encouraged to comment on any additional matters that you think are relevant to our review of the application of IFRS 3.

We will consider all comments received by [Day Month 2014]. We will make our assessment on the merits of the information provided and not on the number of responses to each question.

1. Your background and experience

It is easier for us to understand the information that you give us if we know what your role is with respect to financial reporting and what your experience is in accounting for business combinations.

Question 1

Please tell us:

(a) what your current job title is;

(b) about your role in relation to the business combinations (ie preparer of financial statements, auditor, valuation specialist, user and type of user[2], regulator, standard-setter, academic, accounting professional body etc);

(c) what your principal jurisdiction is;

(d) whether your jurisdiction or company is a recent adopter of IFRS and, if so, the year of adoption;

(e) how many business combinations accounted for under IFRS have you

[2] Type of user includes: buy-side analyst, sell-side analyst, credit rating analyst, asset manager, creditor/lender, other (please specify).

been involved with since 2004 and what were the industries of the acquirees in those combinations; and

(f) whether your involvement with business combinations accounting has been mainly with IFRS 3 (2004) or whether it has been with IFRS 3 (2008).

If you work in a non-IFRS environment your input is still useful to us—but we would like to know about your current reporting of business combinations so that we can assess your information within that context.

2. Definition of a business

IFRS 3 (2008) amended the definitions of a business and of a business combination and included additional guidance for identifying when a group of assets constitutes a business.[3] The assessment to determine whether a transaction involves a business is critical to determining whether a transaction is within the scope of the Standard or whether it is an acquisition of an asset or group of assets.

The accounting for business combinations differ from the accounting for an asset acquisition in the following key areas:

- the accounting for a premium paid in addition to the identifiable net assets. Such a premium is either recognised as a separate asset (ie goodwill in business combinations) or is allocated to the identifiable assets based on their relative fair values (asset acquisition);

- the accounting for deferred taxes. Deferred tax assets and deferred tax liabilities arising from the initial recognition of assets and liabilities, are recognised on the acquisition date in the case of business combinations, but, in the case of asset acquisitions they are not; and

- the accounting for acquisition-related costs. They are capitalised in the case of asset acquisitions but recognised as an expense in the case of business combinations, with the exception of costs to issue debt or equity securities.

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[3] IFRS 3 (2004) defined ‘business’ as “an integrated set of activities and assets conducted and managed for the purpose of providing: (a) a return to investors; or (b) lower costs or other economic benefits directly and proportionately to policyholders or participants. […]” and a ‘business combination’ as “the bringing together of separate entities or businesses into one reporting entity”. IFRS 3 (2008) amended the definition of ‘business’ as follows: “An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants”. It also amended ‘business combinations’ as follows: “A transaction or event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred as ‘true mergers’ or ‘mergers of equals’ are also business combinations as that term is used in this IFRS”.

Question 2

(a) **What are the benefits of having separate accounting treatments for business combinations and asset acquisitions?**

(b) **What are the main practical implementation challenges you face when assessing a transaction to determine whether it is a business? For the practical implementation challenges that you have indicated, what are the main considerations that you take into account in your assessment?**

3. Fair value

Fair value measurement has long been a feature of business combination accounting. IAS 22 *Business Combinations*, issued in 1983, required each asset acquired and liability assumed in a business combination to be measured at fair value.

The IASB is interested in finding out whether the following factors, or any others, have had an impact on the extent of the use, implementation challenges, audit and enforcement of fair value measurements in business combinations:

- The amendments to the criteria for recognition of intangible assets in IAS 38 *Intangible Assets* as a consequence of IFRS 3 (2004) and IFRS 3 (2008) (see Question 4) were intended to result in more intangible assets being recognised in business combinations (rather than being subsumed in goodwill).
- The financial crisis that started in 2007 may have increased the challenges in measuring specific assets and liabilities at fair value.

Fair value is also used in the impairment calculations of goodwill and other assets or groups of assets.

Question 3

(a) **To what extent is the information disclosed about fair value measurements sufficient? If there are deficiencies, what are they?**

(b) **What have been the most significant valuation challenges in measuring fair value within the context of business combination accounting?**

(c) **Are there particular elements, for example, specific assets, liabilities, consideration etc, that have presented particular challenges in measuring fair value?**

4. Separate recognition of intangible assets from goodwill

IFRS 3 (2004) stressed the previous requirement in IAS 22 and the previous version of IAS 38 for recognising an intangible asset acquired in a business combination separately from goodwill, because the IASB had observed that, despite those requirements, intangible assets were often included in the amount recognised as goodwill. The IASB believed that the usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill. Consequently, IFRS 3 (2004) and IFRS 3 (2008) amended the criteria in IAS 38 for recognition of intangible assets arising from business combinations. The expected effect of those changes is an increase in the intangible assets recognised as a result of business combinations.

In addition, IFRS 3 (2004) introduced changes in the accounting for negative goodwill by requiring its immediate recognition in profit or loss. The IASB concluded that the most representationally faithful treatment of negative goodwill arising from a bargain purchase is immediate recognition in profit or loss. IFRS 3 (2004) also required entities to disclose the nature of any excess recognised in profit or loss;[4] IFRS 3 (2008) replaced this disclosure by requiring a description of the reasons why the transaction resulted in a gain.

Question 4

(a) What do you find useful about the separate identification of intangible assets? How does it contribute to your understanding and your analysis of the acquired business? Do you think changes are needed and if so, what are they?

(b) What are the main implementation, auditing or enforcement challenges in the separate identification and measurement of intangible assets from goodwill? What do you think are the main causes of those challenges?

(c) **How useful do you find the recognition of negative goodwill in profit or loss and the disclosures about its underlying reasons?**

[4] IFRS 3 (2004) referred to negative goodwill as the *excess* of an acquirer's interest in the net fair value of an acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination.

5. Non-amortisation of goodwill and indefinite life intangible assets

One of the main changes to business combinations accounting introduced by IFRS 3 (2004) was to preclude amortisation of goodwill and instead to require goodwill to be tested annually for impairment. The main reason for this change is that we understood that assessing the impairment of goodwill annually provides better information than an arbitrary allocation of a charge through amortisation, which depends on factors that are not possible to predict such as the useful life of the acquired goodwill and the pattern in which it diminishes.

In addition, IAS 38 was amended to require an intangible asset to be regarded as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. Intangible assets with an indefinite useful life are not amortised but are instead tested for impairment annually.

The requirements for performing the annual impairment test of goodwill and of intangible assets with indefinite useful lives are set out in IAS 36 *Impairment of Assets*. IFRS 3 (2004) also clarified the allocation of goodwill to cash-generating units (or groups of units) in IAS 36. This included specifying the treatment of goodwill that had been previously allocated to an operation within a cash-generating unit (group of units) when an entity disposes of that operation. IFRS 3 (2004) also set out the reallocation of goodwill when an entity reorganises its reporting structure in a manner that changes the composition of cash-generating units (groups of units) to which goodwill had been allocated.

Question 5

(a) **How useful have you found the information obtained from annually assessing goodwill and intangible assets with indefinite useful lives for impairment, and, why?**

(b) **In relation to the information provided by the impairment test, do you think improvements are needed? If so, what are they?**

(c) **What are the main implementation challenges in testing goodwill or intangible assets with indefinite useful lives for impairment (or auditing or enforcing the impairment tests), and why?**

6. Non-controlling interest

As part of the 2003 revision of IAS 27 *Consolidated and Separate Financial Statements*, minority (non-controlling) interests were required to be presented in the consolidated statement of financial position within equity, separately from the equity of the shareholders of the parent. At that time, the IASB concluded that a minority (non-controlling) interest is not a liability of a group because it does not meet the definition of liability in the *Conceptual Framework*. IFRS 3 (2008) changed the term 'minority interest' to 'non-controlling interest' and redefined it.[5]

In addition, IFRS 3 (2008) introduced:

- a choice of measurement basis for NCIs that are present ownership interests to be measured at either fair value or the present ownership interests' proportionate share in the recognised amounts of the acquiree's net identifiable assets;
- amendments to IAS 27 (2008) to require that after control of an entity is obtained, changes in a parent's ownership interest that do not result in a loss of control are accounted for as equity transactions. This means that no gain or loss from these changes should be recognised in profit or loss. It also means that no change in the carrying amounts of the subsidiary's assets (including goodwill) or liabilities should be recognised as a result of such transactions; and
- amendments to IAS 27 (2008) to require an entity to attribute total comprehensive income applicable to NCIs to those interests, even if this results in the NCIs having a deficit balance.

Question 6

(a) How useful are the presentation and measurement requirements for NCIs? Does the information resulting from those requirements reflect the claims on consolidated equity that are not attributable to the parent? If not, what improvements do you think are needed?

(b) What are the main challenges in the accounting for NCI, or auditing or in enforcing such accounting? Please specify the measurement option under which those challenges arise.

To help us assess your answer better, we would appreciate it if you could please specify the measurement option under which you account for

[5] IAS 27 (2003) defined 'minority interest' as "that portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent". IFRS 3 (2008) modified the term to 'non-controlling interest' and changed the definition to "the equity in a subsidiary not attributable, directly or indirectly, to a parent".

NCIs that are present ownership interests and whether this measurement choice is made on an acquisition-by-acquisition basis.

7. Step acquisitions

IFRS 3 provides guidance on how to account for step acquisitions. These are business combinations that are achieved in stages; the acquirer first purchases a minority stake in the target entity, and then in a separate and independent transaction, it acquires one or more additional stakes that, cumulatively, give it control of the target entity. The two main changes to the accounting for step acquisitions that were introduced by IFRS 3 (2008) are:

- Assets and liabilities of the acquiree are measured at fair value at acquisition date and goodwill is measured as the difference at acquisition date between the value of any investment in the acquiree held before the acquisition, the consideration transferred, the amount of any non-controlling interests and the net assets acquired.

  Prior to IFRS 3 (2008) the assets and liabilities of the acquiree in a step acquisition were measured at fair value at each step in a step acquisition for the purposes of calculating a portion of goodwill. This often resulted in assets being measured at a composite of the different fair values at the different dates on which the acquirer had purchased each tranche, with goodwill being recognised at each step in a step acquisition.

- The acquirer remeasures its previously held equity interest at its acquisition-date fair value and recognises the related gain or loss in profit or loss.

The IASB had decided to require this accounting because:

- it thought that the acquisition-date fair values used for the assets and liabilities of the acquiree would result in more useful information. The recognition of gains or losses in profit or loss at the acquisition date facilitates the use of the acquisition-date fair values for the assets and liabilities and also reflects the significant change in the relationship between the acquirer and the acquiree. In other words, the IASB thought that obtaining control was a significant change in the nature of and economic circumstances surrounding that investment (ie a significant economic event); and

- it concluded that the revised treatment of business combinations achieved in stages would improve the understandability and relevance of the information provided and would also reduce the cost of accounting for such transactions.

In addition, IFRS 3 (2008) amended IAS 27 to require that any investment that a parent had in a former subsidiary after control is lost is measured at fair value at the date that control is lost and also to require that any resulting gain or loss should be recognised in profit or loss. The IASB believed that, aligned with the requirement of remeasuring any previously held interest when an acquirer gained control of an acquiree, remeasuring the remaining investment at fair value reflected the IASB's view that the loss of control of a subsidiary is a significant economic event.

Question 7

(a) **How useful do you find the information provided by the step acquisition guidance under IFRS 3? If any of the information is unhelpful, please explain why.**

(b) **How useful do you find the information provided by the accounting for a parent's retained investment upon the loss of control in a former subsidiary? If any of the information is unhelpful, please explain why.**

8. Disclosures

IFRS 3 requires information to be disclosed that enables users to evaluate the nature and financial effect of a business combination that occurs during the current reporting period or after the end of the reporting period but before the financial statements are authorised for issue. In particular, IFRS 3 requires, among other things, information about the assets and liabilities of the acquiree, about the consideration transferred, including equity interests of the acquirer and contingent consideration, about transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination and about the contribution of the acquiree to the performance of the group.

Question 8

(a) **Is other information needed to properly understand the effect of the acquisition on a group?**

(b) **Of the information provided, are parts not useful and should therefore be reassessed?**

(c) **What are the main challenges to preparing (or auditing or enforcing) the disclosures required by IFRS 3, and why?**

9. Other matters

The accounting for business combinations encompasses a wide range of areas. The preceding questions focus on those areas that we understand pose the most significant challenges. This question aims to ensure that respondents have an opportunity to comment on any additional matters that they think are relevant and that have not been addressed by any individual question in this RfI.

Question 9

Are there other matters that you think the IASB should be aware of as it considers the PiR of IFRS 3?

The IASB is interested in:

(a) **understanding how useful the information that is provided by the Standard is, and what improvements are needed, and why;**

(b) **learning about practical implementation matters, whether from the perspective of applying the Standard, auditing the information or enforcing the Standard; and**

(c) **any learning points for its standard-setting process.**

10. Effects

When we issued the revised IFRS 3 in 2008, we thought that the Standard would benefit both preparers and users of financial statements by converging to common high quality, understandable and enforceable accounting standards for business combinations in both IFRS and US GAAP. We thought that the unification of business combination accounting across the world’s major capital markets would improve the comparability of financial information and would simplify and reduce the costs of accounting for entities that issue financial statements in accordance with both IFRSs and US GAAP.

We also thought that constituents would also benefit from the following:

- the guidance in IFRS 3 (2008) is not unduly complex;
- expected lower costs of applying IFRS 3 (2008) by requiring particular assets and liabilities (for example those related to deferred taxes and employee benefits) to continue to be measured in accordance with existing accounting standards rather than at fair value or by carrying over the basic requirements of IFRS 3 (2004) until

the IASB had comprehensively reconsidered the accounting for contingencies in its liability project; and

- IFRS 3 (2008) addressed deficiencies in IFRS 3 (2004) and IAS 27 without changing the basic accounting.

In answering this question please focus on whether you:

- incurred significant unexpected costs, either as a one-time expense when implementing, using, reviewing or enforcing the requirements of the Standard or as a recurring cost in each period. If you did incur unexpected costs, please explain what these were; and/or,

- benefited from the changes brought in by the Standard because of improvements in the relevance of the information provided (ie information with more predictive and confirmatory value), because the information provided represented business combinations more faithfully and/or because additional guidance had been included.

Question 10

From your point of view, which matters or areas of the Standard:

(a) **represent benefits to users, preparers, auditors and/or enforcers of financial information;**

(b) **have resulted in considerable unexpected costs to users, preparers, auditors and/or enforcers of financial information; or**

(c) **have had an effect on how acquisitions are carried out (for example, an effect on contractual terms) and/or an effect on the way in which management approaches the accounting for a business combination?**